THE JOINT BANK-FUND DEBT SUSTAINABILITY FRAMEWORK FOR LICs

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INTERNATIONAL MONETARY FUND

Paper presented at the Workshop: Debt Sustainability Analysis Workshop
Organized by the International Monetary Fund (IMF)
April 20, 2007
Tokyo, Japan

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The Debt Challenges of LICs

- Low-income countries (LICs) face large financing needs but their capacity to carry debt is relatively limited
  - Narrow tax bases
  - Shallow domestic financial sectors
  - Small, vulnerable export sectors

- Excessive levels of debt (external and domestic) can undermine macroeconomic stability and constrain fiscal policy

- Debt crises are very costly, economically and socially
An Altered Landscape

- LICs also face a new international financial environment:
  - Debt relief for the most indebted
  - Scaling up prospects from traditional creditors
  - The emergence of new private and official creditors

- These changes provide opportunities for faster progress towards the MDGs...

- ... But they need to be managed in order to avoid too rapid a build-up of debt
The Joint Bank-Fund DSF

The Bank and Fund have jointly developed – and recently strengthened – an instrument to address the analytical challenges of prudent borrowing:

– The Debt Sustainability Framework for Low-Income Countries (DSF)

The DSF is designed to detect early debt vulnerabilities and help design strategies to address them.

The DSF is not the framework used in the context of the HIPC Initiative; it serves a different purpose.
Main Objectives

- Improve World Bank and IMF assessments and policy advice in these areas and guide provision of needed technical assistance.

- Support LICs in achieving development objectives and Millennium Development Goals, while maintaining sustainable levels of debt.
  - Assess risk of future debt distress so that preventive action can be taken.
  - Guide new borrowing decisions to match financing with ability to repay debt.
  - Encourage creditors to ensure long-term debt sustainability when providing loans and grants to LICs.
Analytical Foundations

- Need broad-based analysis and long-term perspective to detect early debt vulnerabilities and allow for correction (e.g., low debt service may hide future problems)

- LIC vulnerabilities differ from that of richer countries: Exogenous shocks larger and longer, weaker institutions, incomplete information

- Empirical analysis shows that the likelihood of debt distress is linked to the size of the debt burden, exogenous shocks, and the quality of policies and institutions
Three “Pillars”

- Twenty-year projections of debt burden ratios under baseline and alternative scenarios
- Risk ratings based on policy-dependent indicative debt-burden thresholds
- Recommended borrowing strategy and possible financing responses from lenders
Other DSF Features

- Conducted on an annual basis, which allows for corrections/adjustments
- Transparent assumptions and forecasts, in relation to historical trends
- Standardization facilitates cross-country comparisons, but does not prevent tailoring to country circumstances
Avoiding Unsustainable Debts

- Recent developments make maintenance of debt sustainability even more challenging

- Addressing this challenge will require:
  - Better analysis (DSF strengthening)
  - Raising awareness of debt sustainability risks among borrowers and creditors
  - Fostering broader exchange of information between borrowers and creditors, and among creditors
  - Continued emphasis on concessional finance
Raising Awareness of Debt Sustainability Risks

- The DSF has already had an impact on Bank and Fund policies
  - IDA financing terms
  - IMF policy advice and program design

- However, the DSF will be effective in preventing new crises only if *both* other creditors *and* borrowing countries act in broad harmony with it
Creditor Outreach

- Some multilaterals already use – or plan to use – DSAs in their lending decisions
- The IMF and the World Bank are stepping up outreach to major creditor groups
  - MDBs
  - Traditional bilateral creditors
  - Export Credit Agencies
  - Emerging creditors
Medium-Term Debt Strategies

- The ultimate purpose of the DSF is to enable borrowers to design appropriate financing strategies.
- MTDS is centered on identifying a debt path that is sustainable while consistent with development plans and poverty reduction strategy.
- MTDS is a key element for discussion of the fiscal stance and determination of appropriate financing terms.
- MTDS could be used actively to obtain better terms on new finance.
First Steps Towards MTDS

- Country authorities can gain from familiarity with the DSF
- Authorities should have a more active role in preparation and discussion of DSAs
- DSAs should have a more central role in policy design and discussions
- This, combined with dialogue with staff, would help make the case for better financing packages
Building Debt Management Capacity

- Strong messages from both IMF and IDA Boards in support of capacity building
- Need to ensure better coordination of existing providers and initiatives
- Authorities can help by proactively identifying their needs
- DSF training workshops have already been offered to government staff of a number of LICs and more will be offered if needed
  - Authorities are encouraged to make the most of these opportunities