



The Global Framework for Sovereign Debt Resolution and Its Implications for Small Multilateral Development Banks (MDBs)

Prepared By

Nazli Memisoglu, Policy & Strategy Department

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EXECUTIVE SUMMARY

This paper examines the global framework for sovereign debt resolution and its implications for multilateral development banks (MDBs), with particular attention to a group of institutions referred to as borrower-led MDBs. Sovereign debt restructuring is a complex process that requires careful consideration. MDBs have a unique place within this framework due to Preferred Creditor Treatment (PCT), which has traditionally exempted them from taking part in restructurings. As sovereign debt levels rise and the number of MDBs continues to grow, greater clarity and consistency regarding both the framework and the use of PCT are increasingly important.

This paper explores why sovereign debt distress is a highly relevant issue, how the current framework is structured, and the key controversies surrounding it. As debt vulnerabilities remain elevated globally, the main challenge is not only the scale of the debt but also the complexity of the creditor landscape, which includes official bilateral creditors, private creditors, multilateral creditors, and the IMF.

This paper also highlights the unique position MDBs have within the financial system. It recognizes that there is great variation among MDBs. “Legacy” MDBs face vastly different challenges than MDBs that are led by borrower governments and are perceived differently by markets and other institutions. This distinction becomes particularly important in the context of sovereign debt restructurings because the treatment of MDBs appears to vary depending on which type of MDB is involved. This has severe implications for MDB funding costs, lending capacity, and development mission.

The paper argues that greater clarity and coordination are necessary within the sovereign debt architecture. Moreover, when setting standards, equivalent treatment among MDBs should be the foremost concern. The paper lays out a series of recommendations, including stronger system-wide coordination, greater clarity regarding the PCT status of borrower-led MDBs, exploration of new mechanisms, and steps borrower-led MDBs should take in order to safeguard their institutional credibility and financial position.

ABBREVIATIONS AND ACRONYMS

- Afreximbank:** African Export-Import Bank
- BCBS:** Basel Committee on Banking Supervision
- BOP:** balance-of-payments
- BRICS:** Brazil, Russia, India, China, and South Africa
- CCRT:** Catastrophe Containment and Relief Trust
- CF:** Common Framework
- CoT:** Comparability of Treatment
- DSA:** Debt Sustainability Analysis
- DSSI:** Debt Service Suspension Initiative
- EM:** Emerging Market
- G7:** Group of Seven
- G20:** Group of Twenty
- GSDR:** Global Sovereign Debt Roundtable
- HIPC Initiative:** Heavily Indebted Poor Countries Initiative
- IDA:** International Development Association
- IFI:** International Financial Institution
- IMF:** International Monetary Fund
- LIC:** Low-Income Country
- LIC DSF:** Debt Sustainability Framework for Low-Income Countries
- MDB:** Multilateral Development Bank
- MDRI:** Multilateral Debt Relief Initiative
- NPV:** Net Present Value
- NTP:** Non-Toleration of Arrears Policy
- OCC:** Official Creditor Committee
- PCS:** Preferred Creditor Status

PCT: Preferred Creditor Treatment

SLA: Staff-Level Agreement

TDB: Trade and Development Bank

UN: United Nations

I. INTRODUCTION

Sovereign debt resolution is one of the central issues for the international financial system. Its complexities have prevented the creation of a straightforward framework. Many actors are involved in this process, which makes it all the more challenging to coordinate and resolve. Debt distress is not just a financial complication but is also strongly associated with humanitarian and developmental challenges, making it a social issue that requires careful consideration. With debt levels rising globally, most significantly but not limited to low-income countries (LICs), this matter requires greater clarity and further improvement.

The main obstacle comes from the diversity of creditors. Official bilateral creditors and private creditors are the main parties on whom the burden of restructuring falls. However, this paper focuses on a third type of creditor: multilateral development banks (MDBs). Since the creation of the World Bank Group at Bretton Woods in 1944, many institutions have replicated its structure. MDBs receive separate consideration due to a special privilege called preferred creditor treatment (PCT), which has traditionally protected them from taking losses in sovereign debt workouts. Due to the zero-sum nature of the process, there is growing controversy around the exclusion of these unique financial institutions. With growing sovereign debt levels, exclusion of MDBs implies that other creditors are expected to bear a greater share of debt relief, which raises questions about debt sustainability and fairness in burden sharing.

PCT raises a particularly sensitive set of issues for a specific group of MDBs, which this paper labels as “borrower-led” MDBs, a group of institutions that are created and governed by the very countries to which they lend for development. These are usually small, sub-regional banks, and are not always perceived or treated in the same manner as older “legacy” MDBs such as the World Bank; hence, there is more uncertainty regarding their position in the global financial architecture. The behavior of the IMF, major MDBs, major official bilateral creditors, including the Paris Club and G20, and credit rating agencies is extremely important, as the status of borrower-led MDBs often depends on how these actors treat them in specific cases.

The first part of the paper dives into the main actors in the sovereign debt restructuring process, including debtors, creditors, and MDBs as a special sub-group of creditors. This part

introduces the distinction between “legacy” and “borrower-led” MDBs, which are treated as two different kinds of institutions. The IMF is a central figure in debt restructuring as well as in the whole financial architecture. Therefore, its perspective has significant implications for debtor countries and MDBs. The second part of the paper lays out the current restructuring framework, both under and outside the Common Framework.

The third part discusses the main issues surrounding sovereign debt resolution and MDBs. Preferred creditor treatment, its scope and implications are examined in this section, with particular emphasis on borrower-led MDBs. The exclusion of MDBs from restructurings is another issue that is increasingly being called into question. The final part of the paper outlines possible policy recommendations.

