Reputations, Revisited: What Do Investors Count as a Credible Commitment?

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How Do Credible Commitments Work, Post{Financial Crisis?

- Research on how governments make credible commitments to markets
  - Domestic as well as international
    - ★ Democratic institutions; independent central banks; federalism; IMF agreements; World Bank graduations; BITs; PTAs; PTAs with nice countries; IO accession; presence of foreign banks
- Most looked at market data from 1980s onward
  - For emerging markets, in practice this meant 1990s onward (new bond issues; deepening capital markets)
    - ★ An exceptional time: end of Cold War, market optimism, high appetite for risk, QE

Reexamining Credible Commitments from Three Perspectives (1)

1. "Pull" factors: Emerging Markets
   - EMs growing more resilient to crises (shallower impact, quicker rebound) (Didier et al 2012)
     - As crises of credibility hit OECD countries, less of a gap between EMs and developed countries
     - Less of a need to 'signal' credibility through political or economic commitments
     - Fundamentals, not heuristics, may drive yields post-crisis

2. \Push" factors: The Evolution of Audiences for Those Commitments

- Market sentiment from 1990-2008 may have been unusual
  - Overly dependent on heuristics
  - More incentives to follow herd
  - High appetite for risk
- Post-crisis investor dynamics may have shifted
  - New actors, including institutional investors and rating agencies from Japan, China
    - ★ Heterogenous perceptions of risk

3. The Nature of the Commitment

- Many commitments that seemed to tie a government's hands may not endure
  - Gaps between *de jure* and *de facto* commitments
    - PTAs can go unimplemented; governments can have fair elections but tamper with opposition in other ways; countries can renege on commitments (CBI and BITs)
  - Perceptions of international commitments may have changed
    - With exits and reversals, IOs may not seem so durable
- Saturation effects
  - Commitments may be less "separating" and more "pooling" if countries sign too many of them ...
  - ... or if they're signed by too many countries in the world

Hypotheses

- **H**$_1$ "Pull" factors: Changes in country fundamentals should be associated with changes in sovereign risk
  - More so *post-crisis*
- **H**$_2$ Effect of credible commitments should attenuate post-crisis
  - Saturation effects for country and for world
- **H**$_3$ "Push" factors: Changes in buyers of debt should be associated with changes in the impact of international commitments on sovereign risk
  - Domestic buyers might be less swayed by international heuristics than foreign ones
  - As investor base diversifies, the effects of "commitments" may attenuate (heterogenous perceptions)

Operationalization

- DV: Sovereign yields for 35 emerging markets, 1985-2015
- IVs:
  - Credible commitments: BITs, CBI, PTAs with good countries
    - ⋆ Look at saturation through number of such commitments in the world, and number of commitments a country has taken on
  - "Pull" factors: Inflation, growth, current account balance, government debt/GDP, oil exports/GDP
  - "Push" factors: Domestic vs foreign investors, domestic central bank as purchaser, investor diversity — interacted with credible commitments
    - ⋆ Lots of missingness (only 2003-2015, only 24 countries), but plausibility test

! Across specifications, look at pre- and post-crisis dynamics

Results for H_1 (Pull factors): Effects on Yields

Variable	Pre-crisis	Sig.	Post-crisis	Sig.
Inflation	+		+	
Income	-		-	
Growth	-		+	
Current Account	-		-	
Government Debt	-		-	
Fuel Exports	+		+	

Results for H_2 (Credible Commitments): Saturation

- Saturation in the world: CBI, BITS, PTAs with good countries had strongest and deepest effects in late-1990s
  - Those commitments had been adopted by fewer countries; ‘signal’ was more meaningful
- The fewer commitments a country had signed, the stronger their effect

