Strategic Sovereign Defaults under International Sanctions

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Abstract

Sanctions induce political instability. We present a model where sanctioned regimes may decide to repudiate their public debts in order to keep internal support and avoid being overthrown. To be effective, this strategy requires the share of foreign debt to be sufficiently large. Combining datasets, we highlight that more than a third of all sovereign debt crises in the 1960-2005 period are connected to an international sanction episode. Results confirm a positive relation between sovereign defaults and sanctions’ destabilizing impact.

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