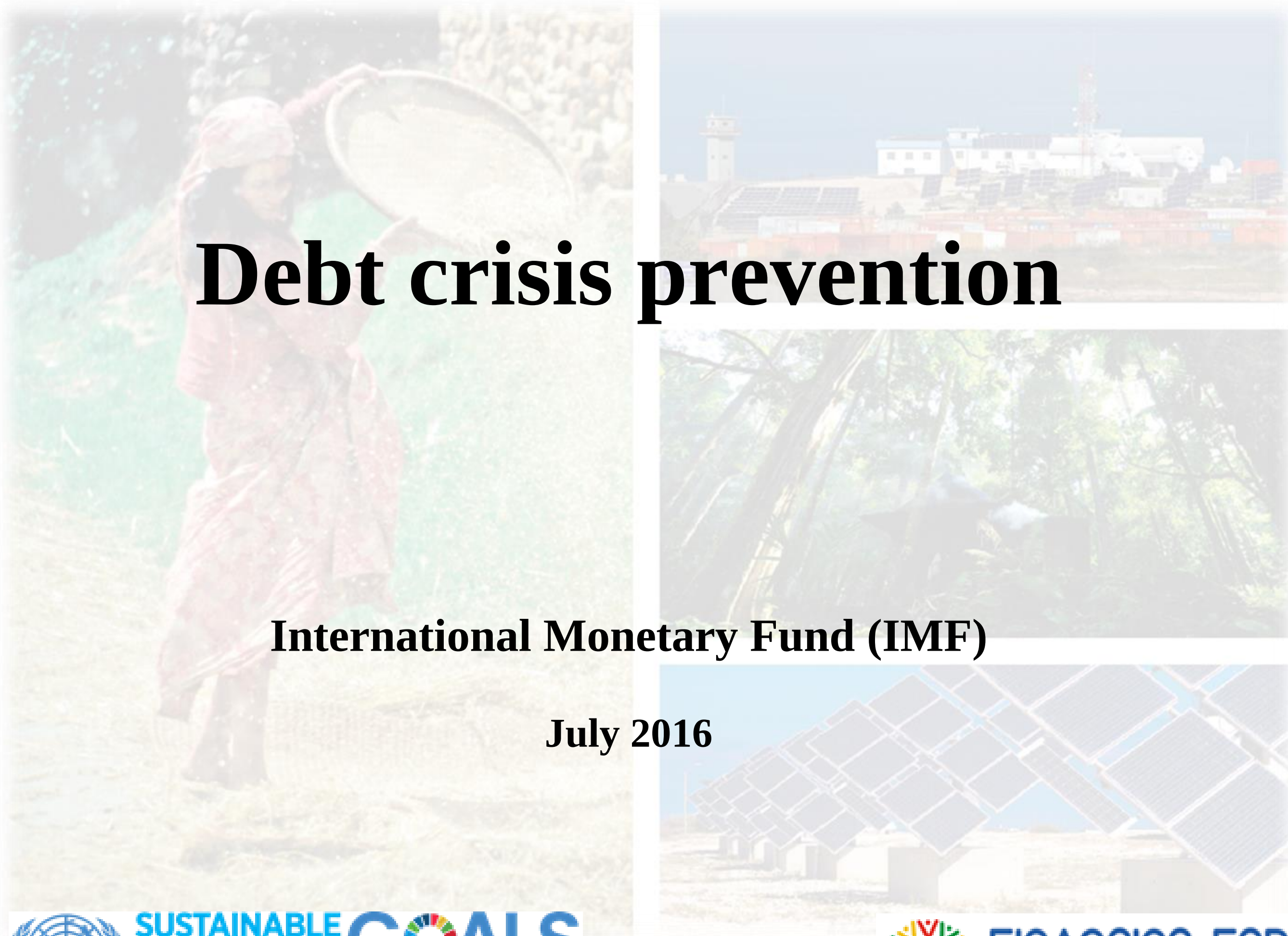
INTER-AGENCY TASK FORCE
ON FINANCING FOR DEVELOPMENT

Issue Brief Series



Debt crisis prevention

International Monetary Fund (IMF)

July 2016

More Information
http://www.un.org/esa/ffd/ffd-follow-up/inter-agency-task-force.html

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1. Introduction

The Addis Agenda reaffirms a commitment to supporting the maintenance of debt sustainability in those countries that have received debt relief and achieved sustainable debt levels. It invites the IMF and World Bank to strengthen the analytical tools for assessing debt sustainability in an open and inclusive process with the United Nations and other stakeholders. The Addis Agenda also welcomes government efforts to strengthen their capacity for prudent public debt management and encourages international institutions to continue to provide assistance to debtor countries in this regard. The Addis Agenda reaffirms that debtors and creditors must work together to prevent unsustainable debt situations. It also encourages the study of new financial instruments for developing countries, noting experiences of debt-to-health and debt-to-nature swaps. Recalling the need to strengthen information-sharing and transparency in debt sustainability assessments, the Addis Agenda invites relevant institutions to consider the creation of a central data registry including information on debt restructurings.

