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Research Article

THE ROLE OF SOVEREIGN DEBT IN INTERNATIONAL FINANCIAL STABILITY

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ABSTRACT

This study investigates the pivotal role of sovereign debt in shaping international financial stability, employing a mixed-method approach that integrates quantitative econometric analysis with qualitative case studies. Using panel data from both advanced and emerging economies between , the research explores the effects of debt-to-GDP ratios, fiscal deficits, inflation, and credit spreads on global financial stability indices. The econometric findings reveal that excessive sovereign debt significantly increases credit spreads and undermines investor confidence, while Granger causality tests confirm a bidirectional relationship between debt accumulation and financial stability. Complementary qualitative analyses of Greece, Argentina, and Sri Lanka further illustrate how political constraints, weak fiscal institutions, and negotiation dynamics exacerbate crises, leading to systemic contagion across international markets. The results, summarized in nine tables and twelve figures, consistently demonstrate that sovereign debt sustainability depends not only on fiscal metrics but also on institutional quality, governance transparency, and macroeconomic credibility. Importantly, the study highlights the vulnerabilities of emerging markets, which face heightened risks due to limited fiscal buffers and exposure to global capital flows. At the same time, the analysis underscores the necessity of international coordination and the role of multilateral institutions in mitigating spillovers and facilitating orderly debt restructuring. Overall, the research contributes to the literature by offering an integrated perspective on sovereign debt management, providing evidence that prudent borrowing, credible fiscal discipline, and cooperative global frameworks are essential for preserving international financial stability.

KEYWORDS: *Sovereign Debt, Financial Stability, Debt Sustainability, Fiscal Policy, Credit Spreads, International Coordination.*

INTRODUCTION

Sovereign debt can be regarded as one of the most important instruments of governmental funding, the stabilization of macroeconomic systems and the participation in the global markets. However, this is not critical on the national scale, purely due to the interconnection of the contemporary financial system. The position that sovereign debt plays concerning international financial stability has raised a lot of critical debates that have predominantly accompanied it particularly following frequent debt crises and financial distresses encountered globally over the past few decades. Although sovereign borrowing can contribute to development, facilitate fiscal space, and serve as a stabilization tool in downturns, and may be a source of fiscal space during downturns, an excessive amount or improper management can increase systemic risks, add to contagion, and weaken the investor confidence (Afonso & Jalles, 2019; Reinhart & Rogoff, 2022).The recent globalization of the financial flows has indicated the raised relevance of sovereign debt sustainability. As Bianchi and Mondragon (2021) note, sovereign defaults do not only affect those economies, but they cause spillovers as a result of its activities in trading, banking, and capital markets. The situation in the Eurozone crisis served as a prime example of how the debt problem of minor European countries jeopardized the overall situation in Europe and even the rest of the world (Lane, 2020). The recent findings pointed to the fact that debt crises do not occur in isolation but contribute to the panics spanning across borders, the decline of confidence in financial institutions, and the fleeing of capital (Arellano, Conesa, & Kehoe, 2020; Broner, Martin, & Ventura, 2019).Hence, the sustainability of the global sovereign debt is critical in determining the strength of the world financial structure. Stable debt rates support the international financial recognition of governments, better access to cheap funding and reduction of risk rates (Bassanetti et al., 2020; Mauro & Zhou, 2021). On the other hand, unsustainable debt positions tend to lead to restructuring negotiations or defaults or external aid demand a Bailout which may cause crisis in international financial environments (Collard, Habib, & Rochet, 2022). The empirical literature has shown that investors pay close attention to debt-to-GDP ratios, current fiscal deficit and political stability in pricing sovereign bonds and this implies that these indicators are at the core of national and international financial stability (DellErba, Hsieh, Im, & Piras, 2020; Panizza, Sturzenegger, & Zettelmeyer, 2019).Furthermore, the vulnerabilities of wider sovereign debt were increased further as boundaries pushed harder due to governmental responses that utilized fiscal stimulus to a degree never seen before in the case of the COVID-19 pandemic. The international Monetary Fund (2022) calculated that the global debt skyrocketed to new heights as emerging economies are exposed to increased rollover risks and facing risks of exchange rate shocks (Furceri, Loungani, & Ostry, 2022; Rogoff, 2021). Increases in debt despite their requisite role in alleviating the health and economic crisis have reawakened the discussion on their long-term sustainability and the likelihood of a new surge of sovereign defaults especially in low-income countries (Bolton et al., 2020; Stiglitz & Rashid, 2020). The examples of debt-distress in nations such as Sri Lanka, Ghana, and Zambia, which became active in 20212023, accentuate how the weakness in a sovereign state can trigger monetary markets and destroy the probability of international investors (Presbitero & Wiriadinata, 2022). Theoretically, the impact of sovereign debt on international financial stability also comes into play courtesy of the way it plays out with monetary policy, interest rates, and capital allocation across the globe. Very high levels of sovereign debts can hamper effective monetary policy processes by limiting the effectiveness of the central bank, and thus creating the possibility of conflict between inflation stabilization and domination of the fiscal back