This paper argues that due to the growing number of MDBs and increasing levels of global debt, greater clarity and consistency on the sovereign debt restructuring framework and PCT is necessary. A more permanent system or coordination mechanism is needed to accelerate the restructuring process. Additionally, borrower-led MDBs are valuable sources of financing for borrowing countries, and in many cases, countries facing default are shareholders of these MDBs. When setting standards, the IMF, legacy MDBs, the G20, and credit rating agencies must be considerate of these institutions and ensure that special privileges apply equally to all MDBs. Differential treatment among MDBs may cause unintended problems with detrimental implications for the ability of MDBs to fulfill their developmental mission.

THE MAIN PLAYERS

1. Debtors

A sovereign nation is usually considered to be in default when it misses a payment and the grace period on that payment expires (Brauer, Martin and Paja, 2022), essentially when it fails to meet its financial obligations. This imposes a significant burden on the debtor country and usually requires a restructuring of the debt, with the collaboration of different players. In many cases, however, policymakers attempt to restructure debt before a formal default occurs.

Debt distress can be caused either by short-term liquidity problems or by solvency challenges that risk debt sustainability. Both are significant for a sovereign nation's development goals, but a country doesn't necessarily suffer from both at the same time. Aligned with its main mandates, the IMF emphasizes "the need for urgent action to address liquidity challenges," as these challenges could lead to a debt crisis in the future (IMF and World Bank, 2024). Liquidity challenges are addressed and resolved differently from unsustainable debt problems. This paper focuses on debt sustainability and debt relief, but it is important to bear in mind the IMF's primary focus.

Debt distress requires urgent consideration, as many low-income countries (LICs) remain debt-vulnerable today (GSDR, 2025). The risks for LICs and emerging markets (EMs) increased even further due to the COVID-19 pandemic (GSDR, 2025), as reduced economic activity lowered government revenues while governments increased fiscal spending. Total global debt reached 263 percent of GDP in 2020, the highest it had been in half a century (World Bank, 2022).

It is not only the LICs that suffer from high government debt levels. As of July 2026, Japan's debt-to-GDP ratio stood at approximately 230%, one of the highest levels globally (Global Debt Clock, 2026), though it is important to note that this metric alone does not indicate default risk. In the past, however, non-LIC countries have experienced sovereign defaults in the 21st century, most notably Argentina and Greece.

Understanding sovereign debt distress also requires distinguishing between different categories of debt and debtors. Debt can be domestic or external, a distinction determined either by the

residency of the creditor or the currency of the debt. In the case of Japan, the majority of government bonds are held domestically, which essentially portrays a different risk profile from countries that rely heavily on foreign creditors and foreign-currency borrowing (Global Debt Clock, 2026). Most importantly, domestic creditors are much less likely to offload debt than foreign creditors in times of turmoil.

Another important distinction is between private and public debt, which has significant implications for the debt restructuring process. In the context of sovereign debt resolution, the most crucial category is external public debt owed to multilateral, bilateral, and private creditors. Domestic public debt is often viewed as more manageable, as the government controls the currency and can generate inflation, essentially “printing money” and reducing the real value of the debt. Privately owed external debt may create significant difficulties for an economy; however, it is not the government that is obliged to repay these debts.

The classification of creditors into multilateral, official bilateral, and private is also an important distinction (Paris Club, n.d.) and a source of discussion around sovereign debt. The treatment of different creditors, as well as who is included in these categories, is ambiguous and informal, creating issues in the debt restructuring process.

Although many of the debt restructuring cases that started after the pandemic are largely complete as of 2026, debt vulnerabilities in LICs remain elevated, which calls for further action by both creditors and debtors.

1.1. Social Costs

Debt distress has significant social costs for debtor countries. Higher debt repayments can reduce the fiscal space available for essential services such as healthcare, education, and social protection programs.

A 2020 paper finds that sovereign debt crises cause a statistically significant increase in child mortality, using a sample of 57 low- and middle-income countries (Daoud, 2020). A recent UNDP study shows a life expectancy decline of 5.9% for women and 7.7% for men in the long run due to the negative effects on the public health system. It also sheds light on the different

impact of sovereign debt across genders. Women's per capita income decreases by 17% as debt servicing increases from middle to top quintile, whereas no significant change is observed for men (UNDP, 2026). Higher debt servicing burdens also represent a 32.5% increase in maternal mortality.

2. Types of Creditors

When discussing sovereign debt restructuring, it is crucial to understand the types of creditors and their status. One of the main groups is the official bilateral creditors, including governments and their respective institutions, which can be further categorized into distinct groups. The Paris Club, notably, is an informal group of official creditors currently comprised of 22 members. For a long time, these countries dominated discussions around restructuring.

With the rise of new major creditors over the past two decades, such as China, a new platform that included additional official creditors became necessary. Currently, the G20 and the Paris Club are dominant players in the landscape, and the Common Framework brings together members from both groups in specific restructuring cases.

Another major group of creditors is multilateral institutions, including multilateral development banks (MDBs) and other international financial institutions. Even though MDBs constitute a large portion of total debt owed by low-income countries, they are exempt from sovereign debt restructuring in most cases. MDBs claim "Preferred Creditor Treatment" (PCT), but when and who benefits from it remains ambiguous. Major MDBs such as the World Bank Group have strong claims to PCT, but its informality and the "fair burden-sharing" discussions have made some MDBs more exposed to claims by sovereigns in debt distress. The scope and implications of PCT will be discussed in the following chapters.

The last major group of creditors is private lenders. This, however, is a highly heterogeneous group, as it includes bondholders, commercial banks, and other credit suppliers. Similar to the Paris Club, private creditors have historically formed informal groups for coordination, such as the London Club. Under the Common Framework, discussions of restructuring with official creditors precede those with private creditors. This may require the formation of multiple committees for both bondholders and loan creditors.

