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Introduction

The onset of the European sovereign debt crisis occurred in 2009 and it is considered one of the most devastating financial crises in the history of Europe. The crisis stemmed from various factors of government debt default in certain Eurozone countries, particularly Greece, Ireland, Portugal, Spain, and Italy. Some of the more prominent issues included chronic under-collection of taxes, long-term fiscal mismanagement, and excessive public spending. This crisis was preceded by the 2008 global financial crisis, where public spending was increased and failing financial institutions were bailed out and this resulted in surging debt levels. Take Greece as an example. The government was caught underreporting fiscal data and budget deficits for years. The same was true for Ireland, whose debt levels surged after it sought to bailout failing banks, while Spain and Portugal saw their deficits rise from the imploding housing markets and stagnant economic growth. Investors began to lose faith in these countries and were not willing to finance their debt, which led to a wider crisis across the eurozone.



There are two broad categories of sovereign debt: domestic debt, denominated in the currency of the home country and governed by domestic law, and external debt, denominated in a foreign currency and owed to foreign creditors. The composition of this debt determines how exposed a country will be to exchange rate risk, interest rate risk, and crises of default.

The connection between economic growth and sovereign debt is complex. Moderate borrowing can drive growth by financing productive investment, public goods, and infrastructure. Too much borrowing can be an obstacle to long-term growth by ballooning the interest burden, crowding out private investment, and causing fiscal crisis. Sovereign debt crises typically lead to economic recession, currency

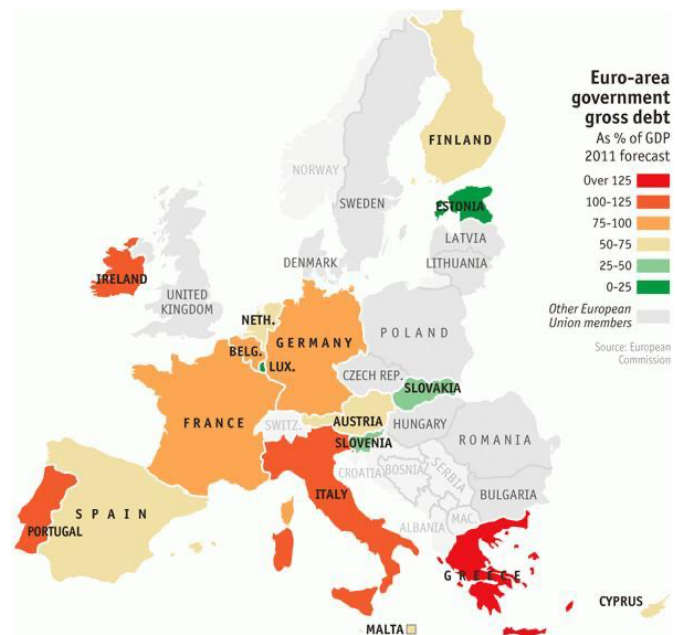


devaluation, and diminished investor confidence, which ultimately stifles growth and increases poverty. This paper addresses sovereign debt management practices to guarantee stable growth of the economy, with an emphasis on fiscal responsibility, mechanisms for re-structuring debt, and the role of international financing institutions such as the IMF in stimulating financial stability.

Background

Causes of the European Sovereign Debt Crisis

The European sovereign debt crisis began in 2009 and was one of the most important financial crises in Europe. It was caused by high levels of government debt in many countries in the Eurozone, especially Greece, Ireland, Portugal, Spain and Italy. The debt crisis emerged after the global financial crisis in 2008, which caused countries to spend greater sums in the form of public expenditure and financial institution bailouts. Some countries were perceived to have borrowed excessively. Greece in particular, floated erroneous fiscal statistics for many, and overstated public spending figures, borrowing and credit status.



Government Debt Levels in the Eurozone (2011 Forecast)

Timeline and National Responses

The crisis began in 2010 when the market was still recovering from the global economic recession. The government of Greece proclaimed their fiscal budget for spending, accepting a greater deficit than was the norm for Eurozone countries. This led to Greece attempting to access financial markets, only to find Greece bankrupt. This forced the withdrawal of the government-sreed public services. The government continued borrowing from the greater European sovereign and international allies and European sovereign and international allies. Ireland and Portugal were forced to bail out their banking sectors to the government in 2010, and then were subsequently reigned in by international lenders at high debt to gdp ratios. Spain and Italy followed the suit, with Spain in 2013, adding helicopter financing measures, and Greece restructured in 2018, while paying back part of bond agreements before 2018.

Structural Weaknesses in the Eurozone

The crisis was caused by weak fiscal discipline and a lack of fiscal integration in the eurozone alongside structural economic imbalances between the member states. Borrowing countries like Greece were economically stagnant because the fixed currency union prevented struggling nations from undergoing currency devaluations to regain their market competitiveness.