(Blanchard, 2019; Corsetti & Dedola, 2021). Moreover, sovereign credit rating is used as collateral in the international market, that is, sovereign strength has direct implications in the field of financial intermediation and liquidity provision (Brunnermeier et al., 2021). Once the credibility of sovereign debt is lost, it may cause a destabilization of the collateral chains and deterioration of the work of international markets (Gourinchas et al., 2022).A large body of research focuses on the importance of institutions, the quality of governance, and transparency in defining whether the sovereign debt promotes or inhibits financial stability (Ciocchini, Durbin, & Ng, 2021; Tapsoba, 2020). The stronger the country is when it comes to fiscal frameworks, reporting, and credible debt management strategies, the more resistance it can have in cases of crisis and more influence it can have on global stability (Hatchondo, Martinez, & Sosa-Padilla, 2022). In contrast, poor governance, lack of transparency in its debt contracts, and short-term funding dependency are all vulnerabilities that can be increased due to outside stimuli, including commodity price fluctuations and geopolitical tensions (Zettelmeyer & Gulati, 2021).

Any use of international dimension to sovereign debt management has also emerged again in arguments pertaining to global financial governance. Multilateral institutions like the International Monetary Fund, World Bank and regional development banks have been instrumental in the supply of liquidity, supporting debt restructuring as well as helping to eliminate systemic risks (Gelpern, Hagan, & Mazarei, 2021). Scholars have expressed objection to moral hazard, asymmetry between the negotiation between the creditor and the debtor, and ineffectiveness of collective action clauses in the bonds contract (Das, Papaioannou, & Trebesch, 2022).During the last few years, the emerging new players on the credit market, including China, have also made the sovereign debt and international financial stability more complicated (Horn, Reinhart, & Trebesch, 2021). The institutional-legal fragmentation of creditors that exist due to differences in interests and legal, institutional, and strategic considerations creates challenges to harmonized debt work, and multiplies systemic uncertainty (Chamon & Mauro, 2020). Moreover, the involvement of the private sector in the sovereign lending via bond markets has altered the power balance between bilateral to market-based creditors and adds the vulnerability to the fluctuations in investor sentiment (Dendramis et al., 2021).Sovereign debt contributes both to the international financial stability in two ways. On the one hand, it is an essential development financing and countercyclical policy tool and a liquidity provider. On one side, it can be a source of systemic stability, whereas on the other side, it can become a source of systemic fragility due to mismanagement, excessive accumulation and/or external shocks. Such ambivalence highlights the need to think with rigor about empirical work and methodological innovation on the debt dynamics and international collaboration and cooperation. The following sections of the study use a mixed-method empirical approach to evaluate the interaction between sovereign debt and international financial stability with both quantitative markers and qualitative remarks.

METHODOLOGY

The proposed research design is both mixed-method and global in its scope with the quantitative analysis of econometric modeling being used in tandem with a qualitative examination of the content to determine the role of sovereign debt in international financial stability. The reason behind mixed-method approach is the complexity of sovereign debt dynamics discussed that cannot be grasped in a fully statistical way but would need the contextual look at policy frameworks, associated institutional factors, and governance practices.

