Why Do Countries Borrow from Foreign Agencies and Entities?

In any discussion of sovereign debt one must look for a moment at the question of why countries borrow from foreign agencies and entities in the first place.

Countries borrow for many reasons. But basically countries borrow, particularly developing countries, because they need the extra capital for their growth. For investment. Because typically poor countries save less, and if you save less you're able to invest less. And that in turn means that you have lower rates of growth and lower development over time.

This is an old practice. The United States would not be a developed economy if throughout the 19th century it had not been able to borrow vast sums, mostly from England but and also from Europe. So in fact the United States ran current account deficits between 5-7 percent of GDP for nearly 70 years. And this is what enabled it to become the industrial power that we saw before the first world war.

Running a current account deficit meant that these countries are importing more than they export. What else does it mean?

A country needds need currency because it has to pay for its imports. And so one way of doing that is to get capital in, and a very common way of getting the capital in is to borrow the additional capital that you need for the investment. So countries typically go through what is called a debt cycle. That is, that in a certain phase of development you need to borrow more, and in this period you have current account deficits but you are paying for them with this capital inflow, with this borrowing. At some point when your income rises enough you are able to start to repay, and that's when you can start running current account surpluses, when you can export more than you import and use those proceeds to repay your debt. This is a standard debt cycle.

Countries get into problems repaying because often they cannot complete that debt cycle. Either the lending stops before they're able to actually repay, or it turns out they've used the money for wrong things, not for investment. Or things beyond their control happen. There could be an economic shock, there could be some major external disaster that affects them, or it could be global economic conditions that change. So when countries experience difficulties in debt it's usually one of these three reasons that is responsible.

The debt cycles have got shorter and shorter. There’s a phase where you can keep borrowing, and then a phase where you have to repay. But in today's world what typically happens is that the debt crisis occurs because investors suddenly start feeling fearful, and they pull out. So it creates, if you like, a premature collapse of the economy.

Most credit systems everywhere allow for the possibility of non-payment. The possibility of default. Bankruptcy. Not so the international system for sovereign debt. Country by country, decade by decade, elected governments hit by sovereign debt crises like those in Greece, Argentina, the Ukraine, have found out what this gap in the international system means for their economy, for their people.

One of the important sources of finance, of course, is debt finance. But the debt market for developing countries is very seriously impaired because there is not an adequate way of dealing with those situations that happen, unfortunately too often, but do happen even in the best of well-functioning markets, where countries become excessively indebted. And there is a need for a fresh start. There's a need for a restructuring of the debts.

One country, Argentina, brought their case to the UN General Assembly in a resolution calling on member states to address the issue. Backed by majority vote from start to finish the resolution is now in effect.

On 29 July 2015 the United Nations laid down clear principles in tackling sovereign debt. The international body adopted principles, that could underlie a new legal framework and regulatory mechanisms.

The UN Conference on Trade and Development UNCTAD, as the focal point for debt issues in the UN, has long advocated international rules and mechanisms to better manage sovereign debt problems along the lines commonly found at the national level. UNCTAD was entrusted by the UN General Assembly with the task of sharing its expertise with the committee.

In what was hailed as a historic breakthrough in international law, on the 9th of September of 2015 United Nations (UN) committee unanimously adopted nine principles upon which new regulatory mechanisms could be built to tackle sovereign debt crises.

One essential principle states that Sovereign immunity from jurisdiction and execution regarding sovereign debt restructurings is a right of States before foreign domestic courts and exceptions should be restrictively interpreted.

The UN is the right place for that discussion to occur. It's not the IMF. The IMF is an institution of creditors. And you would not ask Citibank to design the bankruptcy law in the United States. We know how it would design the law. It would have indentured servitude. Most of us think that indentured servitude is not the answer. Or debtor prisons. We need a fair bankruptcy law, and to go further. An efficient bankruptcy law. And the bankruptcy laws that come out of creditors are neither fair nor efficient.

The only place where one can have all those, creditors and debtors at the table, is the UN. And so that's why this is the right place for these discussions to take place.