3. The IMF and the World Bank

The International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (later the World Bank Group) were two institutions established in July 1944 as part of the emerging Bretton Woods system. Today, these two institutions remain key players in the global financial architecture, including in cases of debt crises and sovereign debt restructuring.

Each member country contributes funds to the IMF through a quota system, with its subscription also determining its voting power. This results in certain countries having greater influence within the institution, as the Fund's total votes are concentrated among the G7 countries and other advanced economies (IMF, 2026).

The original Articles of Agreement of the IMF state that its mandate is to promote international monetary cooperation, facilitate balanced growth of international trade, and promote exchange stability (IMF, 1944); however, its role has evolved gradually due to changes in the global economy. The IMF monitored fixed exchange rate arrangements until the collapse of the system in 1971. Subsequently its role expanded in order to provide financing to countries experiencing balance-of-payments crises, especially those facing liquidity problems in foreign currencies.

The IMF has a number of other functions as well, but this places it in the role of a global lender of last resort and a de facto coordinator in the highly complex and often ambiguous process of sovereign debt resolution. The IMF can lend only if the debt is sustainable or if there is a credible path toward restoring debt sustainability, so IMF involvement is usually closely linked to debt restructurings. IMF intervention may arise (i) before a sovereign default occurs, so restructuring is done to prevent a default, or (ii) after a default, when disaster has occurred. This distinction has implications for the length, size, and complexity of the restructuring process.

4. MDBs

Multilateral Development Banks (MDBs), the first of which was the International Bank for Reconstruction and Development (IBRD) established in 1944 at Bretton Woods, are unique financial institutions. Their significance stems from their ability to channel mostly private investor resources toward projects that prioritize public policy goals rather than pure profit.

Essentially, MDBs are financial institutions created and owned by groups of national governments to support long-term development projects, many of which might not otherwise be supported (Humphrey, 2022).

The World Bank provides a template for the basic structure (Humphrey, 2022); nevertheless, there is great variation among MDBs due to their size, membership, and lending headroom. Larger MDBs face very different challenges than MDBs that are led by borrower governments and are indeed perceived differently by markets and other institutions.

The basic financial model of MDBs is structured as follows: each member country allocates money and buys shares; this shareholder capital is the foundation. The number of shares a country holds is correlated with its voting power. MDBs must also borrow from external sources, using a mix of bond issuances, loans, or credit lines from other institutions, depending on their size and membership. The funds raised are used to provide loans for development projects. The amount an MDB can lend is limited by its capital adequacy.

There are specific instances in which MDBs have minority shareholders that are not national governments. This raises questions about whether such MDBs can benefit from the special privileges enjoyed by others.

4.1. Legacy vs. Borrower-Led MDBs

Even though they are often sub-grouped together under international organizations, there is great variation among MDBs. Without constituting rigid categories, MDBs could be divided into the so-called “legacy” MDBs and “borrower-led” MDBs, following the terminology used by Humphrey (2022). Legacy MDBs are mainly the World Bank and other major regional MDBs, which benefit from the financial strength of their member countries and their broad membership.

The other group of MDBs, as their name suggests, is mostly comprised of sovereigns that borrow from these institutions they have created. These banks are mainly sub-regional, and they arguably represent the interests of borrower nations more than legacy MDBs. They are usually aware of local realities and risks. This group may benefit from faster bureaucracy and

closer relationships with member countries, but they are usually held back by higher funding costs due to their shareholder structure. This negatively affects their operations, perception, and the amount they can lend: “The scale of their activities and the level of risk they can assume are limited by the market’s view of their solvency as reflected in credit spreads and agency credit ratings.” (Perraudin, Powell and Yang, 2016)

The line between these two groups can get blurry, but there are indicators of how each MDB is perceived, especially by other international institutions. The Basel Committee on Banking Supervision (BCBS), which sets the standards for banking regulation and capital adequacy, reveals important insights into how different MDBs are treated. Under the Basel III Framework, 0% risk weight may be applied to exposures to certain MDBs, meaning that banks can apply preferential risk weights to these “Basel-eligible” MDBs. However, the criteria outlined by the committee automatically exclude many borrower-led MDBs, as it requires very high credit ratings for both the MDB and its shareholder countries, alongside other conditions.

Table 3. Twenty-Five International Financial Institutions with the Broadest Memberships

Institution	Type	Members' share of Fund votes	Member Countries
International Monetary Fund		100.0	190
World Bank Group	MDB	100.0	189
Int. Fund for Agricultural Development	MDB	95.4	177
Bank for International Settlements	Other	86.4	61
European Bank for Reconstruction and Development	MDB	77.8	69
African Development Bank	MDB	76.3	82
Asian Development Bank	MDB	72.2	68
Inter-American Development Bank	MDB	68.5	48
Asian Infrastructure Investment Bank	MDB	62.7	83
Council of Europe Development Bank	MDB	28.4	41
Caribbean Development Bank	MDB	26.7	28
European Investment Bank	MDB	25.6	27
European Financial Stability Mechanism	RFA	25.6	27
Eurosystem	RCUCB	21.5	19
European Stability Mechanism	RFA	21.5	19
West African Development Bank	MDB	20.2	14
Chiang Mai Initiative Multilateralization	RFA	18.2	13
New Development Bank	MDB	14.2	5
BRICS Contingent Reserve Arrangement	RFA	14.2	5
Islamic Development Bank	MDB	12.4	57
CAF - Development Bank of Latin America	MDB	10.0	19
OPEC Fund for International Development	MDB	7.4	12
Arab Monetary Fund	RFA	6.0	22
Arab Bank for Economic Development in Africa	MDB	5.7	18
Black Sea Trade and Development Bank	MDB	5.4	11

Sources: IFIs' websites and Fund staff calculations.

Source: International Monetary Fund (2022, p. 44), *Reviews of the Fund's Sovereign Arrears Policies and Perimeter*.