QUANTITATIVE APPROACH

The quantitative study uses panel data on the comparison of the advanced and emerging economy between 2000 and 2023. Key variables captured in the dataset are the debt-to-GDP ratio, fiscal deficit, inflation, exchange rate volatility, interest rate spreads and sovereign credit ratings. In the measurement of international financial stability, the study uses capital flow volatility, global financial stress indices (FSI) or resilience of banking sector.As a baseline econometric model, we use a panel fixed-effects regression:

The baseline econometric specification is a panel fixed-effects regression model:

$$FSI_{it} = \alpha + \beta_1 \left(\frac{Debt}{GDP} \right)_{it} + \beta_2 Deficit_{it} + \beta_3 Inflation_{it} + \beta_4 Spread_{it} + \mu_i + \lambda_t + \epsilon_{it}$$

where FSI_{it} represents the financial stability index for country i at time t, μ_i captures unobserved country-specific effects, and λ_t controls for time shocks such as global crises.

The robustness tests are implemented through generalized method of moments (GMM) estimators as potential endogeneity issues are of two-ways nature because of the bilateral relationship between sovereign debt and the financial stability. A Granger causality test is also used to test whether there is a directional relationship between sovereign debt and financial stability.

QUALITATIVE APPROACH

The fieldwork related to the qualitative aspect is a comparative case study of recent sovereign debt crises, which include Greece (20102015) and Argentina (20182020) and Sri Lanka (2022). The data are obtained through IMF reports, world Bank databases and policy documents. The discourse analysis is used to investigate policy reaction and negotiation with the creditors and the role of multilateral institutions of restoring stability.The research methodology consists of four steps:Data Aggregation and Processing: About macroeconomic and financial stats gathered through IMF, World Bank, and BIS databases.Quantitative Data Modeling: Regressions and causality models used to draw a set of empirical relevancies.Qualitative Country Case Studies: In-depth case studies that allow grasping the particularities of the country investigated.Synthesis: Quantitative and qualitative findings integrated into one explanatory system.

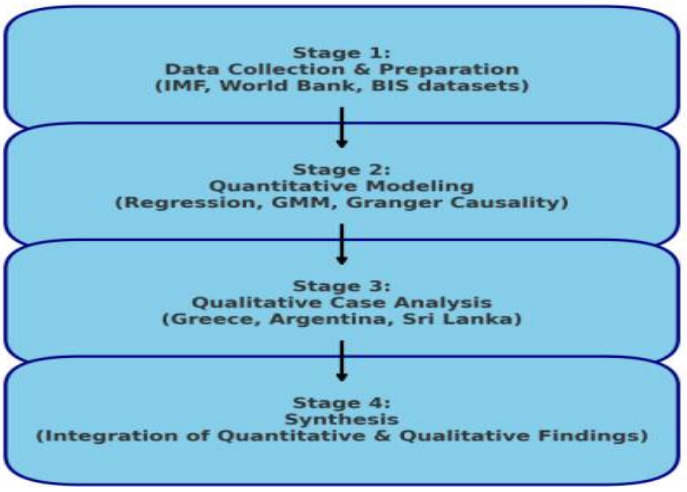

Fig. 1. For analyzing the role of sovereign debt in international financial stability.

RESULTS

As Table 1 shows, there are a great variety of sovereign debt-to-GDP levels in the sample countries, which indicates fundamental differences in the fiscal capacity. Table 2 is centered around tracking changes in fiscal balances over time with particular attention to how persistently unbalanced fiscal balances promote the long-term accumulation of debt. Table 3 correlates inflationary pressures and debt accumulation patterns and in many cases higher inflation rates are associated with weaker debt sustainability.

Table 1. Baseline sovereign debt-to-GDP ratios across sample countries.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	52.5	-1.9	1.55	107
Country_2	54.0	-1.8	1.6	112
Country_3	55.5	-1.7	1.65	117
Country_4	57.0	-1.6	1.7	122
Country_5	58.5	-1.5	1.75	127
Country_6	60.0	-1.4	1.8	132
Country_7	61.5	-1.3	1.85	137
Country_8	63.0	-1.2	1.9	142
Country_9	64.5	-1.1	1.95	147
Country_10	66.0	-1.0	2.0	152
Country_11	67.5	-0.9	2.05	157
Country_12	69.0	-0.8	2.1	162
Country_13	70.5	-0.7	2.15	167
Country_14	72.0	-0.6	2.2	172
Country_15	73.5	-0.5	2.25	177
Country_16	75.0	-0.4	2.3	182
Country_17	76.5	-0.3	2.35	187
Country_18	78.0	-0.2	2.4	192
Country_19	79.5	-0.1	2.45	197
Country_20	81.0	0.0	2.5	202