Consequences and Global Spillover

The aftermath of the crisis was undoubtedly disastrous. Affected countries experienced deep recessions and a staggering recession in the rate of employment which was especially pronounced in Greece and Spain. There was austerity on a wide scale and the eurozone saw declining levels of confidence. To prevent future crises, the EU was forced to create new financial safety nets such as the ESM. The eurozone also caused a global market downturn which decreased global levels of investment due to a lack of confidence.

Ongoing Relevance: Zambia's 2020 Default

Additional examples in today's economy include Zambia's sovereign debt default in 2020. During the COVID-19 pandemic, Zambia became the first African nation to default on \$42.5 million eurobond payment, making it the first African default. This brings to focus the debt crisis that developing countries face, the reliance on commodities, and the dependence on external forces showing that sovereign debt crises remain a topic of global concern.

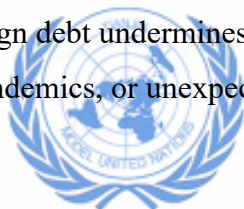
Problems Raised

Limited Provision of Public Goods

When governments spend the majority of their budgets servicing debts, they have limited funds to direct towards critical public goods like healthcare, education, and infrastructure. Governments in debt nations cut back on public expenditure as part of creditor-enforced austerity, derailing the health system and accelerating disease, especially among poor nations, claims Partners in Health (PIH). This constriction of fiscal space deprives governments of the capacity to satisfy minimum social obligations, making disparity in access to public services broader.

Inability to Respond to Economic Shocks

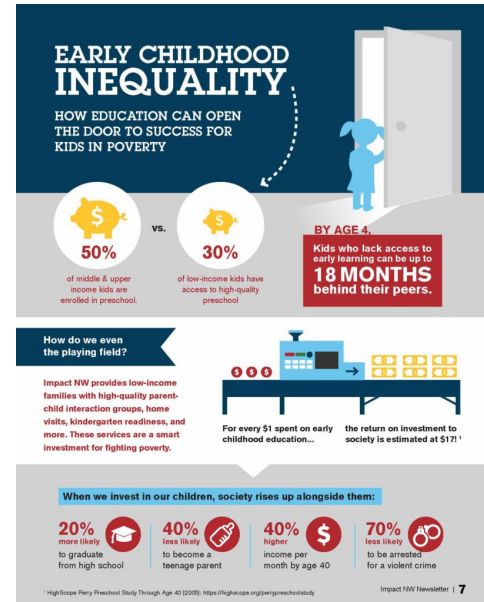
High sovereign debt undermines a nation's ability to absorb economic crises and emergencies, like natural disasters, pandemics, or unexpected recessions. The IMF raises that nations with greater debt



cannot muster countercyclical fiscal responses when crises emerge since markets call for tighter borrowing rates and lenders place tougher conditions. This weakness shows that nations have no fiscal cushions to support the public during crisis times.

Poverty and Income Inequality

Debt crises normally reinforce poverty and inequality as austerity measures are efficient in cutting social welfare programs and adding burdens on the poor. National Bureau of Economic Research (NBER) establishes that sovereign debt crises lead to long-run rises in poverty rates as well as economic inequality since the poor experience unemployment and lower utilization of social services. Foreign lenders are repaid debt servicing in countries with excessive indebtedness over domestic welfare expenditures in most instances, perpetuating structural imbalances.



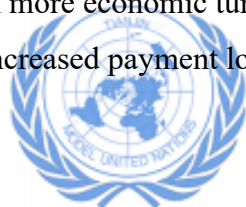
Rising Unemployment

The IMF uses Debt Sustainability Analyses (DSAs) to evaluate whether countries can meet their current and future debt obligations without requiring debt relief or entering default. The DSA serves as an early warning tool by identifying potential debt vulnerabilities and guiding decisions on appropriate levels of financing. While this framework has been instrumental in aligning lending with debt sustainability and in supporting long-term economic stability, its effectiveness has varied. Critics argue that DSAs sometimes rely on overly optimistic growth projections or incomplete data, which can result in delayed interventions or underestimated risks. As a result, although DSAs have improved debt transparency and policy coordination, they have not always prevented debt crises, especially in politically unstable or low-capacity economies.

Early Childhood Inequality & Imbalances

Weak National Currency

Those nations experiencing sovereign debt difficulties would experience weakening national currencies, especially when their debt is denominated in foreign currency. A weaker currency will cause the price of imports to rise and drive inflation further, making it even more costly to refinance the debt in real terms. Markets get terrified at highly indebted nations, states Investopedia, and the currencies are discarded, with even more economic turmoil resulting. This exchange rate weakness has the potential to fuel a cycle where increased payment loads further erode investor confidence and economic stability.