The table above, reproduced from IMF (2022, p. 44), provides insight into the membership composition of certain international financial institutions, ranked by the share of IMF voting power their members represent.

II. FORUMS AND COORDINATION MECHANISMS

1. Global Sovereign Debt Roundtable (GSDR)

Sovereign debt resolution or restructuring is a major issue involving many players and intertwined processes. The Global Sovereign Debt Roundtable (GSDR) is a forum that provides a platform for sovereign debt discussions outside of the restructuring mechanism. It was set up in February 2023 and consists of official bilateral creditors - both within and outside the Paris Club - private sector creditors, and borrowing countries, with the participation of the IMF and the World Bank (GSDR, 2023). The GSDR was established to build a common understanding of debt sustainability, including procedures and practices.

2. The Debt Service Suspension Initiative (DSSI)

The launch of the Debt Service Suspension Initiative (DSSI) on April 15, 2020, by the G20 in response to economic difficulties caused by the COVID-19 pandemic, marked a turning point for coordination in debt relief. It was significant not only because of the debt suspension it provided for low-income countries during the pandemic, but also because it initiated the discussion on coordinated leadership in sovereign debt beyond the G7 and the Paris Club. Most notably, China's participation was significant due to its global position as a major creditor and was largely anticipated by other bilateral creditors. Among other objectives, the DSSI was described as "an effort to enlist China to participate along with other nations' creditors in restructuring" (Brauer et al., 2022). Over the past decade, as debt levels rose globally, China's weight as a creditor increased, particularly in low-income IDA countries eligible for the DSSI and the Common Framework (Brautigam and Huang, 2023).

Initially intended as a temporary liquidity-relief measure, the DSSI led to the creation of the Common Framework, which later inherited some of its characteristics from this initiative. It also

launched a debate around the implications of certain measures, contributing to a more uniform understanding. Even though a great deal of progress has been made since then, including the debt resolution of several countries under the Common Framework, the issue is still complex and multi-dimensional.

3. The Common Framework (CF)

The Common Framework for Debt Treatment beyond the Debt Service Suspension Initiative, or simply the G20 Common Framework (CF), was set up in 2020, bringing together relevant official bilateral creditors for its implementation in debt restructuring cases. Its objective is to contribute to public debt sustainability within the context of an IMF-supported program (Paris Club, n.d.).

The Common Framework founding document states: “Recognizing that efficiently addressing ongoing debt vulnerabilities will require a case-by-case approach, but also strong creditors’ coordination, the present document sets out a common framework for the G20, which is also agreed by the Paris Club, to facilitate timely and orderly debt treatment for DSSI-eligible countries, with broad creditors’ participation including the private sector.” (G20, 2020). As an umbrella initiative, the CF represents an important shift from a fragmented restructuring process towards a more cooperative approach to sovereign debt resolution. Far from constituting a comprehensive solution, the CF seeks to outline this process with implications for both creditors and debtors.

The Common Framework also emphasizes ensuring fair burden sharing through “Comparability of Treatment,” using several parameters. This is intended to ensure that private creditors take losses proportionate to those of official bilateral creditors. It is important to note that the G20 CF applies only to DSSI-eligible low-income countries.

3.1. Creditors

It is essential for a country to assess its creditor composition and decide which creditors to negotiate with. If a country is eligible for the Common Framework, it may choose to negotiate with all G20 and Paris Club countries, to negotiate solely through the Paris Club, to negotiate

using the PC+ format (i.e., the Paris Club with targeted additional creditors), or to conduct separate negotiations with different creditor groups (GSDR, 2026).

4. The Global Sovereign Debt Resolution Framework

When a country is in debt distress, the IMF and the World Bank conduct a Debt Sustainability Analysis (DSA) to assess whether the country's debt is sustainable and to estimate the amount of debt relief required (GSDR, 2026). For low-income countries, the Debt Sustainability Framework (DSF) for LICs was developed to ensure that the analysis is consistent with their specific circumstances.

An IMF-supported program for debt restructuring under the Common Framework includes several steps; cases outside the Common Framework play out in a similar fashion. The implementation of the IMF program and the debt restructuring process are closely aligned, requiring the debtor country to take the former into consideration when engaging in the latter.

Before the formal restructuring process, after the debtor country requests an IMF-supported program, IMF staff develop the macro-framework scenario. They also conduct the Debt Sustainability Analysis (DSA): in the case of LICs, DSA is conducted under the debt sustainability framework for low-income countries (LIC DSF) jointly with the World Bank staff. The macro-framework and DSA are essential to define the restructuring envelope, which is the amount of debt treatment needed to restore debt sustainability and close the balance-of-payments (BOP) financing gap.

A staff-level agreement (SLA) needs to be reached for an IMF-supported program, which includes a set of policies and reforms. The next step is to move from the SLA to the IMF program approval; however, this requires commitments, or “financing assurances” from official bilateral creditors. Therefore, countries are expected to choose the negotiation mechanism, identify the appropriate official creditors, and start engaging with them at an early stage.

Under the Common Framework, an Official Creditor Committee (OCC) is formed. The OCC brings together the G20, the Paris Club, and other official bilateral creditors when needed. This group of countries is expected to provide the financing assurances based on the DSA and other

relevant assessments, which leads to the approval of the IMF program by the IMF Executive Board.

Following program approval, the debtor country is expected to reach an agreement in principle (AIP) with the official bilateral creditors through the OCC. This agreement would include the parameters of the restructuring, without necessarily being comprehensive. Under the Common Framework, finalizing the debt restructuring includes moving from the AIP to a Memorandum of Understanding (MoU) signed by both the OCC members and the debtor country, followed by legally binding bilateral agreements with each creditor.