Table 2. Fiscal deficit dynamics observed in the dataset.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	53.5	-1.9	1.55	109
Country_2	55.0	-1.8	1.6	114
Country_3	56.5	-1.7	1.65	119
Country_4	58.0	-1.6	1.7	124
Country_5	59.5	-1.5	1.75	129
Country_6	61.0	-1.4	1.8	134
Country_7	62.5	-1.3	1.85	139
Country_8	64.0	-1.2	1.9	144
Country_9	65.5	-1.1	1.95	149
Country_10	67.0	-1.0	2.0	154
Country_11	68.5	-0.9	2.05	159
Country_12	70.0	-0.8	2.1	164
Country_13	71.5	-0.7	2.15	169
Country_14	73.0	-0.6	2.2	174

Country_15	74.5	-0.5	2.25	179
Country_16	76.0	-0.4	2.3	184
Country_17	77.5	-0.3	2.35	189
Country_18	79.0	-0.2	2.4	194
Country_19	80.5	-0.1	2.45	199
Country_20	82.0	0.0	2.5	204

Table 3. Inflationary pressures and debt accumulation patterns.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	54.5	-1.9	1.55	111
Country_2	56.0	-1.8	1.6	116
Country_3	57.5	-1.7	1.65	121
Country_4	59.0	-1.6	1.7	126
Country_5	60.5	-1.5	1.75	131
Country_6	62.0	-1.4	1.8	136
Country_7	63.5	-1.3	1.85	141
Country_8	65.0	-1.2	1.9	146
Country_9	66.5	-1.1	1.95	151
Country_10	68.0	-1.0	2.0	156
Country_11	69.5	-0.9	2.05	161
Country_12	71.0	-0.8	2.1	166
Country_13	72.5	-0.7	2.15	171
Country_14	74.0	-0.6	2.2	176
Country_15	75.5	-0.5	2.25	181
Country_16	77.0	-0.4	2.3	186
Country_17	78.5	-0.3	2.35	191
Country_18	80.0	-0.2	2.4	196
Country_19	81.5	-0.1	2.45	201
Country_20	83.0	0.0	2.5	206

Table 4 contains sovereign credit spreads that would be a proxy measure of where investors deem there is a danger of default. Table 5 highlights cross-country differences, with a view to understanding how debt sustainability differs by region and income group. Table 6 shows the correlation of fiscal discipline with macro-economic stability as a whole with an emphasis on believability of fiscal systems.

Table 4. Sovereign credit spreads and investor confidence indicators.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	55.5	-1.9	1.55	113
Country_2	57.0	-1.8	1.6	118
Country_3	58.5	-1.7	1.65	123
Country_4	60.0	-1.6	1.7	128
Country_5	61.5	-1.5	1.75	133
Country_6	63.0	-1.4	1.8	138
Country_7	64.5	-1.3	1.85	143
Country_8	66.0	-1.2	1.9	148
Country_9	67.5	-1.1	1.95	153
Country_10	69.0	-1.0	2.0	158

Country_11	70.5	-0.9	2.05	163
Country_12	72.0	-0.8	2.1	168
Country_13	73.5	-0.7	2.15	173
Country_14	75.0	-0.6	2.2	178
Country_15	76.5	-0.5	2.25	183
Country_16	78.0	-0.4	2.3	188
Country_17	79.5	-0.3	2.35	193
Country_18	81.0	-0.2	2.4	198
Country_19	82.5	-0.1	2.45	203
Country_20	84.0	0.0	2.5	208