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International Actions

The European Union's Austerity Measures

With the onset of the European sovereign debt crisis, nations seeking financial assistance from the EU, IMF, and World Bank had to adopt stringent austerity policies to eliminate budget deficits and restore economic stability. Such policies included the reduction of public expenditure and increased taxation, along with other strict measures aimed at fiscal discipline improvement. The Corporate Finance Institute even reported that France and Germany, who did not need bailouts, still sought out austerity policies to ease the burden of debts post crisis. While some nations did restore fiscal balance, these policies deepened recessions and caused increased social unrest in other countries.

G20's Debt Service Suspension Initiative (DSSI)

In July, the G20 introduced the Debt Service Suspension Initiative to temporarily halt debt servicing for the poorest nations. The balance aimed to ease the financial burden of arms health and economic crises. However, Yale University reported that the DSSI had some constraints like private creditors and lacking long-term debt relief plans. Regardless, the initiative was the first of its kind in trying to encourage global collaboration to stem potential spikes in defaults.

International Monetary Fund's (IMF) Debt Sustainability Analysis (DSA)

To assess whether countries can meet their future debt obligations, the IMF applies a debt sustainability analysis to determine if country can sustain current levels of debt without defaulting, requiring debt write-offs, or being relieved of obligations. Previously, the DSA acts as an early warning mechanism to invoke possible debt vulnerabilities and determine financing levels. Although this framework has significantly contributed to the alignment of lending and debt sustainability, as well as assisting with long-term stability, it is not without weaknesses. Skeptics believe that DSAs often include overly optimistic growth assumptions or incomplete data, which at some point, may impact designing lending instruments, and delay interventions or risk analysis. Overall, while DSAs have improved debt transparency and coordination of public policy, they have not always helped to avert debt crises, especially in economically and politically fragile or low-capacity contexts.

World Bank's International Development Association (IDA)

The International Development Association (IDA) plays a significant role in promoting sustainable financing practices for low-income countries. The debt-related policies of the IDA increase borrowing transparency on the part of Governments, allow Governments to improve debt management at the domestic level, and increase coordination and information-sharing with creditors. Financing from the



IDA consists of concessional loans and grants – financing that is low or zero interest with flexible repayment periods. The IDA recognizes that by providing concessional loans and grants, countries can reduce their reliance on high-interest commercial debt, enhancing their economic resiliency and improving poverty reduction outcomes. The results of the IDA's interventions are generally positive on many fronts, notably in stabilizing a country's fiscal situation and financing essential public sector infrastructure. The effectiveness of the IDA's efforts can vary by country; in some cases, the benefits of the funding have been compromised by poor domestic governance and inadequate absorptive capacity or by external shocks (for example, drops in commodities pricing, pandemics). Nevertheless, the IDA continues to be an important player in ensuring long-term debt sustainability and promoting inclusive development.



The World Bank's Fund for the Poorest (IDA)

United Nations (UN) Initiatives on Sovereign Debt Restructuring

UN advocacy has emphasized building fair and effective ways of restructuring sovereign debt - in a timely and fair way. It is written that the international financial architecture continues to favor creditors, providing little space to consider debtors' development and social needs. The UN has called for a Multilateral Legal Framework for Sovereign Debt restructuring, and more recently both called for and launched to request a UN Framework Convention on Sovereign Debt. Both proposals had the target of creating a rules-based, transparent, inclusive, sustainable debt workout system. While they both have catalyzed meaningful global discussions about debt justice, none of these proposals have yet gained sufficient momentum to create a body of work. This inertia was at least partly related to pushback from several creditor nations and stakeholders in the private lending sectors. In either case, they do represent important landmarks in the transition from a creditor and ratings agency model of sovereign debt crises to a people-centered recovery and development-oriented model.



Key Players

The Eurozone

The 2009 European sovereign debt crisis occurred in the focus of the eurozone economies Greece, Ireland, Portugal, Spain, and Italy, and devastated their economic strengths. According to a study done by the London School of Economics, the crisis is associated with recessions, high unemployment rates, and a sustained lower standard of living in the affected countries. The architecture of the eurozone, i.e. monetary integration but not fiscal union, crippled national governments' attempts to respond to the crisis through devaluation of currency and independent monetary policy. Eurozone institutions like the European Central Bank and the European Stability Mechanism played a significant role in managing the bailouts, enforcing the austerity measures, and restoring market confidence.