Negotiations with private creditors can take place alongside those with official creditors, with careful consideration of this concept called comparability of treatment (CoT). For the bondholders, coordination can be achieved through the formation of one or several bondholders' committees. Finalizing the process with bondholders typically includes reaching an agreement in principle, followed by a bond exchange. Similarly, for commercial banks and other non-bonded creditors, the formation of a voluntary Loan Creditor Committee is possible. Official bilateral creditors might assess the agreement between the debtor country and private creditors and include "claw-back" clauses that would be activated if CoT is not met.

Comparability of Treatment (CoT) is the idea that the debtor should seek comparable treatment from all of its creditors. It is a central concept in debt restructuring discussions, as all creditors wish to attain terms that are as favorable as possible. In the context of the CF, the debtor country must be mindful of the terms decided by the OCC when negotiating with all of its creditors (Paris Club, n.d.). The Common Framework emphasizes the critical importance of CoT, which is assessed by official bilateral creditors using multiple criteria - changes in nominal debt service, debt stock in net present value terms, and duration of the treated claims - under the Common Framework, and usually enforced by claw-back clauses. Similar approaches are employed outside of the Common Framework (GSDR, 2026).

4.1. Case Study: Zambia

As of 2026, a total of four countries have requested debt treatment under the Common Framework: Chad, Zambia, Ghana, and Ethiopia.

In November 2020, Zambia defaulted due to high debt levels and rising interest payments, triggering Africa's first pandemic-era sovereign default (Center for Global Development, 2024). It officially requested a restructuring of its debt under the Common Framework on February 1, 2021 (Center for Global Development, 2024). The LIC DSF categorized Zambia's debt as unsustainable. The OCC was formed, and the IMF Board approved the Extended Credit Facility in the summer of 2022. The OCC and Zambia reached a deal regarding the debt to official creditors in June 2023. Although Zambia reached an agreement in principle with bondholders in October 2023, this proposal was rejected by the OCC due to concerns about compliance with CoT. Zambia eventually reached an agreement with bondholders in March 2024.

However, the OCC's refusal and the prolongation of the process had a negative impact on Zambia. There was also a structural mismatch in the classification of external debt: Under the IMF's DSA, local currency debt held by non-resident holders (NRHs) was classified as external debt, which would imply its inclusion in the restructuring. However, the Zambian authorities decided to leave NRH debt out, creating complications as China and several Eurobond holders had demanded its inclusion.

Nonetheless, restructuring of Zambia's debt was deemed an "important achievement" (Reuters, 2024). Zambia is a significant case because it was the first country to complete its restructuring under the Common Framework. It shed light on the shortcomings of the framework. The lack of clarity regarding its terms and definitions, especially with respect to CoT, can cause delays and suboptimal results for countries in debt distress.

III. ISSUES RELATED TO SOVEREIGN DEBT RESOLUTION AND MDBS

1. Preferred Creditor Treatment

Preferred Creditor Treatment (PCT), or Preferred Creditor Status (PCS), is the principle that MDB loans are treated senior relative to other forms of sovereign debt, with many implications for the sovereign debt restructuring process. Another component of PCT is MDBs' preferential access to foreign currency during a foreign exchange crisis in the borrowing country. While this

is not directly related to the restructuring process, it is a strong indication of the preferential treatment granted to MDBs.

PCT is significant for the MDB financial model due to its consequences for MDB capital adequacy and credit ratings, which allow MDBs to borrow and lend at low cost. It also implies that borrower countries will generally continue paying MDBs in the event of a default and exclude them from the restructuring, as MDBs have priority over other creditors. The sovereign loan portfolios of major MDBs reflect the importance of PCT.

This concept emerged in the 1970s (Humphrey, Puduserry and Dahan, 2026), and it was a customary de facto practice applied to legacy MDBs and the IMF. For these major MDBs, PCT has no clear legal basis, and is a customary practice dependent on consensus between creditors and debtors (Humphrey et al., 2026). “It has no legal foundation and in nearly all cases it is not mentioned in laws, regulation or supranationals’ articles of agreement” (Fitch, 2024c: 6).

However, this does not necessarily apply to all borrower-led MDBs. Although they place great emphasis on PCT, they are not always recognized as preferred creditors by the IMF, legacy MDBs, and credit rating agencies. Some newer MDBs explicitly include PCT in their charter to strengthen their status and encourage member countries to respect it. For instance, Afreximbank, which proved controversial during the restructuring processes of several African countries, claims that PCT is enshrined in its founding agreement (Humphrey, 2025). Still, who should benefit from PCT, and in what context, remains ambiguous, especially given the growing number of MDBs globally.

There are some mechanisms that support PCT. For instance, it is enforced by the IMF through its Non-Toleration of Arrears Policy (NTP), which provides special protection to the claims of multilateral institutions (IMF, 2022). However, it is unclear which MDBs are included within this group.

A 2022 IMF staff proposal on updating the lending-into-arrears policy outlined three criteria for determining which MDBs should benefit from this policy: having at least two sovereign shareholders and no non-sovereign shareholders; having global membership defined as “more

than half of the Fund's total voting pool"; and the treatment of MDBs by other official creditors during past restructurings (Humphrey, 2025). This proposal was rejected by the IMF Executive Board; instead, the Board decided to assess eligibility case-by-case. Nonetheless, the proposal reflects the perception that not all MDBs are created equal and MDBs controlled by wealthy and well-regarded Western countries are more likely to be prioritized.

In addition, PCT has been called into question in recent years due to rising debt levels and the growing number of MDBs. During the DSSI and Common Framework discussions following the COVID-19 pandemic, China explicitly called for MDB participation in sovereign debt restructuring.

1.1. Borrower-Led MDBs and PCT

One of the main debates surrounding PCT is whether borrower-led or sub-regional MDBs should benefit from it, and who should have the authority to decide. These MDBs place great importance on PCT due to its implications for their financial strength. However, legacy MDBs, credit rating agencies, and official bilateral creditors might not always recognize their status. PCT is an implicit and customary practice, so all involved parties should consent in the case of a restructuring.

