

Wilton Park's Dialogue on 'Advancing Sovereign Debt Sustainability'

Current financial conditions and the search for an effective new initiative

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Introduction

Based on the latest data on the financial stress levels in developing countries, this note addresses a series of questions: What challenges are debtors facing? Which countries need liquidity support? Has the situation improved recently? Ideally, how should these countries be supported? Given the public policy failures of the recent past, what might a practical international proposal look like? What are the obstacles?

How have the financial constraints evolved?

Continuing a tradition from three years ago, FDL’s latest annual report divides 58 LLMICs into three categories: seven countries are deemed insolvent, twenty three are solvent but face liquidity constraints, and the rest have no debt concerns.

Table 1. Debt status of Low and Lower Middle Income Countries (LLMICs)

Illiquid		Lower-Risk	
Angola	Papua New Guinea	Burkina Faso	Morocco
Bangladesh	Tanzania	Burundi	Myanmar
Central African Republic	Tunisia	Cambodia	Nepal
Comoros	Ghana, Zambia, Sri Lanka	Chad	Nicaragua
Egypt	2024 Market Issuers	Congo, Dem. Rep.	Rwanda
Ethiopia	Benin	Eswatini	São Tomé and Príncipe
Gambia, The	Cameroon	Haiti	Sierra Leone
Guinea	Côte d’Ivoire	India	Solomon Islands
Jordan	Nigeria	Kyrgyz Republic	Tajikistan
Niger	Kenya	Lesotho	Uganda
Pakistan		Liberia	Uzbekistan
	Insolvent	Madagascar	Vanuatu
Bhutan	Lao PDR	Malawi	Vietnam
Congo, Rep.	Mozambique	Mali	
Djibouti		Mauritania	2024 Market Issuers
Guinea-Bissau	2024 Market Issuers		Honduras
	Senegal		Philippines

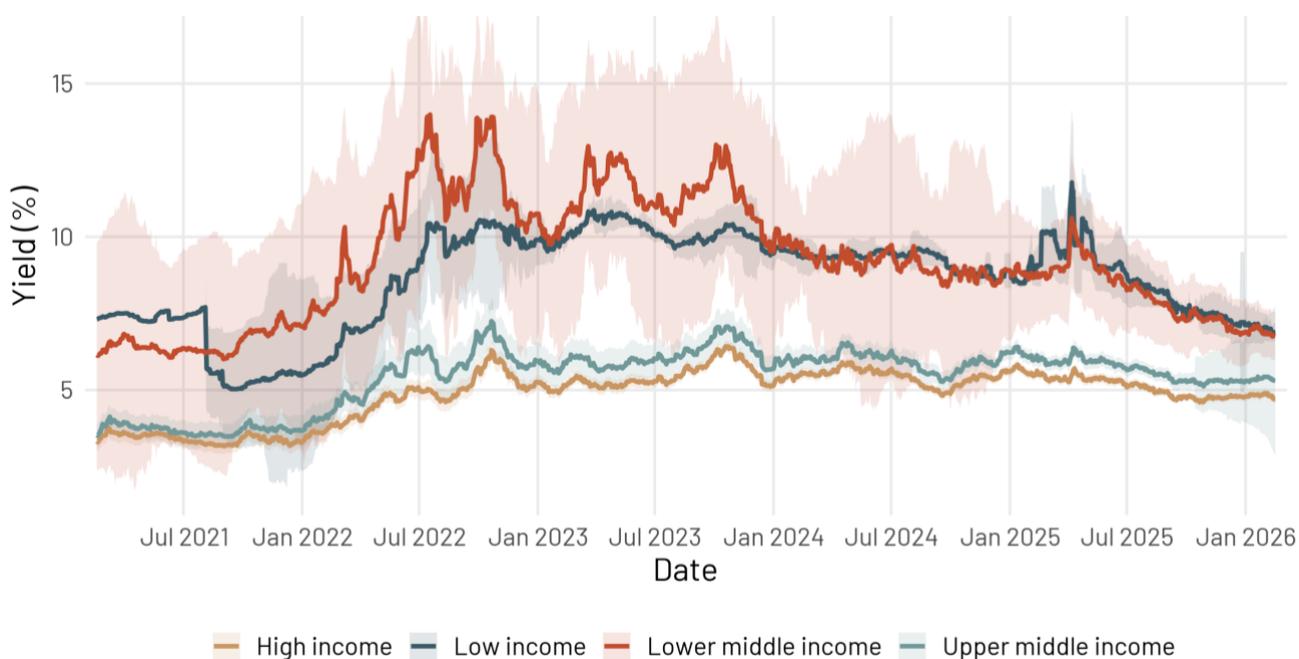
Source: FDL’s forthcoming annual report – as for the subsequent figures.

