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REFORM OF THE POLICY ON PUBLIC DEBT LIMITS IN IMF-SUPPORTED PROGRAMS—PROPOSED DECISION AND PROPOSED NEW GUIDELINES

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This supplement sets forth the proposed decision to modify the current Guidelines on Public Debt Conditionality in Fund Arrangements (the "Guidelines") as outlined in the Reform of the Policy on Public Debt Limits in IMF-Supported Programs. The proposed new Guidelines are included as an attachment to the proposed decision. For the convenience of Executive Directors, Annex I contains a redline text to show how the new Guidelines differ from those currently in place. The summing up will reflect Directors' views on changes to the policy not covered in the Guidelines. Specific revisions to the Guidelines to reflect the reforms include:

- Within the category of members that normally rely on official external financing on concessional terms, the policy makes a distinction between those members that do not have access to international financial markets on a significant scale (Paragraph 7(e)) and those members that do have access to international financial markets on a significant scale (Paragraph 7(f)).

- For those members that normally rely on official external financing on concessional terms that do not have access to international financial markets on a significant scale, and are at a high risk of debt distress or in debt distress, the policy introduces an additional safeguard of a PC or IT on the present value ("PV") of the accumulation of external debt (Paragraph 7(e)(i)).

- In circumstances where the member's capacity for monitoring debt on aggregate levels (including in PV terms) is not adequate, PCs will be specified on a nominal basis on the accumulation of non-concessional external debt, supplemented by a memorandum item, also specified in nominal terms, on the accumulation of concessional external debt (Paragraph 7(e)(iv)).

- For those members that normally rely on official external financing on concessional terms but also have access to international financial markets on a significant scale and are in debt distress or at high or moderate risk of debt distress, the Guidelines state that debt conditionality would normally be specified on the accumulation of public external debt in PV terms, except where alternative formulations are judged to be better tailored to address the member's vulnerabilities (e.g., such alternative formulations could include a PC on the aggregate level of public debt, in nominal terms, in cases where there is substantial foreign investor participation in the domestic bond market, as discussed in paragraph 42 of the Reform of the Policy on Public Debt Limits in IMF-Supported Programs, (Paragraph 7(f)(i)). For members at low risk of debt distress, conditionality on debt would normally not be warranted, except where justified on the basis of the criteria specified in Paragraph 7(e) (e.g., important sources of public debt vulnerabilities are not otherwise captured by fiscal conditionality); see Paragraph 7(f)(ii).

The revisions also reflect the following technical clarifications and updates:

- Debt conditionality should be used only when a member faces significant debt vulnerabilities that cannot be contained by fiscal conditionality alone (Paragraph 1);

- Inclusion of a cross-reference to clarify when public debt conditionality would normally warrant the use of public debt conditionality instead of, or as a complement to, "above-the-line" fiscal conditionality (Paragraph 2);

- Modification of the language of Paragraph 7(a) to make clear that the Guidelines are to be applied in a manner consistent with the Fund's Guidelines on Conditionality;

- Use of public debt conditionality is warranted when important sources of public debt vulnerabilities are not adequately captured in the fiscal accounts and only when addressing these vulnerabilities is judged to be of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, in accordance with the Guidelines on Conditionality (Paragraph 7(c)(ii));

- Addition of collateralized debt as an example of an important source of public debt vulnerabilities not adequately captured in the fiscal accounts, which could warrant the use of public debt conditionality; (Paragraph 7(c)(ii));

- Clarification on the circumstances where the accumulation of non-concessional debt would be allowed for members assessed as facing a high risk of debt distress or in debt distress (Paragraph 7(e)(i)); and

- Clarification that the Guidelines will continue to apply to programs supported by the Policy Coordination Instrument, in addition to the PSI (Paragraph 9).

Proposed Decision

The following decision, which may be adopted by a majority of the votes cast, is proposed for the adoption by the Executive Board:

1. The "Guidelines on Public Debt Conditionality in Fund Arrangements", set forth as an attachment to Decision No. 15688-(14/107) of December 5, 2014, shall be replaced by the "Guidelines on Public Debt Conditionality in Fund Arrangements" as set forth in the Attachment to this decision. Any existing reference in Fund policies to the Guidelines on Public Debt Conditionality in Fund Arrangements shall be read as a reference to the attached Guidelines on Public Debt Conditionality in Fund Arrangements.

2. This decision shall become effective on the last day of the subsequent month following the issuance to the Executive Board of an updated staff guidance note on public debt conditionality in Fund-supported programs. Any performance criterion or indicative target on public debt that is in place when this decision becomes effective shall continue to apply in accordance with its terms unless and until such performance criterion or indicative target is amended consistent with the attached Guidelines on Public Debt Conditionality in Fund Arrangements.