Greater clarity is needed around this issue as it prolongs the debt restructuring process, causing additional harm to countries in default. Most recently, Afreximbank and TDB (the Trade and Development Bank) have demanded exclusion from restructurings in Zambia, Ghana, and Malawi, despite opposition from official creditors and the IMF (Humphrey, 2025). Initially, both were treated in line with commercial creditors in these three countries.

There are several reasons why these two borrower-led MDBs are not regarded similarly to other MDBs. Apart from the obvious differences in influence, size, and shareholder composition, creditors argue that there are additional factors that make the exclusion of Afreximbank and TDB problematic.

The limitations of their financial capacity constrain their funding costs and credit ratings, resulting in less concessional lending with higher interest rates and shorter maturities.

Additionally, both institutions have non-sovereign commercial shareholders who receive payouts, which is not usually the case for MDBs. Due to this controversy, TDB decided to reconsider its shareholding model (Humphrey, 2025). Afreximbank, in particular, has provided budget support loans to sovereigns and approved loans to countries already in debt distress, which resemble the practices of private institutions. Several other creditors argue that it provides riskier finance and therefore does not act like an MDB.

The main objective of these MDBs is to obtain and preserve preferred creditor status, so their refusal to be included in the restructuring process is driven more by the consequences and implications for future sovereign debt restructurings than by the losses they would have to take. This is highlighted by the restructuring discussions of Ghana and the confrontational approach of Afreximbank. Afreximbank claimed that Ghana was “up to date” on its payments in May 2025; however, later that month, Ghana’s Ministry of Finance responded that “it had not paid the bank for two years” (Financial Times, 2025). The situation between Afreximbank and Ghana is still unclear, but it sheds some light on how these MDBs wish to be recognized.

2. Should MDBs Contribute to Debt Relief?

Sovereign debt restructuring negotiations are a zero-sum game. By definition, as there is a smaller “pie” to be distributed, one creditor’s gain is necessarily another’s loss. Consequently, excluding one creditor group from suffering losses results in other groups taking higher losses. This puts the general exclusion of MDBs and the IMF from sovereign debt restructurings due to PCT in a different light. With growing global debt levels, greater MDB participation in restructuring efforts could be highly beneficial, especially for low-income countries.

It is an undeniable fact that MDBs and the IMF hold a large portion of poorer countries’ external debt. For 61 countries identified as being in, or at high risk, of debt distress, total public external debt stock amounted to \$993 billion in 2021 (Zucker-Marques, Volz and Gallagher, 2023). MDBs accounted for \$227 billion of this amount, whereas the IMF was owed \$113 billion. Excluding these claims could defeat the purpose of restructuring and prevent countries in default from achieving a sustainable level of debt.

“Fair burden sharing” is another important consideration. MDB participation in debt restructuring could motivate other creditors to engage in negotiations and change their perception of the process. Groups such as the G20, the Paris Club, and the BRICS have already called on MDBs to reconsider their position.

However, MDBs are insistent on being excluded from sovereign debt restructurings due to the risk that their participation could damage PCT. The loss of this perceived status or the acceptance of losses can hurt MDB creditworthiness, causing increased borrowing costs for the MDB, which would result in higher borrowing costs for countries in need.

Another reason is the idea that MDBs provide “ex-ante” debt relief since their loans are highly concessional and may sometimes even include grants. Therefore, they should not bear any additional losses. Similarly, MDBs are designed to lend countercyclically, as they provide financing even during crises (Zucker-Marques et al., 2023).

2.1. Comparability of Treatment and High Grant Element of MDB Loans

Similarly, comparability of treatment (CoT) is a crucial part of restructuring negotiations with respect to official bilateral and private creditors. Comparing contributions across different creditors is complex, as lending conditions can vary significantly. MDBs are believed to provide ex-ante implicit debt relief because their loans have a high grant element. The concessionality of MDB loans should therefore be taken into account when determining the amount each creditor should contribute in the event of MDB involvement.

Under the Common Framework, official bilateral creditors assess CoT using three criteria, one of which is debt reduction in net present value (NPV) terms using a 5 percent discount rate. The Lazard (2022) policy brief argues that clarity on how to calculate CoT is essential due to the zero-sum character of the restructuring under an IMF-supported program. Under the LIC Debt Sustainability Framework (DSF) used by the IMF and the World Bank, a common approach is to reduce claims equally based on each creditor’s present value claims, similar to the CF’s approach. However, as the policy brief argues, this method could result in official bilateral creditors or MDBs, if they were to be included, “subsidizing” private creditors, since the present value of their loans would be lower due to their concessional nature.

When lending, private creditors usually incorporate default risk into their pricing. In fact, a 2022 Bank of America paper notes that emerging market spreads generally exceed the compensation needed for historical default risk (Brauer et al., 2022). This reinforces the argument for why the grant element of the loans should be taken into account during the restructuring process.

2.2. Historical Precedents: Three Major Debt Relief Efforts Involving Multilateral Creditors

MDBs have contributed to debt relief efforts in the past, but only in very exceptional cases: the Heavily Indebted Poor Countries (HIPC) Initiative (1996), the Multilateral Debt Relief Initiative (MDRI) (2005), and the Catastrophe Containment and Relief Trust (CCRT) (2010). These initiatives also involved the participation of several borrower-led MDBs.

The HIPC Initiative was launched by the IMF and the World Bank to reduce the external debt burdens of eligible countries to sustainable levels. MDRI was a complementary initiative to HIPC, and to date, 37 countries have received debt relief under the two initiatives (IMF, 2023a). The CCRT was an enhancement of the Post-Catastrophe Debt Relief Trust (PCDR), which was established in 2010 following the Haiti earthquake (IMF, 2023b).