The table suggests shows that policy efforts are needed in two directions: to continue to improve the way the CF works so as to be able to restructure rapidly the debts of insolvent countries, and to provide

more liquidity to illiquid but solvent countries. A cross-cutting and important goal is to reduce leakages from the official sector (MDB and Paris Club bilaterals) to what we consider to be a more commercial sector (private and Chinese creditors).

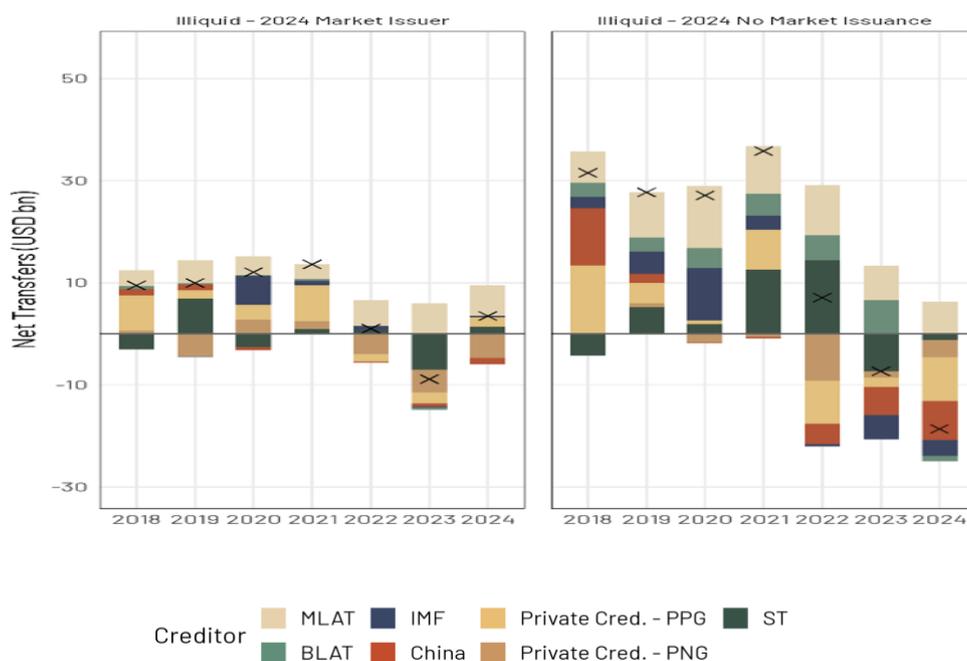
There is currently a mistaken view that financing problems are easing as global interest rates are coming down. Moreover, net transfers (NTs) to the LLMICs have moved from small negative to small positive. While the median yield for LMICs has decreased from 9% to 7%, the dispersion of yields around the median has also fallen. This means that for literally all LLMICs, international rates are above their growth rates. In fact, only 5 of the illiquid LLMICs have managed to refinance themselves in the market 2024 (Table 1), and 4 more in 2025. They all did so at rates above their growth rates (more on this below). We are not yet out of the woods. The four most recent Eurobond issuances (10 years) are by Nigeria at 8.6%, Congo at 9.9%, Cote d'Ivoire at 8.0%, and Kenya at 9.5%. Many LMICs borrow from banks, at rates that are typically higher than these.

Figure 1. Eurobond yields for LICs, LMICs, and UMICs (10-year bonds)