3. It is expected that the Fund will review the implementation of the Guidelines on Public Debt Conditionality in Fund Arrangements no later than five years after the effective date of this decision.

Attachment

Proposed Guidelines on Public Debt Conditionality in Fund Arrangements

1. Public debt conditionality in the form of a performance criterion or an indicative target establishing a limit on public and publicly-guaranteed debt, or some sub-component of this aggregate, will normally be included in Fund arrangements in the General Resources Account (GRA) or under the Poverty Reduction and Growth Trust (PRGT) when a member faces significant debt vulnerabilities that cannot be contained by fiscal conditionality alone.

2. The use of public debt conditionality may also be warranted in situations where the quality and coverage of the fiscal statistics produced by the national system of fiscal accounting and budgeting of the member favor the use of public debt conditionality in place of, or as a complement to, "above-the line" fiscal conditionality (as further elaborated in 7(c) below).

3. Public debt conditionality will be established as a limit on "total" public and publicly guaranteed debt unless country circumstances and program objectives justify the use of more narrowly targeted conditionality:

a) For countries where there is significant segmentation between domestic and external sources of public financing, debt conditionality will normally be established as separate limits on external and domestic public and publicly guaranteed debt.

b) For countries where debt vulnerabilities are specific in nature, rather than linked to aggregate debt levels, public debt conditionality should, to the extent possible, be targeted on the specific areas of vulnerability, with limits covering the relevant sub-categories of debt.

c) The specific design and coverage of public debt conditionality should take into account the quality and timeliness of the financial information produced by the member country's public sector accounting system.

4. The appropriate definition of the public sector for the purposes of specifying public debt conditionality will depend on institutional arrangements in the member country; it will normally include all nonfinancial public enterprises and other public entities, unless explicit exclusions have been made. Explicit exclusions could include specific public enterprises or other official sector entities that are assessed to be in a position to borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government. The specification of what constitutes "public sector" for the purposes of public debt conditionality in a Fund arrangement will be explained clearly in the program documents.

5. For the purposes of specifying public debt conditionality, the concept of "external" debt may be defined on the basis of the residency of the creditor, or the currency of denomination of the debt. The public debt conditionality will specify which of these two criteria is being used for purposes of the definition of external debt.

6. The performance criteria or indicative targets establishing debt limits may be formulated in terms of a) debts contracted or authorized; b) disbursements made; or c) changes in the stock of public and publicly-guaranteed debt. The specific approach chosen will depend on program objectives, the predictability of loan disbursements, and the quality and timeliness of data availability.

7. In accordance with these guidelines, the following considerations will apply when establishing public debt conditionality in Fund arrangements:

a) These guidelines will be applied with a reasonable degree of flexibility while safeguarding the principle of uniformity of treatment among members. These guidelines should be applied in accordance with the Guidelines on Conditionality.

b) The appropriate level and composition of debt for purposes of public debt conditionality will be based on an evaluation of the member's proposed fiscal program, including the associated borrowing plan, and on the member's debt vulnerabilities, as identified through a debt sustainability analysis.

c) For purposes of these guidelines, the quality and coverage of the fiscal statistics produced by a member's national system of fiscal accounting and budgeting will normally warrant the use of public debt conditionality instead of, or as a complement to, "above-the-line" fiscal conditionality when at least one of the following conditions is met:

i. The national system of fiscal accounting and data compilation is such that the quality and timeliness of fiscal financing data is significantly better than the data on "above-the-line" measures (such as the fiscal balance); or

ii. Important sources of public debt vulnerabilities are not adequately captured in the fiscal accounts (e.g., bank recapitalization, issuances of government guarantees, noncommercial state-owned enterprises, and other agencies outside the budgetary framework, the presence of collateralized debt) and these vulnerabilities pose a threat to the overall fiscal position and addressing them is assessed to be of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, in accordance with 7(a) above.

d) The performance criterion or indicative target establishing a debt limit would normally be set on the nominal value of debt, except in cases under paragraphs 7(e) and 7(f) below.

e) For members that normally rely on official external financing on concessional terms that do not have access to international financial markets on a significant scale, public debt conditionality will generally be established as follows:

i. Except as provided in subparagraph (iv) below, for members assessed as facing a high risk of debt distress or in debt distress, public debt conditionality will take the form of (a) a performance criterion specifying a ceiling on the nominal amount of non-concessional external debt accumulation; and (b) a performance criterion or indicative target setting a ceiling in present value (PV) terms on the accumulation of external debt, without distinction between concessional and non-concessional debt. The accumulation of non-concessional debt would be allowed under the conditionality only under limited circumstances to support projects integral to the authorities' national development program or debt management operations that result in an improvement of the overall debt profile.

ii. Except as provided in subparagraph (iv) below, for members assessed as facing a moderate risk of debt distress, public debt conditionality will take the form of a performance criterion setting a ceiling specified in PV terms on the accumulation of public and publicly guaranteed external debt, without distinctions between concessional and non-concessional debt.

