UNIVERSITI SAINS ISLAM MALAYSIA

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Sovereign Debt

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Introduction

- High public debt levels have become unsustainable in some countries
- These countries turned to the IMF and other European governments for financial assistance in order to avoid defaulting on their loans.
- Some countries asked for debt relief either debt restructuring or debt cancellation.
- Disputes over sovereign debt in international arbitral tribunal or international court.

Sovereign Debt

- Sovereign debt, also called public debt or government debt, refers to debt incurred by governments.
- Internal Debt: Domestic
- External Debt: Foreign currency, payable abroad

External Debt

- 1. Debt owed to supranational: eg. IMF and World bank.
- 2. Official debt: Debt owed to a bilateral government agency or a multilateral development agency. (Rutasia International Cooperation Administration)
- 3. Commercial bank debt: Loan or credit from CB.
- 4. Bond debt: A debt contracted under the obligation of a bond
- 5. Trade debt: Money owed for a good or service purchased on credit.

Why?

- For health, education, defense, infrastructure, and research.
- Some borrowing is for consumption, while other borrowing is for investment.
- To run expansionary fiscal policies with the goal of increasing economic activity, spurring economic growth, and decreasing unemployment.

Issues on Sovereign Debt

- 1. There are no internationally accepted laws or bankruptcy courts to provide creditors recourse against governments that refuse to repay their debts.
- 2. Sovereign debt is "unsecured," or not backed by collateral.

Debt Crisis

- A "debt crisis" typically refers to a situation where a country is either unable or unwilling to pay its debt.
- Eg. European debt crisis. PIGS (Portugal, Ireland, Greece and Spain).
- "Unable to pay or unwilling to pay".

Factors of Debt Crisis

- Economic, political factors and natural disaster
- Eg. Economic recessions, fluctuations in the price of imports and exports, currency depreciation, wars, and changes in political leadership.

Effects

- 1. Loan sanctions
- 2. High interest rates
- 3. Country's credit rating: Low ratings: Eg.
- Japan's credit rating was downgraded by (S&P) in 2011. S&P downgraded long term U.S. government debt from AAA to AA+.
- 4. Trade Embargo: Eg. In 1930s Argentina repaid its debt to avoid a trade embargo from the U.K.
- 5. Exclusion from the capital market

Legal Avenue

- 1. The IMF, the World Bank and Paris Club: The Heavily Indebted Poor Countries (HIPC) Debt Relief Initiative. The HIPC: framework for all creditors, to provide debt relief to the world's poorest and most heavily indebted countries, thereby reducing the constraints on economic growth and poverty reduction imposed by the debt build-up in these countries.
- 2. International Arbitral Tribunal: Eg. The International Centre for Settlement of Investment Disputes (ICSID), a branch of the World Bank Group.

Cont…

- 3. The courts of a creditor-friendly jurisdiction, such as New York or London or the courts of the creditors' home country.
- 4. International Court : Eg. ICJ
- The threat of legal "attachments" (a legal process by which a court designates specific property owned by the debtor in default to be transferred to the creditor).

Solution

- Debt Relief
  - Debt Restructuring
  - Debt Cancellation

Debt Relief

- Debt relief is the partial or total forgiveness of debt, or the slowing or stopping of debt growth, owed by individuals, corporations, or nations.
- Reduction, re-financing, re-organization, re-scheduling or cancellation of a debtor country's foreign liabilities.

Debt Restructuring

- Debt restructuring refers to some reorganization of the debt, such as a reduction in principal or lowering of interest rate, that makes debt payment easier for the borrower but still entails some payments to creditors.
- IMF: Sovereign Debt Restructuring Mechanism

Debt Cancellation

- When a creditor forgives a debt without requiring consideration in return.
- The process of a creditor cancelling a debt previously owed by a debtor.
- 17 HIPC countries: 100 percent debt cancellation: Benin, Bolivia,Burkina Faso, Ethiopia, Ghana, Guyana, Honduras, Madagascar, Mali, Mozambique, Nicaragua ,Niger, Rwanda, Senegal, Tanzania, Uganda and Zambia.