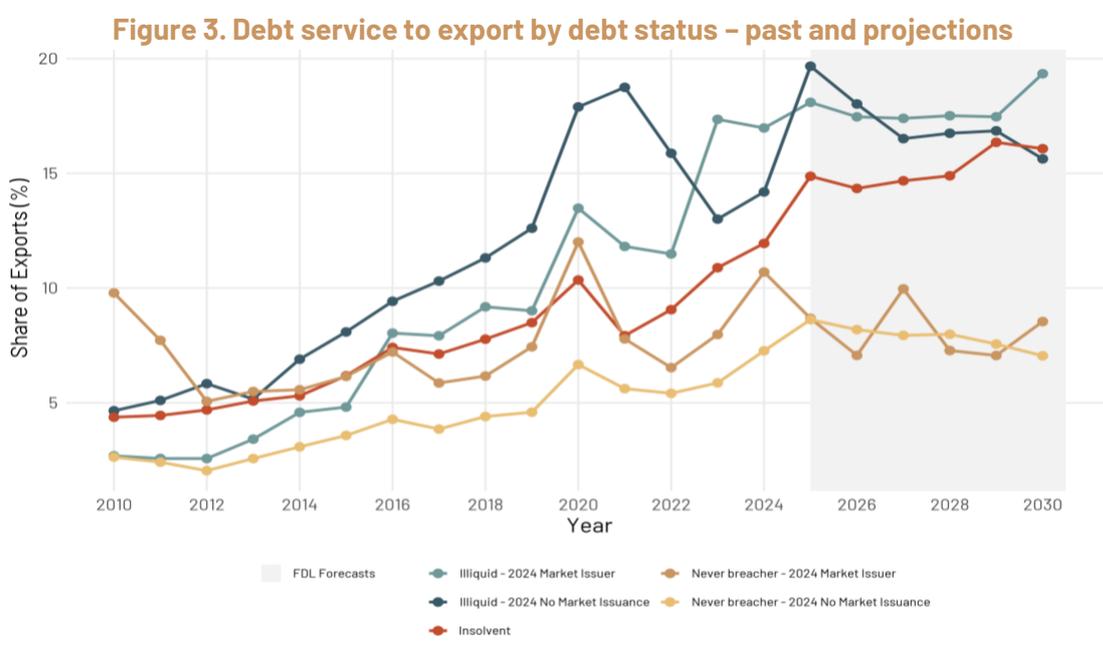


In 2024, the illiquid countries that managed to return to the market barely recorded NTs above zero. Although there is no data for 2025 yet, the situation is unlikely to be much different. The remaining 14 illiquid LLMICs saw negative NTs of nearly \$25b. This includes \$7b to China (out of the \$12b of NT to China for all LLMICs) and \$18b to private lenders. The problem of leakages thus continues unabated but is now concentrated in the large group of LLMICs that did not go back to market.

Figure 2. Net Transfers over time, illiquid countries, borrowers, and non-borrowers



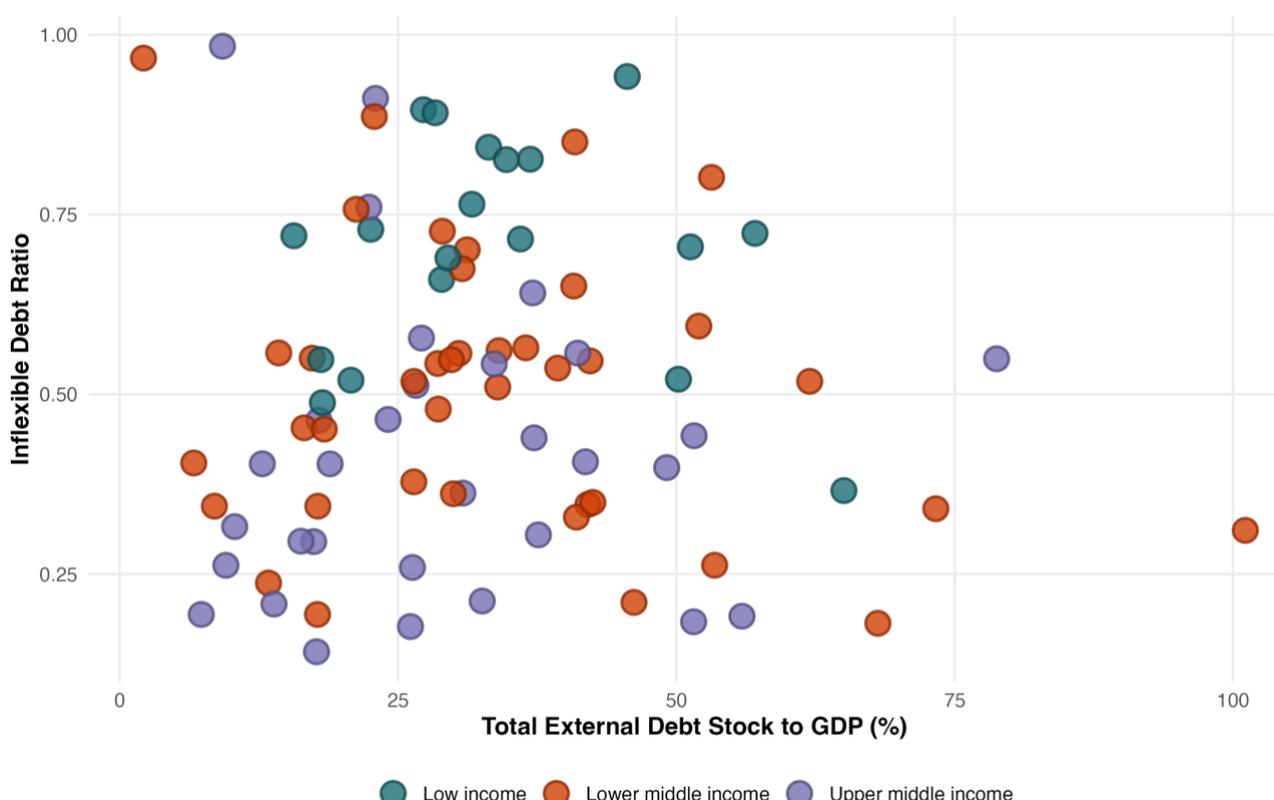
In the LLMICs that have returned to the market, the immediate liquidity problem has eased but at the cost of rising risks of insolvency. The illiquid countries that managed to access international markets in 2024 and 2025 did so at borrowing costs ranging between 7% and 10%, above their growth rates (except for Morocco). These rates exceed their projected growth rates, implying that they have eased short-term liquidity pressures at the expense of increasing medium-term solvency risks. As shown in Figure 3, their debt-service obligations are now projected to rise over time, in contrast to countries that have not returned to the market for new borrowing.