iii. For members assessed as facing a low risk of debt distress, conditionality on debt accumulation would not be warranted, except where justified on the basis of the criteria specified in 7(c) above.

iv. In cases where the member's capacity to monitor debt on aggregate levels (including in PV terms) is not adequate, public debt conditionality will consist of a performance criterion, specified in nominal terms, on the accumulation of non-concessional external debt, supplemented by a memorandum item, specified in nominal terms, on the accumulation of concessional external debt.

f) For members that normally rely on official external financing on concessional terms but also have access to international financial markets on a significant scale, public debt conditionality will generally be established as follows:

i. For members assessed as being at moderate or high risk of distress, or in debt distress, conditionality will normally take the form of a performance criterion setting a ceiling in PV terms on the accumulation of public external debt, without distinction between concessional and non-concessional debt; except in cases where it is judged that alternative formulations of debt conditionality would be better tailored to address critical vulnerabilities.

ii. For members assessed as facing a low risk of debt distress, conditionality on debt would not be warranted, except where justified on the basis of the criteria specified in 7(c) above.

g) In principle, a performance criterion or an indicative target establishing a debt limit will incorporate by reference the definition of debt set forth in paragraph 8 below. Financial instruments that are not covered under the definition, but have the potential to create substantial external liabilities for governments, will be included in the debt limit where appropriate, in which case they would be explicitly specified in the program documents.

8. (a) The performance criterion or indicative target will include all forms of debt. For the purpose of these guidelines, the term "debt" will be understood to mean a current, i.e., not contingent, liability,

created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

i. loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii. suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the PV (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

8. (b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

9. These Guidelines on Public Debt Conditionality in Fund Arrangements shall apply by analogy to programs supported under the Policy Support Instrument Framework Decision No. 13561–(05/85), adopted October 5, 2005, as amended, and under the Policy Coordination Instrument Framework Decision No. 16230-(17/62), adopted July 14, 2017.

Annex I. Proposed Guidelines on Public Debt Conditionality in Fund Arrangements (redlined)

1. Public debt conditionality in the form of a performance criterion or an indicative target establishing a limit on public and publicly-guaranteed debt, or some sub-component of this aggregate, will normally be included in Fund arrangements in the General Resources Account (GRA) or under the Poverty Reduction and Growth Trust (PRGT) when a member faces significant debt vulnerabilities that cannot be contained by fiscal conditionality alone.

2. The use of public debt conditionality may also be warranted in situations where the quality and coverage of the fiscal statistics produced by the national system of fiscal accounting and budgeting of the member favor the use of public debt conditionality in place of, or as a complement to, "above-the line" fiscal conditionality~~.~~ (as further elaborated in 7(c) below).

3. Public debt conditionality will be established as a limit on "total" public and publicly guaranteed debt unless country circumstances and program objectives justify the use of more narrowly targeted conditionality:

a) For countries where there is significant segmentation between domestic and external sources of public financing, debt conditionality will normally be established as separate limits on external and domestic public and publicly guaranteed debt.

b) For countries where debt vulnerabilities are specific in nature, rather than linked to aggregate debt levels, public debt conditionality should, to the extent possible, be targeted on the specific areas of vulnerability, with limits covering the relevant sub-categories of debt.

c) The specific design and coverage of public debt conditionality should take into account the quality and timeliness of the financial information produced by the member country's public sector accounting system.

4. The appropriate definition of the public sector for the purposes of specifying public debt conditionality will depend on institutional arrangements in the member country; it will normally include all nonfinancial public enterprises and other public entities, unless explicit exclusions have been made. Explicit exclusions could include specific public enterprises or other official sector entities that are assessed to be in a position to borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government. The specification of what constitutes "public sector" for the purposes of public debt conditionality in a Fund arrangement will be explained clearly in the program documents.

5. For the purposes of specifying public debt conditionality, the concept of "external" debt may be defined on the basis of the residency of the creditor, or the currency of denomination of the debt. The public debt conditionality will specify which of these two criteria is being used for purposes of the definition of external debt.

6. The performance criteria or indicative targets establishing debt limits may be formulated in terms of a) debts contracted or authorized; b) disbursements made; or c) changes in the stock of public and publicly-guaranteed debt. The specific approach chosen will depend on program objectives, the predictability of loan disbursements, and the quality and timeliness of data availability.