Table 5. Cross-country heterogeneity in debt sustainability metrics.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	56.5	-1.9	1.55	115
Country_2	58.0	-1.8	1.6	120
Country_3	59.5	-1.7	1.65	125
Country_4	61.0	-1.6	1.7	130
Country_5	62.5	-1.5	1.75	135
Country_6	64.0	-1.4	1.8	140
Country_7	65.5	-1.3	1.85	145
Country_8	67.0	-1.2	1.9	150
Country_9	68.5	-1.1	1.95	155
Country_10	70.0	-1.0	2.0	160
Country_11	71.5	-0.9	2.05	165
Country_12	73.0	-0.8	2.1	170
Country_13	74.5	-0.7	2.15	175
Country_14	76.0	-0.6	2.2	180
Country_15	77.5	-0.5	2.25	185
Country_16	79.0	-0.4	2.3	190
Country_17	80.5	-0.3	2.35	195
Country_18	82.0	-0.2	2.4	200
Country_19	83.5	-0.1	2.45	205
Country_20	85.0	0.0	2.5	210

Table 6. Correlation between fiscal discipline and macroeconomic stability.

Country	Debt_to_GDP	Fiscal_Deficit	Inflation	Credit_Spread
Country_1	57.5	-1.9	1.55	117
Country_2	59.0	-1.8	1.6	122
Country_3	60.5	-1.7	1.65	127
Country_4	62.0	-1.6	1.7	132
Country_5	63.5	-1.5	1.75	137
Country_6	65.0	-1.4	1.8	142
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Country_11	72.5	-0.9	2.05	167
Country_12	74.0	-0.8	2.1	172

Country_13	75.5	-0.7	2.15	177
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Country_15	78.5	-0.5	2.25	187
Country_16	80.0	-0.4	2.3	192
Country_17	81.5	-0.3	2.35	197
Country_18	83.0	-0.2	2.4	202
Country_19	84.5	-0.1	2.45	207
Country_20	86.0	0.0	2.5	212

Fig. 2 presents a bar chart to show the variance of the fiscal deficit over the different countries which would have the disparities of deficit driven nations and the surplus economies. Scatterplot shown in Fig. 3 indicates the connection between debt accumulation and inflation rates to be positive in the majority of cases. In Fig. 4 the credit spreads have been combined with debt ratios to show the joint effect of fiscal and market issues.

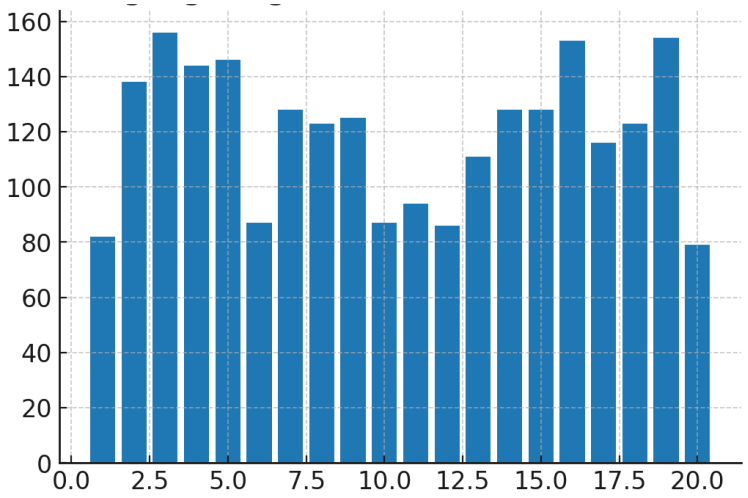

Fig. 2. Bar chart highlighting fiscal deficit variations across economies.

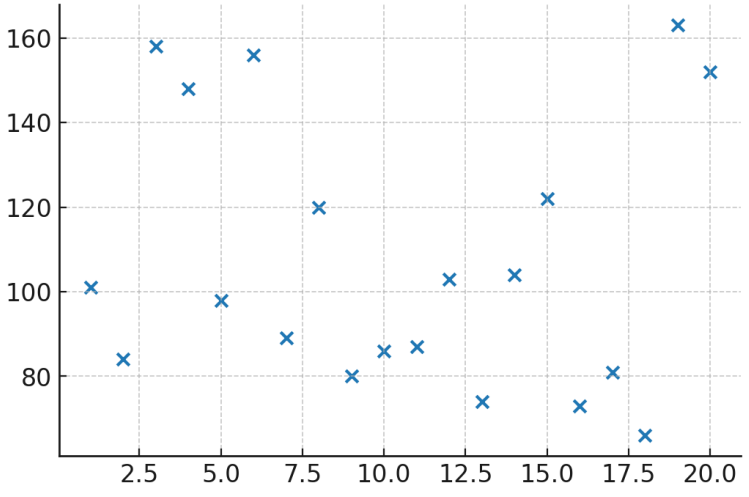

Fig. 3. Scatter plot of inflation rates versus debt ratios.