In the illiquid countries with no market access, official creditors are replacing commercial creditors. One implication, which is not receiving sufficient focus, is the corresponding rise in senior debt, which has grown from an average of 35% to 45% of Debt Outstanding and Disbursed (DOD) between 2018 and 2024. A larger share of senior debt makes commercial debt riskier, for a given debt level. Already, 35

LLMICs have more than 50% of their external debt due to MDBs and 12 of them have a ratio larger than 75%. There is a risk of a doom loop developing, where the rise in inflexible debt leads to a rise in market yields, making it harder to refinance commercial debt in the market.

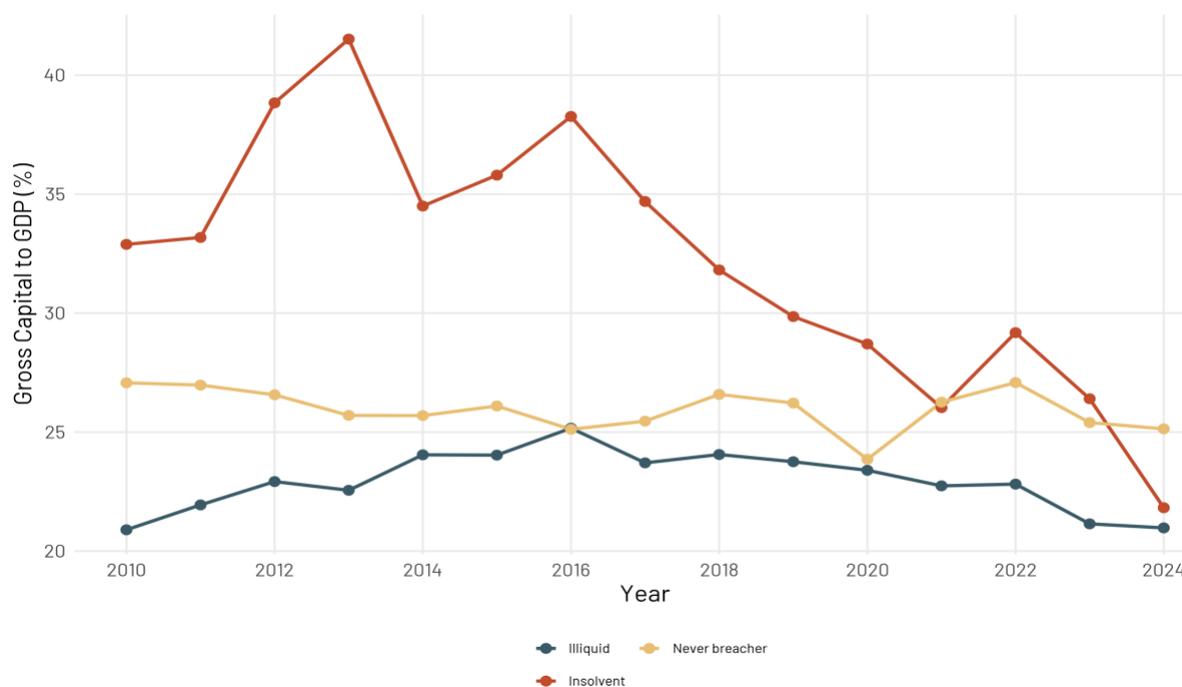
Figure 4. Share of inflexible debt in DOD



All of these countries have the potential to grow at a significantly faster pace if their financing constraints were eased. Their median GDP growth rate averaged 6% between 2015 and 2019, but it has already dropped below 4% and is likely to decline further without renewed support for growth-enhancing investment. As shown in Figure 5, investment levels have already contracted sharply.

In effect, these countries now face a choice between two adverse options: refinancing their debt-service obligations at elevated interest rates, even if this risks increasing the risk of a rapid deterioration in solvency; or allocating scarce fiscal resources to meet large debt-service payments, even if this requires deep cuts in human development spending and strategic investments in infrastructure and resilience.

Figure 5. Investment in LLMICs with various debt profiles



A worrisome problem concerns IDA's performance. A large portion of IDA flows leaks to commercial creditors – private and Chinese. In 2024, there were 28 LLMICs with positive transfers from IDA (around \$7b in 2024) and negative NT to commercial creditors (around \$-3b), which seriously weakens aid effectiveness (see Table 3 below). IDA's financial situation has deteriorated in view of the rise in debt distress among its members, with now over half in debt distress, and receiving grants rather than concessional loans.