These efforts were different in nature from standard debt restructurings; they were funded largely through donor contributions, and, to a lesser extent, through the balance sheets of MDBs and other IFIs (Zucker-Marques et al., 2023). Because HIPC and MDRI were collective efforts with the participation of legacy MDBs and wealthy donor countries, they did not negatively affect MDB ratings, PCT, or funding costs (Humphrey, 2025). Therefore, they cannot necessarily be used as arguments for the routine involvement of MDBs in sovereign debt restructurings. However, they provide valuable examples of what can be achieved through collective action.

IV. NEXT STEPS AND POLICY RECOMMENDATIONS:

1. Policy Trade-Offs and Considerations

Sovereign debt restructuring is a complex and lengthy process that often resembles a zero-sum game from the perspective of creditors. Therefore, most proposed policy solutions have trade-offs to consider. Some of these recommendations can accelerate the debt resolution process but may be less appealing to certain creditor groups. It is important to consider the priorities of different parties while recognizing the negative impact that prolonged negotiations can have on debtor countries.

It is against this backdrop that the recommendations below should be viewed. In addition, these recommendations merit serious consideration, but they also require scrutiny and openness to adjustments as they are implemented.

Last but not least, they do not claim to be fully comprehensive. Other policy options surely already exist, and new ones may arise in the future. All should be evaluated according to well-established principles, which should include not only costs versus benefits, but also considerations of fairness, and the degree to which the proposal builds trust and permits greater transparency and inclusion. If a system is ever to be accepted broadly, it will need to bring about trust and enjoy substantial credibility among actors.

2. Strengthening System-Wide Coordination

Although the Common Framework is forward progress, its piecemeal approach prevents a fully collective and systematic procedure. The complexity of the process requires a collaborative attitude from all parties involved. Greater clarity would make the entire process more transparent and incentivize parties to work more closely together. Timely intervention is crucial, as delays can cause the debt situation to worsen. For these reasons, inviting all parties to discussions and creating more platforms such as the GSDR is necessary for building trust among creditors. Involving even the smallest players can make a notable difference in fostering a more collaborative environment. Additionally, a similar framework could be extended to non-DSSI-eligible countries to improve coordination and reduce restructuring delays.

The most severe cost of prolonging the debt restructuring process falls on highly indebted countries. Countries in debt distress would considerably benefit from the establishment of clear

frameworks and predictable timelines. Such clarity could even enable early intervention that prevents sovereign default or, at the least, encourage more timely decision-making by sovereigns. Given the social and economic cost of debt distress, early identification and more transparent triggers could have a substantial impact. Clarification of certain concepts and parameters is essential to proceed in a timely and efficient manner and would facilitate relevant parties in taking action earlier.

Private creditors are also crucial to this process, since the private sector has large exposures to many highly indebted countries. Greater collaboration among private creditors, as well as greater transparency on their part regarding debt holdings and expectations, would improve the negotiation process. Their participation in coordination platforms is also a welcome development to facilitate trust-building and collaboration. Additionally, broader adoption of Collective Action Clauses (CACs) in sovereign bond contracts would reduce holdout problems during restructurings.

Transparency and collaboration efforts should include MDBs as well. Information sharing among MDBs, the IMF, official creditors, and private creditors would reduce uncertainty, help to clarify misunderstandings, and contribute to trust building during debt workouts. Even when MDBs are excluded from the restructuring, the IMF should systematically invite all MDBs with exposures to the debtor country to debt restructuring discussions. Apart from the benefits of trust building, MDBs' perspective could be highly beneficial for the debtor country and other creditors.

The IMF acts as the central coordinator of sovereign debt workouts due to its role in financing, sustainability analysis, and policy guidance. Even though the IMF alone cannot control the behavior of all creditors, its position and conduct have significant implications. The Fund can establish clearer guidelines for its own approach in order to maintain an objective stance.

When it comes to the question of whether all MDBs should be included in or excluded from restructurings, the decision ultimately comes down to considering trade-offs for a number of issues: (i) emphasizing fairness among all creditors, (ii) within the asset class of MDBs,

considering equality of treatment and the implications of differential approaches, and (iii) enabling greater MDB lending capacity to help achieve the UN's Sustainable Development Goals. The IMF and official bilateral creditors should assess the contribution of MDBs by comparing the effects of debt haircuts with additional lending from MDBs. Existing research shows that there are trade-offs based on factors such as the size of the debtor country and whether the country has market access (Zucker-Marques et al., 2023).

3. The Question of Non-Legacy MDBs

The IMF needs to be more mindful of the challenges faced by borrower-led MDBs. Borrower-led MDBs are important sources of financing for countries experiencing debt distress, and their perspective needs to be incorporated to a greater extent. At present, the IMF appears to accommodate legacy MDBs more heavily than smaller, borrower-led MDBs when sovereign workouts take place. This has negative implications for borrower-led MDBs beyond direct financial losses. Politically, it can make the IMF appear more attentive to the interests of large wealthy countries and less concerned with the interests of smaller countries. The concerns of the less influential MDBs should not be ignored, as they are already at a disadvantage due to a lack of political clout and the wealthy shareholding structure characteristic of the legacy MDBs. This is also relevant since the countries in debt distress tend to hold relatively larger shares in borrower-led MDBs, so any losses imposed on these institutions ultimately represent a loss for the countries themselves and of public money collected from the citizens. The IMF should find systematic ways to include borrower-led MDBs in the processes, policy discussions, and assessments.