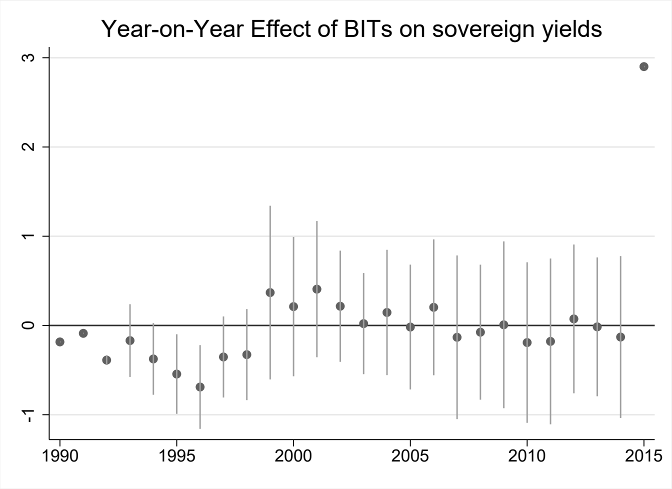
Results for H_3 (Push Factors)

- Ns are very small, but:
  - More domestic central bank investors in EMs post-crisis
  - Foreign investors seem most influenced by "credible commitments" (especially BITs and CBI) pre-crisis
    - Possibly more driven by heuristics, herd
    - Relationship attenuates post-crisis
  - The more domestic CBs purchase debt, the less of an effect the "credible commitments" have

Preliminary Conclusions and Continuing Research

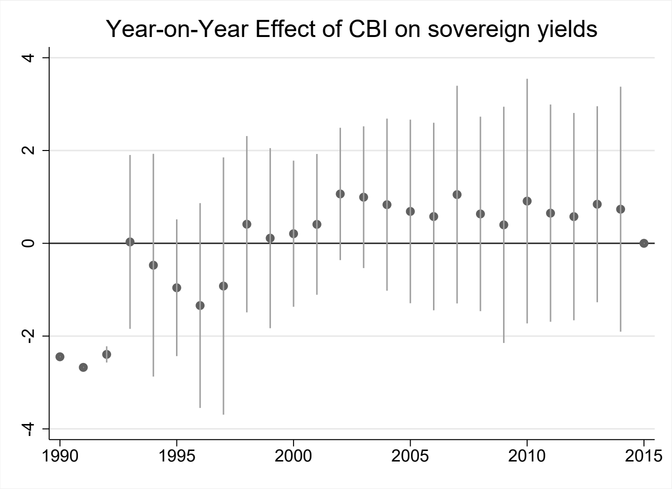
- The strength of "credible commitments" in the 1990s–early 2000s may have been exceptional
  - Commitments had not yet eroded; post-Cold War, pro-globalization investor sentiment
- More work to be done on:
  - Expanding number and kind of commitments
    - Separating out *de jure* and *de facto* nature of commitments; changes in membership; uses of adjudication mechanisms in PTAs and BITs; etc.
  - More information on investor composition of EM debt
    - Currently gathering data on sovereign debt purchasers for EMs

The e ect of BITs on sovereign risk, by year



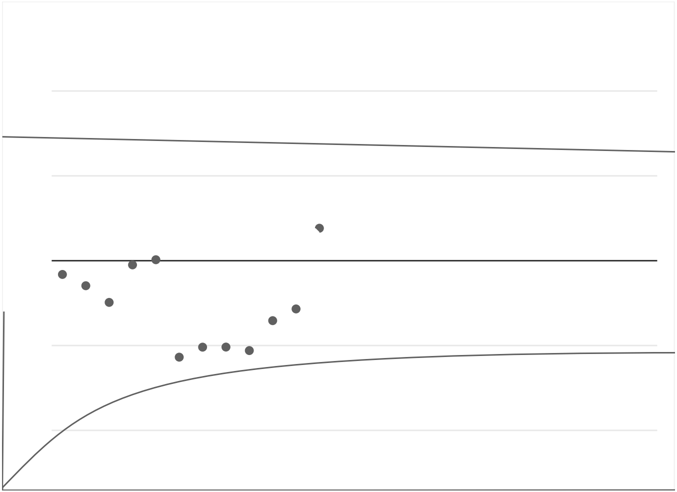
Controls: inflation, growth, current account balance, government debt/GDP, oil exports/GDP

The e ect of CBIs on sovereign risk, by year



Controls: inflation, growth, current account balance, government debt/GDP, oil exports/GDP

The e ect of PTAs on sovereign risk, by year



Controls: inflation, growth, current account balance, government debt/GDP, oil exports/GDP