

# **Title: On foreign debt sustainability of developing countries: a new approach**

*Author: Pietro Vertova, University of Siena*

## **Abstract**

The role of economic theory is to suggest models and indicators that permit to recognize when foreign debt of a developing country is sustainable and when it is “excessive”. The IMF and the World Bank define the external debt sustainability of a country as its ability to meet the current and future external debt service obligations in full, without recourse to debt rescheduling or accumulation of arrears. This concept of sustainability focuses on the behaviour of the borrower (the borrower’s willingness and ability to service its debt “in full”) rather than on the behaviour of the lender (based on the lender’s liquidity and investment alternatives) and implies that countries receiving external debt relief are in a situation of “excess“ debt. But when creditors have to decide for some debt relief measures, they need to establish by a sustainability analysis the sustainable debt level of the borrower. This reasoning is evidently circular and shows how the notion of sustainability is in some way arbitrary. In fact the decision from a debtor country to “meet current and future external debt service obligations in full” is not a mechanical one according to some economic and financial parameters. It isn’t a choice regulated by a natural economic law. On the contrary, this choice depends from a series of factors which include not only the current economic scenario, but also the expectations on future economic performance, and, above all, by prevailing power relations in international arena. So the orthodox notion of foreign debt sustainability has a degree of freedom.

The aim of this paper is to redefine the concept of foreign debt sustainability. I propose a long run dynamic approach based on a flow analysis rather than a stock analysis. In this approach the degree of freedom of the notion of debt sustainability is not hidden like in orthodox theory, but it is explicitly shown. I suggest a way to eliminate this degree of freedom by pursuing development aims.