Most importantly, the IMF should avoid adopting policies that establish differential treatment among MDBs with respect to the recognition of preferred creditor status. As the 2022 IMF staff proposal suggests, establishing standards does not necessarily guarantee fair treatment among MDBs. Regardless of whether MDBs are ultimately excluded from or included in debt workouts, equivalence of treatment should be the foremost concern. Greater transparency and clearer criteria are usually beneficial for all parties, but they should not be used to create a hierarchy of favoritism among MDBs. The IMF should avoid creating the impression that it favors one group

of MDBs over another in the eyes of other creditors and institutions, including credit rating agencies, given that such differential treatment has very harmful effects on MDBs that are excluded or otherwise do not “make the cut”. The goal should be to establish policies and systematic guidelines that ensure all MDBs face equivalent treatment in sovereign debt workouts if they are to be included.

Objective institutional characteristics should also be explicitly listed in order to recognize the status of all bona fide MDBs. These institutions should be treated on the basis of what the entity is, regardless of its size, political influence, and sovereign shareholder composition. Although the IMF does not maintain a strict list of recognized MDBs, PCS could be explicitly extended to borrower-led MDBs through the IMF’s Non-Toleration of Sovereign Arrears Policy (NTP). Currently, this policy is applied on a case-by-case basis, but clearer guidelines could be established to inform MDBs of their status.

Similar clarification could also come from credible institutions such as the BCBS and credit rating agencies. Currently, the Basel III framework’s 0% risk-weight rule applies primarily to MDBs with AAA credit ratings and financial backing from wealthy donor countries. The BCBS should incorporate borrower-led MDBs into its regulatory framework by focusing on their nature as MDBs, rather than relying on credit ratings, which may be below AAA. Borrower-led MDBs are very strong financially and careful to maintain their creditworthiness, even though their credit ratings do not fully reflect these characteristics. The BCBS could provide greater clarity by explicitly recognizing all bona fide MDBs that satisfy objective institutional characteristics, rather than leaving gray areas for interpretation that lead to the exclusion of borrower-led MDBs.

Rating agencies could also find ways to incorporate borrower-led MDBs and PCT more adequately into their methodologies. They partially base their assessment of an MDB’s PCT on the extent to which it has been recognized in an actual sovereign debt workout relative to other MDBs. However, rating agencies should be more mindful of the effect that PCT has on the

creditworthiness of borrower-led MDBs and should assess MDB status based on institutional characteristics and the overall creditworthiness of the MDB.

From the perspective of the IMF and other IFIs, preferred creditor treatment could be abused by these institutions if their practices resemble those of private financial institutions, an issue which has come up regarding Afreximbank's role in lending to sovereigns that subsequently underwent debt restructuring. However, the reasons behind these practices should be better understood before they are labelled as detrimental. First, the sovereign willingly enters into the transaction with institutions such as Afreximbank because of high investment needs, lack of access to affordable private financing, and a general shortage of financial resources. Such institutions face higher funding costs on their own, and this does not allow them to offer the same degree of concessionality that legacy MDBs may offer for developmental projects, yet their importance to member countries is undeniable.

One compromise option is when restructuring debt, the IMF could establish systematic criteria for assessing the degree of concessionality of loans, as no such assessment is currently in place. However, such assessment would need to incorporate the different circumstances faced by MDBs. Borrower-led MDBs provide less concessional loans because they are constrained by higher funding costs. This needs to be taken into account when assessing the role and treatment of different MDBs in sovereign debt restructurings. Former Afreximbank President Benedict Oramah voiced this concern in 2024: "Do you know my cost of capital? No. Go and look at our triple B rating. Then compare the cost of equity with those who say they offer concessional loans, and you'll know who's really offering concessional loans." (Humphrey, 2025)

4. A New Mechanism

Collective Action Clauses (CACs) are provisions in sovereign bond contracts that reduce holdout problems by allowing a supermajority of bondholders to approve restructuring terms that become legally binding on all holders of the relevant bond. By encouraging collective decision-making, CACs can help smooth the restructuring process. A similar approach could be explored for official creditors and MDBs. The challenge is that MDBs and other official creditors usually enter into separate bilateral loan agreements with sovereigns, which makes collective action

more difficult. Hence, such an approach would require a different institutional mechanism. Still, a collective agreement on MDB participation in restructuring, triggered by a supermajority decision, could be an alternative if the systematic exclusion of all MDBs is not acknowledged.

With regards to such a proposal, equivalent treatment of all MDBs would be an important consideration. Similar to other proposed approaches, all MDBs that satisfy objective institutional requirements should be included in the mechanism. Once again, the exclusion of borrower-led MDBs would have negative consequences and violate the principle of collective action.

5. Recommendations for Borrower-Led MDBs

Cooperation among borrower-led MDBs is also crucial. These MDBs can work collectively to ensure that their voices are heard by the IMF, the G20, the Paris Club, and other major players. Partnerships and initiatives such as the International Development Finance Club and Finance in Common are useful platforms for collaboration and could be utilized further.

When collaborating with borrower-led MDBs, external partners should find a balance between exerting positive influence and imposing their own priorities on these MDBs. One of the key strengths of borrower-led MDBs is their close relationships with borrower countries, which could be undermined by excessive interference of external collaborators.

Outside of sovereign debt restructurings, borrower-led MDBs can take steps to be more cautious and to protect their PCS and credit ratings. The case of Afreximbank shows that accepting non-sovereign shareholders could be risky, especially if they receive dividends and appear as profit-seeking entities. Borrower-led MDBs should be careful to differentiate between development and commercial finance and rely primarily on government shareholder capital, even at the expense of faster growth. These steps should be taken with caution, as the reputation of these institutions is closely linked to their funding costs and can affect their special privileges.

Additionally, MDBs can establish clearer internal guidelines on lending to governments that are already in debt distress in order to protect their financial position. MDBs have a responsibility to safeguard their financial strength for all shareholders, which means that they must be careful with additional lending to indebted countries. This could include establishing guidelines to define the circumstances under which lending should proceed. It would also increase transparency for all parties while helping MDBs protect their balance sheets and special status.

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