Solutions and proposals

Financial tightness among LLMICs has been evident since 2019. In the initial phase, IFIs and bilateral creditors responded by substantially scaling up financing, including through the Debt Service Suspension Initiative (DSSI). By 2022, however, the sharp rise in global interest rates introduced a new and more destabilizing dimension: market refinancing effectively came to a halt, and what has been described as a “silent development crisis” began to unfold. In 2023, [proposals put forward by FDL](#), the U.S. Treasury, and the Brazilian G20 presidency converged into a joint World Bank–IMF articulation of the “[three-pillar](#)” approach. This framework was meant to promote a strategy centered on ambitious, growth-oriented reforms (pillar 1); increased official-sector financing and guarantees (pillar 2); and a commitment from bilateral and commercial creditors to maintain net exposure during the adjustment period (pillar 3), thereby avoiding destabilizing capital outflows.¹ The approach has been broadly endorsed by the recent South Africa G20, the Sevilla Finance for Development Compromiso, and the Vatican's Jubilee Report.

¹ One interpretation was that bilateral creditors would reschedule, while private creditors would be provided guarantees if necessary to generate new financing.

Ultimately, the three-pillar approach has fallen short, with only [Cote D'Ivoire](#) emerging as a potential success story – but even in this case, the refinancing gains were very modest. There are two reasons that explain the failure. First, the IFIs, who had scaled up their support around 2020-21, reduced their transfers prematurely, instead of scaling them up; notably, guarantees were not scale up and remained reserved for low-risk countries, thus excluding most countries on our list of liquidity-constrained nations. Second, borrowing costs for LMICs remained very high, and given the dearth of guarantees, refinancing remained modest, resulting in the continuation of leakages. Together, these trends mean that the declining transfers from IFIs became increasingly less effective at supporting reforms and growth, as they largely ended up bailed out commercial creditors – private and Chinese in particular, with little liquidity remaining in the countries to support reforms and investment. In fact, commercial creditors were neither incentivized to refinance at reasonable rates – these very conditions of low growth and rising levels of inflexible debt kept interest rates facing debtor countries high – nor compelled to contribute, despite the IMF's capacity to condition its support more forcefully on flow relief. As a result, pillar 1 also failed: at the end, LMICs were not offered sufficient financing to elicit ambitious structural and pro-growth reforms, beyond domestic resource mobilization.

The persistence of elevated sovereign yields reflects not only domestic policy constraints, but also [powerful external drivers](#): high U.S. interest rates, heightened global uncertainty, and the growing share of senior official debt in overall external liabilities. The alternative to voluntary liability management operations (LMOs), when these prove to be too expensive, is a **coordinated preemptive restructuring** of maturities across different creditor classes. It is commonly thought that the coordination of bondholders is impossible due to market fragmentation. However, this is not true, ownership of LMICs bonds seems to be, by most accounts, highly concentrated, and moreover, CACs facilitate collective action. The [Ecuador 2022](#) preemptive restructuring can serve as a model. The main reason this best practice was not followed is the absence of clear IMF guidance for “grey-zone” cases. More assertive methods of forcing a rescheduling involve defaulting, an option LMICs have shied away from, due to concerns about protracted treatment under the Common Framework.

Box. Ecuador's voluntary rescheduling - Excerpts from [FDL Policy Note 16: "Lessons from the Ecuador 2020 Debt Restructuring Case"](#), by S. Cueva, H. Chekir and J.A. Gonzalez

Securing a six-month standstill was key in putting the debt negotiations on the right track and avoiding default. The successful consent solicitation for a 6-months interest deferral was a turning point in establishing an orderly restructuring process. Starting negotiation pre-default was seen as a sign of good faith.

The third generation of Collective Action Clauses, based on an offer designed to maximize incentives to participate, turned out to be very effective in avoiding holdout issues.

Restructuring discussions were more effective because reputable creditors, with high stakes and concerns about the soundness of the asset class, took the lead.

By the time the government started to negotiate the terms of the bond restructuring, had reached agreements with the IMF and World Bank on an ambitious reform program, with financial commitments to back it.

Throughout this process, the authorities kept the bondholders' involved, which facilitated efficient debt restructuring talks by signaling proactive government involvement and control. The negotiation process focused on providing the country with both short-term relief measures and ensuring long-term debt sustainability in ways to make the agreed program work.

A new push is needed

A new effort to find ways to make the 3-pillars approach work is thus warranted. Developing ways to make Pillar 3 work – the ability to restructure and smooth commercial debt repayment over a longer horizon – has become especially important because the early hope of a quick reversal of the interest rate cycle has been dispelled by a variety of new sources of uncertainty about the evolution of growth and monetary policy globally.

By now, LMICs have become differentiated along two groups: one still hopeful of accessing capital markets soon; and one unable to do so even in the medium term. They both need to adjust to a new world, and this requires a big push of IFIs' support to allow them to recover and grow out of their financing problems. Their goals with respect to commercial creditors differ. The first group needs support to access refinancing loans. The second group requires concerted flow relief from commercial creditors through long-maturity reschedulings.