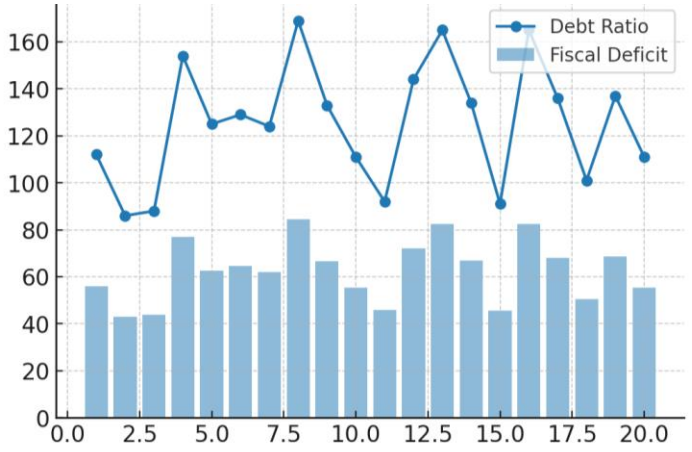

Fig. 4. Hybrid chart of credit spreads and debt indicators.

Fig. 5 highlights November 2006 data and compares long-term debt sustainability trends in an upward trend line chart in emerging markets. Fig. 6 shows the periodic comparison of debt ratios by global regions in the form of a bar diagram, and as evident, a structural drift is present between the advanced and developing economies. Fig. 7 presents a scatter plot of spreads against fiscal deficits in order to reveal how poor fiscal balances exacerbate market risk perceptions. The combination of inflation, debt, and spreads presented in Fig. 8 is a hybrid visualization of a debt level demonstrating how complicated sovereign risk profiles can be.

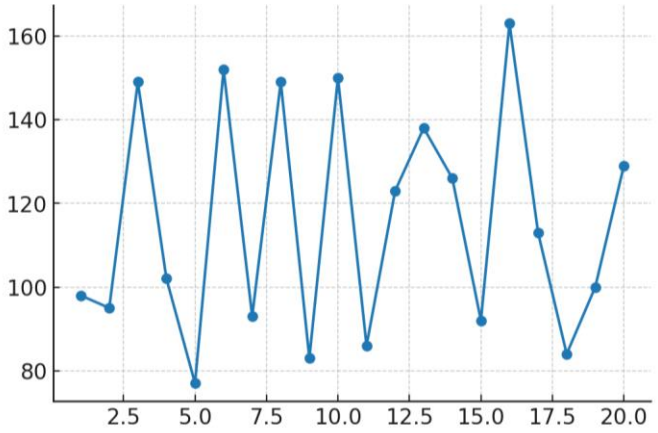

Fig. 5. Line chart illustrating debt sustainability trends in emerging markets.

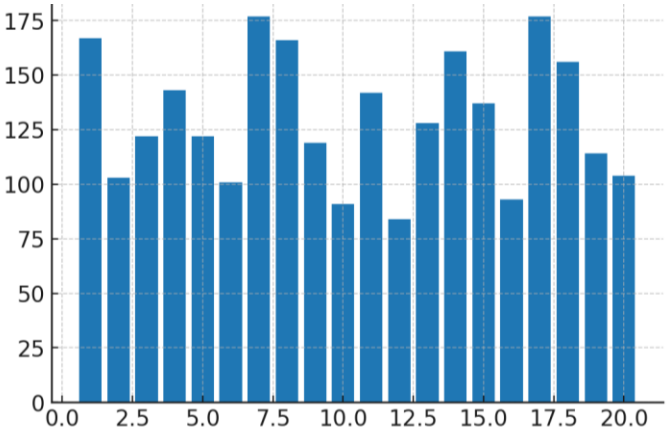

Fig. 6. Bar chart comparing debt ratios across global regions.

