

## **Government Debt and Default in a Minimal State**

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I construct a model of a small open economy in which government spending is necessary to mitigate transaction cost. This provides a simple *raison d'être* for a government and generates features many sovereign default models do not have: taxes and government spending. Yet, the model can be reduced to a structural form that is almost identical to standard sovereign default models. Even though the government sector is tiny compared to modern economies, the model can generate realistic growth rates and levels of government debt as well as some second moments that are close to the business cycle statistics of Argentina. The model is solved using a novel technique that reduces the number of policy functions that have to be approximated from five as in Arellano (2008) to two.