For the first group of market-access countries, guarantees, or access to new sources of refinancing are the way to go. These are countries willing to gamble on regaining market access, and to sacrifice short-term growth in order to ensure larger long-term growth. These are LMICs that have previously made strides in accessing markets, where private activity is established, and external debts remain low. While their current external borrowings are expensive, their *average* cost of capital can remain modest enough to hope that they can grow out of debt if they manage to secure IFIs' support for ambitious recovery programs through larger programs and access to more guarantees.

For the second group of LLMICs, the most effective way to secure meaningful flow relief is to operationalize the three-pillar approach with credible enforcement mechanisms. The objective should be to scale up support in a way that elicits ambitious, growth-enhancing reforms. This requires not only expanded IFI financing and close World Bank-IMF coordination around a sustainable, pro-growth macro-structural program, but also a credible mechanism to ensure non-negative net transfers from commercial creditors—at least for the duration of the program. Continuing with the status quo only leads to IFIs loans replacing commercial debt, making overall debt more inflexible, and a return to the market more improbable. Reduced aid effectiveness would increasingly push the IFIs to reduce their involvement, a trend already visible.

Under current practice, when debt-stock vulnerabilities threaten the viability of a Fund-supported program, restructuring is required. By contrast, when binding constraints arise from debt-service flows—the so-called “grey zone” cases—no comparable requirement exists. This asymmetry should be addressed. Given the persistent stigma attached to preventive restructurings, the preferable approach is to establish a clear, rules-based trigger rather than rely on discretionary judgment. In grey-zone countries, official financing should be scaled up on the condition that commercial creditors provide sufficient flow relief to ensure program feasibility when senior debt exceeds a defined threshold, for example, 60 percent of total external claims.

The scaling up of IFI funding is a central part of the 3-pillars approach. IFIs *can* muster the financial muscle to scale up their support. While IDA is constrained, the IMF could raise additional funding for the PRGT, and the RST remains largely uncommitted with ample liquidity. The PRGT itself is now constrained by design given that it needs to raise grants to finance its 0% lending rate. This constraint can, however, be lifted if it, or an alternative program, can support the recovery of illiquid LLMICs at low but positive interest rates. The IMF has the credibility needed to attract more SDRs to finance larger support programs, without posing enormous political problems. On the World Bank side, the IBRD is highly liquid since its reserve requirements were lowered, and it can be argued that it should extend its support even to poor countries – for example in the form of guarantees – if this helps IDA’s finances, given that it provides a large share of its profits to IDA.

What remains to be done is to convince commercial creditors to continue to lower the rates at which they lend to countries that try to return to market, and to reschedule their obligations in a more concerted way – as in the case of Ecuador – for those that can’t do this for the time being. The section below addresses recent proposals to support these developments.

Liquidity Funds

Two main proposals have emerged to establish dedicated “liquidity funds” aimed at refinancing costly short-term debt, with a focus on less risky countries – i.e., those in the “market access” category.

The African Stability Mechanism’s main objective is to provide debt refinancing support to illiquid African sovereigns. Africa is the only region of the world without its own Monetary Fund, and few countries have access to large swaps. The financing of the AFSM would be typical of MDBs – capitalized by shareholders’ contributions, initially set at USD \$3bn of paid-in capital. The AFSM has also proposed funding plans using SDRs applied to hybrid capital. The aspiration target is to be able to disburse up to \$5b in loans per year – around 50% of total annual African sovereign Eurobond refinancing. The aim is to act as a complement, or even as a rapid bridge, to a potential IMF program, but not as a substitute.

The Debt-Swap Facility proposal from the Tony Blair Institute for Global Change shares similar goals, and it rests on two innovations. The first is to provide concessional financing strictly through guarantees from bilaterals –to borrow from financial markets at a low interest rate. The second idea is to lend to countries at rates dependent on the quality of public financial management -- based on the Public Expenditure and Financial Accountability (PEFA) score – to provide incentives to improve governance. The facility would be administered by an MDB, and would complement the reform incentives embedded in Fund conditionality.

For such funds to be effective, their financing must be additional—rather than reallocating existing ODA across different windows. Ideally, it should also be junior, to avoid making debt more inflexible. These conditions suggest that ideally, these funds would be financed by mobilizing fresh bilateral resources. But bilateral fiscal space is currently limited, making it difficult to meet these design criteria. The proposal by the African Development Bank to deploy SDRs as hybrid capital for an African Liquidity Fund meets the additionality test (but the proposal has not (yet) gained sufficient political traction). On the flip side, the ASM would provide senior claims. The TBI facility on the other hand has the advantage of being structured as junior claims, thereby avoiding further rigidification of countries’ external debt

profiles. But there are no indications to date that it would be able to raise large amounts of additional funds from bilateral sources.

