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Debt

Joseph Stiglitz shows that a suspension of debt repayments can be beneficial for a country and its people

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Since the European Union started facing an abyssal debt crisis and several countries have been caught in the stranglehold of their creditors, the prospect of defaulting has become a real possibility. A majority of left-wing and orthodox economists consider that a suspension of debt payment must be avoided. The loans granted by the Troika to Greece (May 2010), Ireland (November 2010), Portugal (May 2011), and Cyprus (March 2013) were allegedly intended to prevent those countries from defaulting, which it was claimed would have had disastrous consequences for the populations in the concerned countries. Yet several economists also develop strong arguments to defend a suspension of debt payment. Anyway, it has now become difficult to deny that the conditions attached to those loans combined with the increase in those countries' debts have a dramatic impact on the populations starting with the Greek people. It is high time to understand that suspending debt payment can be a justified option.

Joseph Stiglitz, 2001 laureate of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel, chair of President Bill Clinton's Council of Economic Advisors from 1995 to 1997, chief economist and vice-president of the World Bank from 1997 to 2000, gives strong arguments to those who seek a suspension of public debt repayment. In a collective book published by OUP in 2010, [1] he claims that Russia in 1998 and Argentina in the 2000s are proof that a unilateral suspension of debt repayment can be beneficial for countries that make this decision: "Both theory and evidence suggest that the threat of a cut-off of credit has probably been exaggerated." (p.48).

When a country succeeds in enforcing debt relief on its creditors and uses funds that were formerly meant for repayment in order to finance an expansionist tax policy, this yields positive results: "Under this scenario the number of the firms that are forced into bankruptcy is lowered, both because of the lower interest rates [2] and because of the improved overall economic performance of the economy that follows. As the economy strengthens, government tax revenues are increased - again improving the fiscal position of the government. [...] All this means that the government's fiscal position is stronger going forward, making it more (not less) likely that creditors will be willing to again provide finance." (p.48) He adds: "Empirically, there is little evidence in support of the position that a default leads to an extended period of exclusion from the market. Russia returned to the market within two years of its default which was admittedly a âEurosÜmessy one' involving no prior consultation with creditors [...] Thus, in practice, the threat of credit being cut off appears not to be effective." (p.49)

Joseph Stiglitz considers that those who believe that one of the central functions of the IMF is to impose the highest possible price on countries that wish to default are wrong. "The fact that Argentina did so well after its default, <u>even without</u> an IMF program, (or perhaps <u>because</u> it did not have an IMF program) may lead to a change in these beliefs." (p.49)

Joseph Stiglitz also clearly challenges the part played by bankers and other creditors who granted massive loans without checking the solvability of borrowing countries or, worse, who granted their loans while knowing full well that there was a high defaulting risk. He adds that since creditors demand high rates from some countries to compensake for risk it is only right that they should accept losses due to debt cancellation. Those creditors should have used the high interests they received as a provision against possible losses. He also exposes âEurosÜraider' loans all too lightly granted by bankers to indebted countries (p.55).

In short, Stiglitz argues that creditors should take responsibility for the risks they run (p.61). Towards the end of his contribution he claims that countries that choose to default or renegotiate debt relief will have to enforce a temporary control on currency exchange and /or taxes to prevent a capital drain (p.60). He is in favour of the doctrine of odious debt and claims that such debt must be cancelled (p.61). [3]

In an article published in *Journal of Development Economics* [4] under the title âEurosÜThe Elusive Costs of Sovereign Defaults,' Eduardo Levy Yeyati and Ugo Panizza, two economists who worked for the Inter-American Development Bank, set out the findings of their thorough enquiry into defaulting in some forty countries. One of their main conclusions is that âEurosÜDefault episodes mark the beginning of the economic recovery.' It couln't be better put.

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[1] Herman, Barry; Ocampo, José Antonio; Spiegel, Shari, 2010, *Overcoming Developing Country Debt Crises* OUP Oxford, Oxford, ISBN: 9780191573699

[2] Indeed one of the conditions set by the IMF when it helps a country about to default is that it raise local interest rates. If a country is free not to comply with IMF conditions, it can lower its interest rates so as to prevent bankruptcies.

[3] Joseph Stiglitz has defended this position on several occasions over the past ten years. See his book Globalization and Its Discontents, 2002.

[4] *Journal of Development Economics* 94 (2011), 95-105.