7. In accordance with these guidelines, the following considerations will apply when establishing public debt conditionality in Fund arrangements:

a) These guidelines will be applied with a reasonable degree of flexibility while safeguarding the principle of uniformity of treatment among members. These guidelines should be ~~interpreted in the light of~~applied in accordance with the Guidelines on Conditionality.

b) The appropriate level and composition of debt for purposes of public debt conditionality will be based on an evaluation of the member's proposed fiscal program, including the associated borrowing plan, and on the member's debt vulnerabilities, as identified through a debt sustainability analysis.

c) For purposes of these guidelines, the quality and coverage of the fiscal statistics produced by a member's national system of fiscal accounting and budgeting will normally warrant the use of public debt conditionality instead of, or as a complement to, "above-the-line" fiscal conditionality when at least one of the following conditions is met:

i. The national system of fiscal accounting and data compilation is such that the quality and timeliness of fiscal financing data is significantly better than the data on "above-the-line" measures (such as the fiscal balance); or

ii. Important sources of public debt~~-creating activities~~ vulnerabilities are not adequately captured in the fiscal accounts (e.g., bank recapitalization, issuances of government guarantees, noncommercial state-owned enterprises, and other agencies outside the budgetary framework, the presence of collateralized debt) and these vulnerabilities ~~activities~~ pose a threat to the overall fiscal position and addressing them is assessed to be of critical importance for achieving the goals of the member's program or for monitoring the implementation of the program, in accordance with 7(a) above.

d) The performance criterion or indicative target establishing a debt limit would normally be set on the nominal value of debt, except in cases under paragraphs 7(e) and 7(f) below.

e) For members that normally rely on official external financing on concessional terms that do not have access to international financial markets on a significant scale, public debt conditionality will generally be established as follows:

i. Except as provided in subparagraph~~s~~ (iv~~) and (v~~) below, for members assessed as facing a high risk of debt distress or in debt distress, public debt conditionality will take the form of (a) a performance criterion specifying a ceiling on the nominal amount of non-concessional external debt accumulation; and (b) a performance criterion or indicative target setting a ceiling in present value (PV) terms on the accumulation of external debt, without distinction between concessional ~~external~~and non-concessional debt. The accumulation of non-concessional debt would be allowed under the conditionality only under ~~exceptional circumstances~~limited circumstances to support projects integral to the authorities' national development program or debt management operations that result in an improvement of the overall debt profile.

ii. Except as provided in subparagraph~~s~~ (iv~~) and (v~~) below, for members assessed as facing a moderate risk of debt distress, public debt conditionality will take the form of a performance criterion setting a ceiling specified in ~~present value (~~PV~~)~~ terms on the accumulation of public and publicly guaranteed external debt, without distinctions between concessional and non-concessional debt.

iii. For members assessed as facing a low risk of debt distress, conditionality on debt accumulation would not be warranted, except where justified on the basis of the criteria specified in 7(c) above.

iv. ~~Where~~In cases where the member's capacity to monitor ~~the contracting of~~ debt on aggregate levels -(including in PV terms) is ~~weak~~not adequate, public debt conditionality will consist of a performance criterion, specified in nominal terms, on the accumulation of non-concessional external debt, supplemented by a memorandum item, specified in nominal terms, on the accumulation of concessional external debt.

~~v.~~f) For members ~~with an open capital account and significant financial integration with~~that normally rely on official external financing on concessional terms but also have access to international financial markets on a significant scale, public debt conditionality ~~may be set on total public debt accumulation rather than on the accumulation of external debt.~~ will generally be established as follows:

i. For members assessed as being at moderate or high risk of distress, or in debt distress, conditionality will normally take the form of a performance criterion setting a ceiling in PV terms on the accumulation of public external debt, without distinction between concessional and non-concessional debt; except in cases where it is judged that alternative formulations of debt conditionality would be better tailored to address critical vulnerabilities.

ii. For members assessed as facing a low risk of debt distress, conditionality on debt would not be warranted, except where justified on the basis of the criteria specified in 7(c) above.

~~f~~g) In principle, a performance criterion or an indicative target establishing a debt limit will incorporate by reference the definition of debt set forth in paragraph 8 below. Financial instruments that are not covered under the definition, but have the potential to create substantial external liabilities for governments, will be included in the debt limit where appropriate, in which case they would be explicitly specified in the program documents.

8. (a) The performance criterion or indicative target will include all forms of debt. For the purpose of these guidelines, the term "debt" will be understood to mean a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows:

i. loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans and buyers' credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements);

ii. suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until some time after the date on which the goods are delivered or services are provided; and

iii. leases, i.e., arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of these guidelines, the debt is the PV ~~present value~~ (at the inception of the lease) of all lease payments expected to be made during the period of the agreement excluding those payments that cover the operation, repair, or maintenance of the property.

8. (b) Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

9. These Guidelines on Public Debt Conditionality in Fund Arrangements shall apply by analogy to programs supported under the Policy Support Instrument Framework Decision No. 13561–(05/85), adopted October 5, 2005, as amended, and under the Policy Coordination Instrument Framework Decision No. 16230-(17/62), adopted July 14, 2017.