Kenneth Rogoff writes: Argentina's latest default poses unsettling questions for policymakers. True, the country's periodic debt crises are often the result of self-destructive macroeconomic policies. But, this time, the default has been triggered by a significant shift in the international sovereign-debt regime.

The shift favors hardline creditors in bond issuances governed by US law. With emerging-market growth slowing, and external debt rising, new legal interpretations that make debt future write-downs and reschedulings more difficult do not augur well for global financial stability.

There are no heroes in this story, certainly not Argentina's policymakers, who a decade ago attempted unilaterally to force a massive generalized write-down on foreign bondholders. Economists who trumpeted the "Buenos Aires consensus" as the new way to run economies also look foolish in hindsight. The International Monetary Fund has long recognized that it made one too many loans to try to save Argentina's unsustainable dollar peg as it collapsed back in 2001.

This is not the first time that an Argentine default has upended international capital markets. According to the tabulation that Carmen Reinhart and I compiled in our 2009 book *This Time is Different*, Argentina has defaulted on seven previous occasions – in 1827, 1890, 1951, 1956, 1982, 1989, and 2001.

Argentina may be almost as famous for its defaults as it is for its soccer teams, but it is hardly alone. Virtually every emerging-market country has experienced recurrent sovereign-debt problems. Venezuela is the modern-day record holder, with 11 defaults since 1826 and possibly more to come.

Back in 2003, partly in response to the Argentine crisis, the IMF proposed a new framework for adjudicating sovereign debts. But the proposal faced sharp opposition not only from creditors who feared that the IMF would be too friendly to problem debtors, but also from emerging markets that foresaw no near-term risk to their perceived creditworthiness. The healthy borrowers worried that creditors would demand higher rates if the penalties for default softened.

Recently, as an outgrowth of a reconsideration of the IMF's lending to the periphery of Europe (and Greece in particular), the Fund has advanced another approach to debt rescheduling, one that might be easier to implement. The IMF now recognizes that the bulk of its financing was effectively being used to allow short-term creditors to exit loss-free. As a result, there was not enough money left over to help soften budget cuts necessitated by the sudden stop in foreign funding.

The experience of the recent eurozone crisis stands in sharp contrast to the Latin American debt crisis in the 1980s, when banks were not allowed to exit precipitously from their loans. If the new proposal is adopted, the IMF would conditionally refuse funds to countries carrying debt burdens that Fund staff determine are most likely unsustainable; creditors would first have to agree to a "reprofiling" of debt.

Reprofiling is a euphemism for debt restructuring, which allows countries to borrow from existing creditors for longer periods and at lower interest rates than they would be able to do on the open market. Although it is far from clear how easily the IMF could hold the line against hard-bargaining creditors, the new policy, if adopted, would toughen the Fund's approach to cases where it finds itself repeatedly throwing good money after bad.

At present, the United States seems reluctant to go along with the IMF's proposal. Evidently, US authorities believe that in some situations geopolitics trump economics (reflected, for example, in the IMF's recent re-entry into Ukraine after a string of failed programs). This American resistance is unfortunate. It would be far better if the US found ways simply to organize outright grants in exceptional cases like Ukraine, rather than design the international financial system around them.

Given the recurring complications of adjudicating sovereign-debt contracts in foreign courts, and the world's inability to organize a credible and fair procedure for foreign bankruptcies, perhaps the best idea is to steer the bulk of international debt flows through debtor-country courts. Jeremy Bulow and I made a proposal along these lines 25 years ago; it is still the right approach.

In this scenario, countries interested in borrowing large amounts from abroad would need to develop institutions that made the promise to repay credible. By and large, experience supports this method. Indeed, the huge expansion in emerging-market domestic-debt issuance in recent years has helped reduce market tensions (though continuing reliance by corporates on foreign debt still leaves many countries vulnerable).

But domestic borrowing is not a panacea. To believe that any country issuing debt in its own currency is risk-free as long as the exchange rate is flexible is astonishingly naive. For one thing, there is still inflation risk, particularly for countries with weak fiscal institutions and heavy debt burdens.

Nonetheless, Argentina’s latest debt trauma shows that the global system for sovereign-debt workouts remains badly in need of repair. Deepening domestic debt markets – and perhaps change along the lines proposed by the IMF – is sorely needed.