

What is the Trigger of Sovereign Default?

-Willingness versus Incapability-

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Abstract

The conventional default model is based on the assumption of government's willingness to default. However, the government can also default by its incapability of repayment. I build a new DSGE model for the analysis of incapability to default, and develop a willingness to default model incorporating government policies. From the comparison of these two types of default models, I quantitatively show that the default in Greece is not attributed to its willingness but incapability, while the case of Argentinean default is opposite. The simulation result of the model captures important features of the Greece' default such as the high debt-to-GDP ratio, frequency of default and moments of main variables. The model is also flexible enough to obtain the effects of many varieties of government policies such as the austerity measurements before and after the default.

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