
Principles on Promoting Responsible Sovereign Lending and Borrowing – *Comments* –

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Lofty objective, weak instrument?

- Final objective of *initiative*
 - Prevent unsustainable sovereign debt situations
- Intermediate objective of *principles*
 - Provide guidance to responsible sovereign borrowing and lending
- Relative to objectives, will principles help?
 - Principles are inferior to, and not a substitute for, market discipline and well-designed, *enforceable* regulations & institutions
 - They arguably can't hurt, except perhaps where they take side in favor of particular solutions (e.g., “consensual” debt restructuring – see below)
 - Their usefulness depends on answers to key questions
 - Will principles raise incentives for institutional reform?
 - Will principles help raise minimum standards in lending/borrowing practices?

Reasons to be skeptic

- Stating the obvious is not sufficient to change incentives
 - “Lenders should assess the debtors’ capacity to pay”
 - “Borrowers should honor debt contracts, except where they can’t”
 - “Lenders should adhere to the relevant laws and regulations”
 - “Borrowers should not over-borrow”
- There is no system to monitor and assess progress towards compliance with principles – to shame the non-compliant
 - Should learn from other standard-setting experiences (e.g., BCP, ICR, A&AS, IOSCO Principles, IAIS Principles, etc.)
 - Should involve expert assessors in design of principles (e.g., debt management TA program at WB)
 - But what would be the marginal benefit of yet another ROSC?
- In the end, do principles have any teeth?

What is missing?

- Transparency on the lender side
 - Shouldn't lenders also be required to disclose sovereign loan terms?
- What is truly different in sovereign lending/borrowing compared to private case
 - Agency differences? Government officials are agents of citizens, corporate managers are agents for shareholders
 - Risk pricing? Rating and market pricing of sovereign default risk seems to be at least as good as that of private debt
 - Moral hazard? Are sovereigns more likely to be bailed out than private debtors? The systemic threat seems to operate in both cases
 - Financial literacy? Are less developed country governments less sophisticated than poor consumers?

What is insufficient, if not wrong?

- Principle on debt restructuring unduly emphasizes “voluntary,” “consensual” features and willingness to pay...
 - Lenders should act in good faith and cooperate
 - Borrowers should communicate and seek supermajority agreement
- ... but debt restructuring where capacity to pay is impaired entails a thorny collective action problem that requires policy
 - Winners and losers, loss recognition and allocation
 - Deep wedges between the private and social interests
- Solutions go beyond good will & consensual arrangements
 - **Mandatory** collective action clauses in debt contracts
 - Ultimately, the world needs an enforceable **SDRM**

Thank you