The International Monetary Fund (IMF)

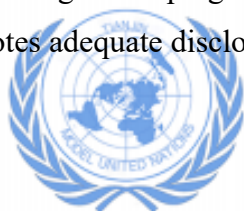
Managing sovereign debt is a core function of the IMF. They are the primary advocate of encouraging debt transparency and provides financial and technical assistance to those with unsustainable debt levels. With tools of governance such as the Debt Sustainability Analysis (DSA), the IMF helps countries determine their sustainable borrowing levels and their areas of vulnerability. The IMF provides necessary economic assistance and helps negotiate with other countries and provide the necessary aid in the settlement of the owe and debt politics.



The International Monetary Fund (IMF)

The World Bank

The World Bank, specifically using its International Development Association (IDA) strategy, puts emphasis on ensuring developing countries can manage debt sustainably. It analyzes debt sustainability, promotes adequate disclosure, provides concessional financing, and seeks to lessen



dependence on high-interest loans. Through capacity-building programs, the World Bank improves governance so that developing countries can manage their debt. It further collaborates with the IMF and other debt holders to provide multilateral responses to debt problems.

Possible Solutions

Proactive Debt Management

One of the best ways to forestall sovereign debt crises is through proactive debt management. The World Bank aims to assist countries to design comprehensive medium-term debt management strategies to help countries align borrowing with projected revenues, interest rates, and foreign exchange risks. Active management further entails diversification of debt instruments, restriction of over dependence on foreign currency debt, and improvement of the fiscal governance to avert unsustainable budget deficits. There is also the ability to construct “fiscal buffers” during economic booms to help countries weather future shocks.

Implementing Proactive Debt Recovery Techniques



The Importance of Proactive Debt Management

Debt Restructuring

For efficiently resolving some country's issue of having overshoot their allowed debt ceilings, restructuring certain aspects of their debt repayment can be helpful. According to the United Nations, restructuring means some form of adjustment to the repayment terms, like extending payout periods, reducing interest rates, or giving some debt forgiveness to restore the entity to solvency while minimizing the economic and societal damage. “The United Nations also stresses that recent reforms made to the sovereign debt restructuring system that has enhanced the collaboration between creditors and aligned

attempts to relieve debt with the long-term growth agenda of the countries has been beneficial,” the IMF noted. With that said, there still are many concerns with private creditors and equitable burden sharing.

Increasing Transparency and Coordination

For efficient management of debt, as well as to prevent incurring debt crises, maintaining an accurate record of debt is of utmost importance. The IMF and World Bank emphasize the need for countries to provide accurate and timely information about their borrowing, including loans from private and non-traditional lenders. Improved risk assessment, early support for the countries, and market enabling are some of the upsides of improved accuracy. Through the frameworks developed by the G20, the Paris Club and other UN initiatives, collaboration is likely to improve fairness and timeliness while also reducing the risk of “free-rider” problems, where some creditors refuse to participate in debt relief agreements.



The Paris

Linking Debt Policies with Sustainable Development

The World Economic Forum and BSR make the case for a climate-first and people-first agenda for debt management. By aligning debt solutions with climate finance and the sustainable development goals, countries can invest in long-term resilience without sowing the seeds of future crises. Debt-for-nature swaps, for example, enable countries to wipe out debt obligations in return for commitments to environmental protection, offering a double dividend for fiscal and environmental sustainability.

Glossary

Sovereign Debt

The total amount of money that a national government owes to domestic or foreign creditors, typically issued in the form of bonds. It arises when government spending exceeds revenue.

Debt Restructuring

A process in which a country renegotiates the terms of its debt obligations to restore its ability to repay. This can include reducing interest rates, extending repayment periods, or partially forgiving debt.

Austerity Measures

Government policies aimed at reducing budget deficits by cutting public spending, increasing taxes, or implementing structural reforms. These measures are often conditions for receiving financial bailouts.

Debt Sustainability Analysis (DSA)

A tool used by the IMF and World Bank to evaluate a country's ability to meet its current and future debt obligations without requiring debt relief or accumulation of arrears.

Debt Service Suspension Initiative (DSSI)

A temporary measure introduced by the G20 in 2020 to suspend debt repayments for low-income countries during the COVID-19 pandemic, providing fiscal space for crisis response.

External Debt

Government debt that is borrowed from foreign lenders and typically denominated in a foreign currency, exposing the borrower to currency and interest rate risks.

Fiscal Buffer

Financial reserves accumulated by a government during periods of economic growth to provide support during future crises, reducing the need for excessive borrowing.

Eurozone

A group of European Union countries that use the euro as their common currency. The eurozone was significantly affected by the 2009 European sovereign debt crisis.



Bailout

Financial support provided to a country in severe financial distress, often by international institutions such as the IMF or World Bank, in exchange for implementing economic reforms.

Debt-for-Nature Swap

An arrangement in which part of a developing country's foreign debt is forgiven in exchange for commitments to environmental conservation or climate-related initiatives.



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