However, we also found that if a country has more oil under-ground, then it is viewed by investors as more risky in the long run. This result may seem counterintuitive, but having a large stock of oil may increase a country’s ability to withdraw from international financial markets, thereby raising the likelihood of default. At some point, defaulting may become more beneficial to a country than repaying its debt as long as it can still sell oil on international markets. This is the main result of our paper, which is quite surprising for a lot of people.

We welcome letters to the editor, as well as questions for “Ask an Economist.” You can submit them online at www.stlouisfed.org/re/letter or mail them to Subhayu Bandyopadhyay, editor, The Regional Economist, Federal Reserve Bank of St. Louis, P.O. Box 442, St. Louis, MO 63166-0442.

Q: Do oil-producing countries have difficulties repaying their debts?

A: People may think that countries with a lot of oil do not default on their sovereign debt, but that is not the case. Given that big oil-producing countries sometimes hold a significant amount of public debt, this issue is very relevant and is an important one to study. Among the top 25 net oil exporters, for instance, the average public debt from 1979 to 2010 was about 50 percent of GDP! All but eight of those 25 countries defaulted during that period, with the amount of time in default ranging from two years (Kuwait) to 25 years (Sudan).

In a recent paper with Franz Hamann and Enrique G. Mendoza, we examined the effect of having oil on sovereign risk, i.e., investors’ perception of the risk in lending to the country. We found that possessing oil can have two different effects on sovereign default. At some point, defaulting may become more beneficial to a country than repaying its debt as long as it can still sell oil on international financial markets, thereby raising the likelihood of default. This result is very intuitive. Producing more oil means a country has a greater ability to repay its debt and, therefore, has a lower risk of sovereign default.

However, we also found that if a country has more oil under-ground, then it is viewed by investors as more risky in the long run. This result may seem counterintuitive, but having a large stock of oil may increase a country’s ability to withdraw from international financial markets, thereby raising the likelihood of default. At some point, defaulting may become more beneficial to a country than repaying its debt as long as it can still sell oil on international markets. This is the main result of our paper, which is quite surprising for a lot of people.

1 For figures showing average public debt to GDP and default episodes for these countries, see Arias, Maria A. and Restrepo-Echavarria, Paulina. “Sovereign Default and Economic Performance in Oil-Producing Economies.” Economic Synopses, No. 20, 2016.