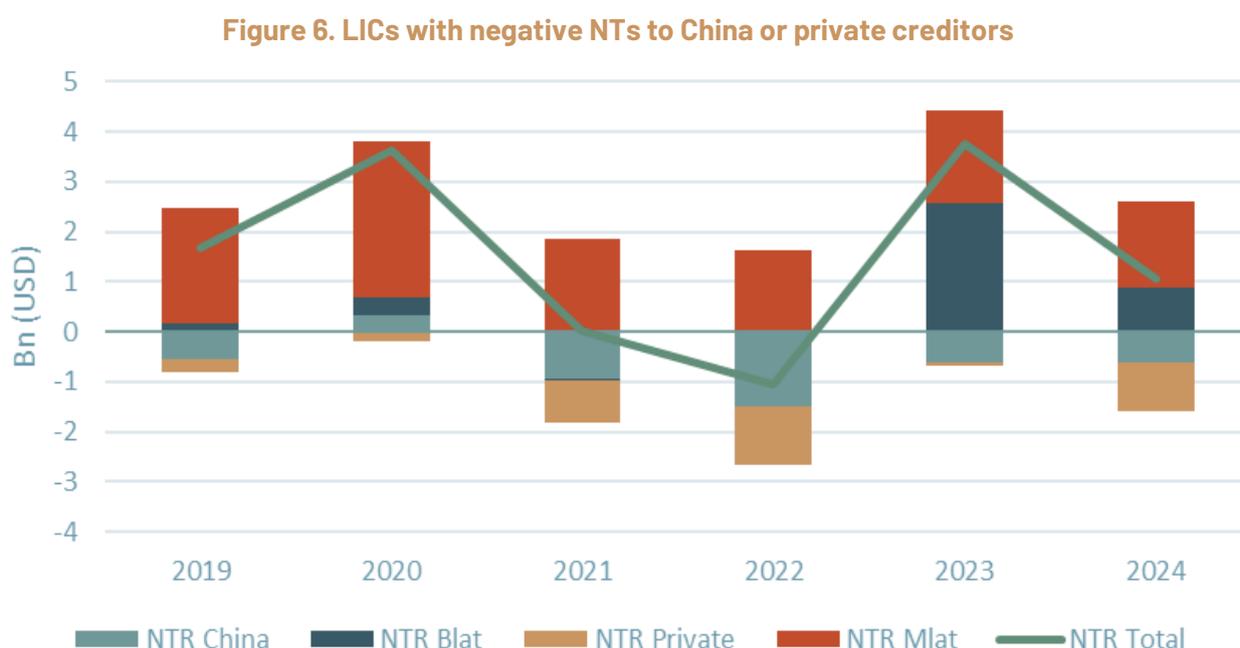
Table 2. Three proposed facilities

Initiative	Goal	Targeted Countries	Size	Funding Structure	Lending Terms	Relation to IMF program
AFSM By AfDB and African Union	Debt refinancing support to illiquid countries	African sovereign wt outstanding Fixed Income Securities	Ability to disburse up to \$5b/ year (Ultimately \$11b in Net Shareholder Equity and \$26b in total Assets)	Two options: <u>Leveraged:</u> Capital Market Debt + Member’s (and others) Equity <u>Non-leveraged:</u> Member’s (and others) Equity only Targeted rating AA to A- (leverage ratio 1.5-2.5)	<u>Loans:</u> For countries with loss to market access (like IMF) – 50 bps over funding cost Lending in Hard Currency <u>Primary/Secondary Market Purchase</u> <u>Guarantees:</u> On newly issued debt Conditionality attached	Cooperation between AFSM and IMF. AFSM to act as a complement or bridge to a potential IMF program.
Debt Swap Facility by TBI	Swapping debt to create fiscal space and debt sustainability	African sovereigns with loans in domestic and hard currencies	\$100b of debt refinanced	Strictly guarantees from rich countries on the SPV buying back debt	Loans – up to \$2b per country Pricing conditional on PEFA ratings (higher ratings equals lower cost of financing)	Use the IMF’s (and WB) PEFA indicators
Jubilee Fund Spain	Restructure debt though buybacks	Distressed sovereigns	n.a	IMF to lend to the fund SDRs	Loans at favorable terms for countries to buy back their debt	Possibly, subject to a program.

A Jubilee Buy-back Fund for the poorest countries

The Jubilee Fund, championed by Spain, as a follow up to the Sevilla Conference, has proposed to buy back commercial claims of the poorest countries – particularly those financed by IDA. Several IDA recipients still hold commercial debt acquired from China when it expanded its lending to poor countries after the year 2000, and when markets were flushed with liquidity in the 2010s. These countries now experience significant leakages to commercial creditors, face substantial repayment cliffs, while they have limited or no access to new commercial loans. Ideally, these countries should pursue coordinated debt restructuring, as recommended above. To complement such a mechanism,

especially when these claims are too small to justify what could turn into a lengthy CF restructuring process, buying back and refinancing through IFIs makes sense for countries that do not intend to return to the market anytime soon. The Jubilee Fund proposes to fund its operations using SDRs. But if that does not happen, and if bilateral funds are not forthcoming, one possibility is to use multilateral funding. Unlike LMICs, the poorest countries have limited access to IMF funds and no access to IBRD lending. An IFI facility designed to refinance short-term and high-cost claims with longer-maturity, lower-cost financing could substantially ease liquidity constraints. In these cases, the share of senior debt in total debt would rise, but this would not alter incentives given the absence of market access. We have identified 26 LLMICs where IFI-supported liability management operations could improve financing conditions (the 10 worst cases are shown in Figure 6). These interventions should be embedded in a framework of credible country commitments to reform. Potential vehicles include expanded use of IBRD guarantees or the IMF’s Resilience and Sustainability Facility (RSF).²