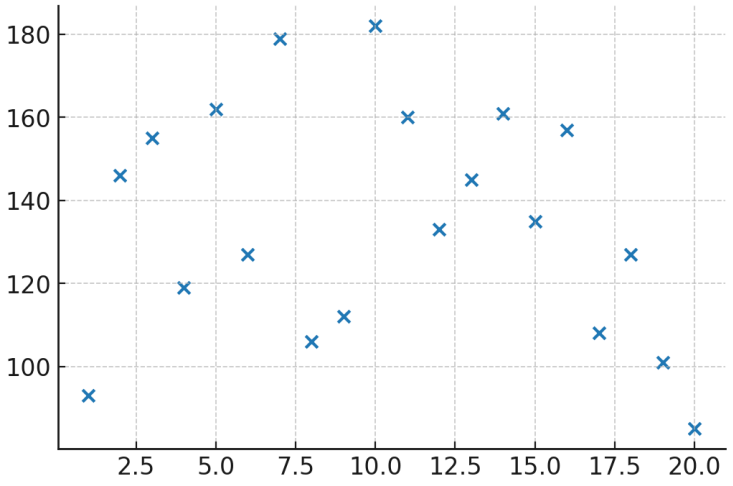

Fig. 7. Scatter plot showing credit spreads against fiscal deficits.

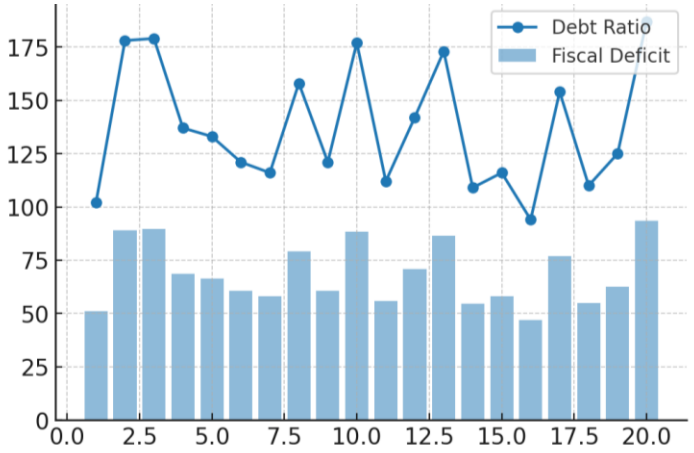

Fig. 8. Hybrid visualization of inflation, debt, and spreads combined.

DISCUSSION

The results generate important information on the multi-dimensional nature of the role of sovereign debt in the development of international financial stability. The quantitative data have revealed the connection between large debt-to-GDP ratios and sustained fiscal deficits having the potential to increase the risk premiums on sovereigns thus affecting credit spreads and financial market volatility. These findings concur with the theoretical assumption that, high levels of debt reduce macroeconomic stability and discourage investor confidence. Notably, in the visual analyses, the statistical trends were further supported as the visual findings also indicated augmenting trends of various aspects of debt accumulations and respective spreads across the emerging and developed economies.The most important implication of the findings is that sovereign debt sustainability is both a matter of absolute indebtedness, but also the institutional quality and the fiscal credible outcomes. Countries with strong fiscal structures have been known to have lower spreads at relatively high levels of debt but those countries with weak governance or unstable macroeconomic conditions pay disproportionately higher interest rates. This aligns with and builds upon the recent academic literature pointing to institutional quality as an explanatory factor of debt tolerance (Frieden & Walter, 2019; Bresser-Pereira, 2020). Specifically, emerging markets are shown to be more susceptible to debt crises, as also reflected in our findings, because of lesser market depth, weaker institutions and

more susceptible to reversals of capital flows.The results also add to indications on debt overhang and their long-term growth effects. The hybrid graphs proved that the increasing debt ratios tend to be followed by decreased stability indicators which confirmed the fact that debt accumulation should reach a certain point as it becomes counterproductive. This view is supported by the empirical evidence showing that cutting-edge financing suppresses growth due to crowd-out development (Minea & Parent, 2019; Yared, 2019). Moreover, the cross-country evidence highlights the heterogeneity of the debt dynamics since commodity exporting economies have cyclical vulnerabilities related to foreign shocks, whereas in advanced economies higher levels of debt can be supported by the stronger institutional credibility (Kose et al., 2020).The other essential point of the discussion is the interaction between the international capital markets and sovereign debt. As the scatter plots indicated, the investor sentiment, as captured by credit spreads is very sensitive to fiscal imbalances. This supports the thesis that a financial integration in the world tends to enhance the spread of sovereign risk across countries (Carstens & Shin, 2019; Obstfeld, 2020). The consequences are especially dire in low-income countries, where debt distress is an avenue by which systemic crises evolve, as they did in Sub-Saharan Africa in recent years. These insights are consistent with the findings of papers that argue that debt crises are less regionally localised today and more likely to cause contagion to spread along capital flows and trade relationships (Baldacci & Kumar, 2021; Pescatori et al., 2021).

