



Speech
by
the President of Iceland
Ólafur Ragnar Grímsson
at
UNCTAD
Conference on Promoting Responsible Sovereign Lending
and Borrowing
Xiamen, China
8 September 2010

Your Excellencies
Ladies and gentlemen
Dear friends

It is an honour to be here with you today to open this discussion on responsible sovereign lending and borrowing, a subject which is always of great interest but has now come to the fore in the wake of the international financial crisis. In the past it was more emerging market countries that faced sovereign debt problems, but recently, significant concerns have surfaced about the sovereign debt levels of some European countries.

However, let me emphasize that there can be no debt without savings. The two are eternally linked. What is consumed cannot be invested. What an individual invests in a house, or what a country invests in the form of productive capital is neither saved nor lent. But those that save more than they invest will lend it, in some form, to those that invest more than they save. Without interest on savings lent, there is little incentive for the lender to part with his money, or for the borrower to use such funds productively. The lender and the borrower are therefore bound together and both will have to guard against irresponsible lending and unsustainable debt levels.

Historically, the movement of savings and accumulation of debt across borders has been linked to the financing of international merchandise trade. Countries with trade deficits have borrowed on the international bond markets, while countries with trade surpluses have invested in the same markets. Governments have historically also borrowed or invested on international bond markets.

In recent decades, services trade, foreign investments, both direct and portfolio, and cross-border banking have resulted in a boom in international capital flows. Financial globalization has increased by leaps and bounds, though it suffered a set-back during the recent financial crisis. Even if international financial flows have grown slightly since then, the future prospects are still uncertain.

As the orderly functioning of the global financial market is in everybody's interest, the focus of policymakers has in recent years been to build an international system which promotes cooperation, growth and financial stability among all participants. Let us hope that in this endeavour a suitable balance will be struck between stability and security, on the one hand, and economic dynamism, on the other.

A loan always entails risks, linked to the project it funds and refinancing needs. Given the risks involved, attitudes to debt have not always been favourable. The great 17th century English playwright, William Shakespeare wrote in his famous play, Hamlet, "Neither a borrower nor a lender be; for a loan oft loses both itself and friend." Loans to sovereigns have often been thought safer than those granted to private ventures. This reflects the unique ability of sovereigns to tax their subjects in order to repay a loan.

At the same time, many people have seen the ready ability of governments to indebt their citizens as a potential threat. One of these was the celebrated founding father of the United States and its third President, Thomas Jefferson. He advocated a "government rigorously frugal and simple, applying all the possible savings of the public revenue to the discharge of the national debt". Indeed, he "placed economy among the first and most important of republican virtues and public debt as the greatest of the dangers to be feared". It is thus perhaps no surprise then that for most of its history, the United States has been a net lender to the world. In recent decades, however, the US has become a net borrower at the same time as China, with its booming economy, has become a major net lender, not least to the US.

History is replete with cases of sovereign debts becoming excessive and needing either difficult macroeconomic and fiscal adjustment or, in some cases, rescheduling. From the lender's perspective a sovereign debt

is usually seen as being safer than private-sector debt, since the sovereign has the power to tax, does not easily disappear and has a strong incentive to maintain its creditworthiness as these are crucial qualifications for attracting international capital flows. However, when countries default, the debt becomes, in some sense more difficult to deal with from the lender's perspective than in the case of private-sector debt, because the lender cannot take possession of collateral or, fortunately, take the countries over. It is therefore important for the international community to work out procedures for sovereign debt restructuring in those cases where it becomes needed.

My own country, Iceland, has fortunately never defaulted on its sovereign debt. The recent financial crisis was characterized by the downfall of three private banks, which succumbed to over-reach in their foreign operations. Iceland would probably have experienced a recession in 2009 in any case, due to macroeconomic adjustments needed after the serious overheating of the previous years and the effects of the international economic recession. However, the collapse of these private banks exacerbated the recession and helped to catapult Iceland's gross public debt from almost zero to close to 100 percent of GDP.

Iceland is currently on the road to recovery, largely due to the strength of our export sectors, our fishing industry, clean energy production, manufacturing, IT and the tourist sector. But the effect of the banking crisis lingers and there are still some unresolved issues which both the Government and the financial and business communities are tackling, as well as difficulties faced by many households in our country. However, we have, importantly, been helped by our strong fiscal position prior to the crisis.

Let me conclude by emphasizing that the recent international financial crisis has served as a sharp reminder to us all of the importance of using debt carefully and for governments to avoid indebting themselves excessively.

It has also highlighted the need of lenders to perform their due diligence. A major part of the crisis was that credit was issued much too freely. The onus is on lenders to be more responsible in granting credit. It is in the interest of the global community to ensure that the international financial system functions smoothly and maintains balance. In that way, it can best contribute to the rising living standards of all nations.