



For Immediate Release

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## **U.S. Policy Favors Foreign Sovereign Debtors Over Domestic Creditors, Paper Argues**

On September 20<sup>th</sup>, Argentine President Néstor Kirchner will reportedly ring the ceremonial bell on Wall Street. What many on Wall Street may not know is that President Kirchner's government is also ringing up, and has defaulted on, over \$30 billion in foreign debt. Even more troubling, however, as a new Washington Legal Foundation WORKING PAPER discusses, is that American government policy favors and encourages such actions, against the interests of U.S.-based creditors and sound U.S. foreign policy.

The publication, **SOVEREIGN DEBT DEFAULT: CRY FOR THE UNITED STATES, NOT ARGENTINA**, was authored for WLF by **Professor Hal S. Scott** of Harvard Law School. Scott is Nomura Professor of Law, the Director of Harvard's Program on International Financial Systems, and the author of **INTERNATIONAL FINANCE: TRANSACTIONS, POLICY AND REGULATION** (13<sup>th</sup> ed. 2006).

Professor Scott argues that the U.S. policy of siding with sovereign defaulters against U.S. creditors is fundamentally misguided, inspiring foreign nations to take on increasing amounts of debt with little or no consequences. He uses Argentina's 2001 foreign debt default as a case study to support his arguments. After briefly recounting the Argentine default, Professor Scott notes that its occurrence was inspired by a lack of future consequences in the market, along with a lack of present consequences, caused mainly by U.S. policies which undermine creditors' rights. The merger of these two factors leaves the world markets at constant risk of a vicious cycle of sovereign overborrowing and default, the author argues.

During his discussion of creditors' rights, Professor Scott explains how the U.S. government has, in federal court litigation between creditors and sovereign debtors, consistently supported defendant nations. Such support has swayed most judicial rulings toward favoring debtors. Other U.S. policies which undermine domestic creditors include American acquiescence in ineffective International Monetary Fund policy and decisions, and the promotion of weak "collective action clauses" ("CACs") in sovereign debt bonds.

Returning to the Argentine case study, Professor Scott opines that the U.S. has sided with foreign debtors, rather than U.S. creditors, in debt restructuring primarily for foreign policy reasons. Such reasoning, however, is undermined by the reality of what is going on in Latin America. Argentina is joining anti-West figures like

Venezuela's Hugo Chávez, in rallying popular support by flouting debt repayment and lashing out at the IMF and the U.S. Professor Scott adds, "the U.S. has a strong interest in discouraging overborrowing since this is what eventually produces fiscal and political instability, impoverishing people of the region and leading to the rise of anti-American populist leaders."

In the WORKING PAPER's final section, Professor Scott outlines what actions the United States should consider taking to encourage more responsible debt activity and protect the rights of domestic creditors. His suggestions are:

- Start intervening in court cases on the side of U.S. creditors, not on the side of defaulting sovereigns.
- Put more teeth in anti-bailout policies by creating more political barriers to sizeable IMF bailouts.
- Stop pressuring countries to adopt CACs. Let the market freely decide what kind of CACs it wants for a particular borrowing, as was the case before the Argentine default.
- Take the lead internationally in removing safe havens for sovereign assets in cases of debt defaults, such as under the BIS rules.
- Exclude sovereigns in default on court judgments in G7 countries from selling their bonds in the United States.
- Change the Foreign Sovereign Immunities Act to strengthen creditor rights.

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Copies of this educational paper, WLF WORKING PAPER, Number 140 (September 2006), can be obtained by forwarding a request to: Publications Department, Washington Legal Foundation, 2009 Massachusetts Avenue, NW, Washington, D.C. 20036, or calling (202) 588-0302.