² Such an initiative would have been ideal for a country like Ethiopia, which has only \$1b bond outstanding, but which has generated a multi-year unending negotiation and difficult COT challenges that have complicated unnecessarily relations with large bilateral lenders.

Conclusion

In sum, liquidity problems have persisted since 2019, and the international community is still seeking a solution 5 years into the crisis. Yet, the structural solutions have been apparent for a while – they just demands more institutional courage and determination to make the “3-pillars approach” work.

Such an initiative could be advanced under the auspices of the UK’s G20 presidency. A dedicated commission could be tasked with developing operational recommendations. The commission would examine how to create a richer toolbox to strengthen each of the 3 pillars. This should include:

- (i) Increased coordination in joint IMF-World Bank programs to support country-led growth recoveries.
- (ii) A scaling up of IFIs' disbursements, including guarantees, and encouragement for countries to engage in more forceful pro-growth reforms.
- (iii) For market countries, the launch of a Liquidity Fund to support LMOs.
- (iv) For non-market countries, stricter rules that force liquidity relief as needed.
- (v) The initiation of a Jubilee Fund to buy back commercial debts of the poorest countries.

Table 3. Net Transfers on external debt to various creditors (\$Billion), 2024, for all IDA countries where NT by IDA is positive, and NTs to China and/or private are negative

Country	Status	IDA	China	Private	Other	IMF	MLAT	Bilat	PPG
Burkina Faso	LIC Low risk	0.291	-0.011	0.060	0.117	0.033	0.390	-0.015	-0.204
Bangladesh	LMIC Illiquid	1.323	-0.194	-0.937	4.679	0.715	2.442	2.845	-0.404
Congo, DR	LIC Low risk	0.472	-0.139	-0.013	0.171	0.124	0.559	-0.041	0.000
Comoros	LMIC Illiquid	0.013	-0.008	0.000	0.003	0.001	0.017	-0.002	0.000
Djibouti	LMIC Insolvent	0.027	-0.032	0.000	-0.024	-0.002	0.014	-0.009	0.000
Ethiopia	LIC Illiquid	1.022	-0.051	-0.077	1.431	1.099	0.996	0.358	0.000
Guinea	LMIC Illiquid	0.060	-0.145	0.079	0.185	0.006	0.298	-0.059	-0.020
Guinea-B	LIC Insolvent	0.007	0.000	-0.013	0.034	0.015	0.030	-0.004	0.000
Honduras	LMIC Low risk	0.140	-0.072	0.433	-0.099	-0.025	0.026	0.040	0.302
Kyrgyz	LMIC Low risk	0.044	-0.086	0.000	-0.037	-0.112	0.120	0.000	0.861
Cambodia	LMIC Low risk	0.370	-0.041	0.000	0.667	-0.013	0.626	0.424	-2.606
Lao PDR	LMIC Insolvent	0.065	-0.134	-0.279	-0.165	-0.008	0.060	-0.152	-1.248
Liberia	LIC Low risk	0.109	-0.002	0.021	-0.039	-0.046	0.116	-0.001	0.043
Lesotho	LMIC Low risk	0.055	-0.001	0.000	-0.061	-0.033	0.037	-0.010	0.012
Madagascar	LIC Low risk	0.315	-0.013	0.024	0.050	-0.027	0.356	0.036	-0.013
Mauritania	LMIC Low risk	0.037	-0.046	0.000	-0.110	0.050	-0.046	-0.077	0.000
Malawi	LIC Low risk	0.186	-0.004	0.000	-0.056	-0.041	0.188	-0.018	0.000
Niger	LIC Illiquid	0.071	-0.038	-0.032	-0.139	0.027	-0.062	-0.033	0.000
Nicaragua	LMIC Low risk	0.052	-0.017	-0.001	-0.222	-0.082	-0.047	-0.041	-0.223

Nepal	LMIC	Low risk	0.257	-0.010	0.000	0.188	0.021	0.464	-0.040	-0.106
Senegal	LMIC	Insolvent	0.224	-0.077	2.577	-0.033	-0.248	0.372	0.067	-1.025
Tanzania	LMIC	Illiquid	1.260	-0.157	-0.129	1.038	0.328	1.872	0.098	0.500
Uganda	LIC	Low risk	0.328	-0.117	-0.307	0.076	0.093	0.227	0.084	-0.123
Total			7.778	-1.413	-2.533					



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