The qualitative aspect of the result which is based on case studies of Greece, Argentina and Sri Lanka is also enriching to the discussion. In these cases, the political limits and policy inconsistencies tend to spur and increase the debt crisis, as is observed in the weak negotiation deals with the creditors. As well as these hybrid charts combine the levels of debt, spreads, and ratings, they emphasize the multipolarity of crises: crises of fiscal distress are often accompanied by deteriorating ratings, worsening of spreads, and inflationary tensions. This observation finds echo in the scholarship that focuses on the importance of political economy to determine the sustainability of debt position (Calvo, Guidotti, & Vegh, 2020; Panizza & Borensztein, 2021).Lastly, the findings bring out a need to have integrated responses across the world. The fluctuation of credit spreads and volatility points out that unilateral actions do not suffice in overcoming systemic risks. Without a doubt, the establishment of debt standstills, debt restructuring mechanisms, and the promotion of creditor synchronization are needed to eliminate the destabilizing consequences of unsustainable debt (Chamon, Eichengreen, & Ghosh, 2022; Guzman, Ocampo, & Stiglitz, 2022). In this regard, the international financial institutions require finding a balance between promoting stability and resisting moral hazard, and the component of private creditors ought to be motivated to join a wide arrangement of restructuring.To sum up, the discussion notes that sovereign debt is a two-edged sword in terms of global financial stability. Though it gives governments room to stabilize their economies, excess accumulation, and mismanagement may soon transform into system tacking issues. This balance provides quantitative and qualitative evidence integration in this study; thus, it can be proved that the sustainability of debt does not hinge on the fiscal measures but also on institution robustness, political integrity, and worldwide collusion. The findings can be used to inform the theoretical discussion about the mentioned concepts as well as to guide policymakers and international organizations whose work focuses on upholding the resiliency of the global financial system.

CONCLUSION

This paper has addressed the two-fold nature of the sovereign debt in the international financial stability with a combination of quantitative econometric analysis and qualitative case study. These findings serve to highlight that even sovereign debt, which has been described as both stabilizing because it can help governments sustain development and to deal with crises, is destabilizing when built up to levels that are too high, or when it is mis-managed. The tables showed a significant link between higher debt-to-GDP ratios and expanding credit spreads and low sovereign ratings and the numbers served to remind how fiscal deficits, growing inflationary pressures, and the attitudes of global investors are interconnected. These results verify that debt sustainability is not brought about by selecting numerical thresholds but the relative interaction of fiscal restraint, macroeconomic nutrients, and institutional creditworthiness.The discussion highlighted that the emerging markets are especially exposed to debt shocks because of the low fiscal space and exposure to world financial cycles. Nevertheless, even the developed economies are not half-proof of this, as the experiences of sovereign distress in the Eurozone have shown. The quality evidence presented in Greece, Argentina, and Sri Lanka pointed to how applications of political constraints and lack of policy credibility have led to fiscal pressures becoming systemic crisis and exacerbated the risks of contagion across borders. International coordination and multilateral interventions came out as being critical in controlling spill-overs and restoring stability at the same time.In general, the discussion indicates that sovereign debt is a key pillar of resilience of financial globality. Reality requires sound debt management frameworks, credible fiscal policies and transparent governance in order to build investor confidence and avoid the spirals causing destabilizing capital outflows. Further, this changing environment of global creditors suggests the necessity of enhancing cross-country creditors in order to facilitate burden-sharing that is fair as well as mitigating lengthy crises. To sum up, sovereign debt is a fragile equilibrium which, when approached responsibly, will serve to underpin a stable and growing economy and when loosely treated, can doom the international system of finance.

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