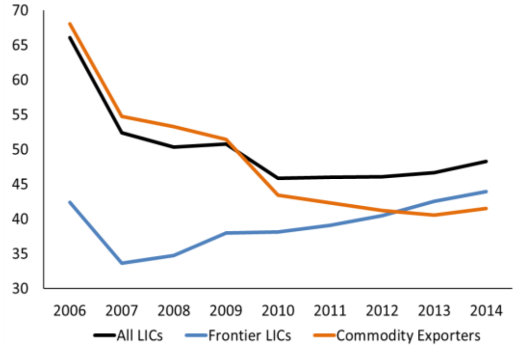
2. Stocktaking

2.1 Maintaining debt sustainability and improving debt sustainability assessments

Public debt has, on average, declined over the past decade for many low-income countries (LICs), although the financing landscape has been rapidly changing. A recent IMF-WB report[1] finds that debt relief programs, strong growth, and high demand for commodities drove the average debt-to-GDP ratio down from 66 percent in 2006 to around 48 percent at end-2014 in a sample of 74 LICs (Figure 1). However, with debt relief programs largely over and the continuing need to finance priority projects, LICs' average debt ratios have risen modestly in recent years to levels broadly similar to those in 2007. This development has been accompanied by an increased use of non-concessional financing, reflecting expanded use by some countries of domestic financing, international capital markets, and non-concessional bilateral financing (Figure 2).

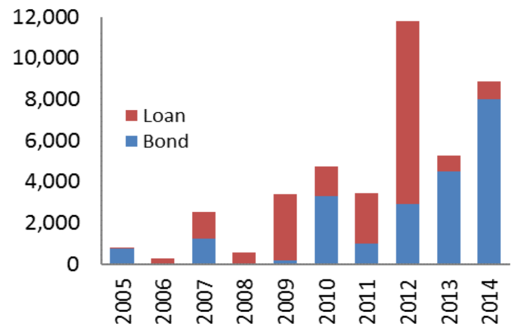
[1] International Monetary Fund–The World Bank (2015), "Public Debt Vulnerabilities in Low-Income Countries: The Evolving Landscape." See http://www.imf.org/external/pp/longres.aspx?id=5004

Figure 1: Total Public Debt
(In percent of GDP)



Source: LIC DSF Database.
Frontier markets are LICs which are increasingly resembling Emerging Markets in terms of international market access.

Figure 2: External Commercial Borrowing: Frontier LICs
(In US$ million)

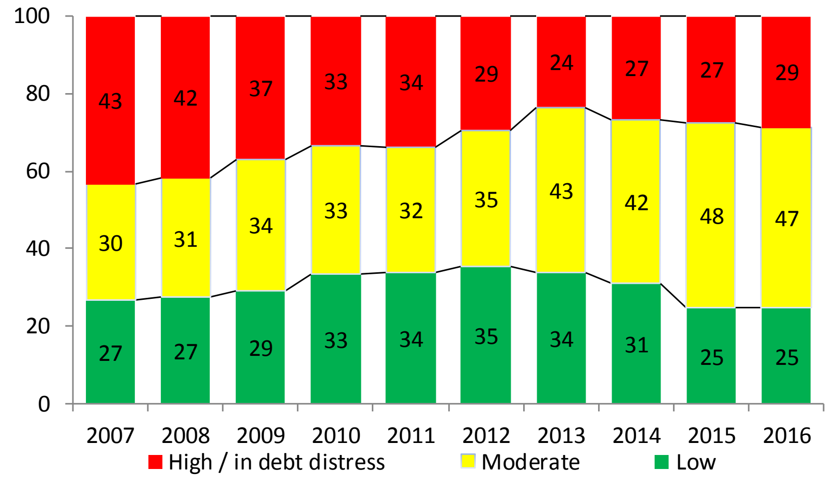


Sources: Dealogic, Bloomberg.

The changing financing landscape calls for vigilance. Although the shift in the financing landscape broadens borrowing options for LICs and appears to be part of a natural progression of borrowing sources to more market-based ones, concerns about debt vulnerabilities, particularly in the context of shifting global conditions, are rising. Prospects for tighter global liquidity conditions and a weaker global growth outlook could raise the cost of borrowing and especially impact frontier markets, given their increased reliance on market-based financing, both domestic and external. Domestic borrowing, although limiting currency risk, can generally carry a higher interest rate than bilateral official financing and international market borrowing, and excessive domestic borrowing can crowd out private credit and investment.

Risk ratings for external debt distress for LICs have generally improved since 2007, but have worsened in recent years (Figure 3). The share of countries in high risk of debt distress has declined from 43 percent in 2007 to 29 percent in 2016. However, there has been a deterioration since 2013 when only 24 percent were in high risk of external debt distress. Of the 14 countries that have seen recent downgrades, eight were commodity exporters, of which three were also considered frontier LICs. Inadequate fiscal discipline under less favorable external conditions was the leading cause of the downgrades.

Figure 3: Evolution of the Risk of Debt Distress
(in percent of total)



Sources: LIC DSF database and staff calculations.
Note: DSAs produced up to end-May 2016 were considered.

In light of the changing financing landscape and less favorable external conditions facing LICs, staff from the IMF and the WB are currently reviewing the debt sustainability framework for LICs (LIC DSF). The review aims at identifying what elements of the framework, in particular those related to predicting debt developments and risks, and the approach to derive risk ratings for external debt distress, warrant change. Extensive inputs have been received through consultations with main stakeholders, including country authorities, major creditors, multilateral development banks and UNCTAD. It is expected that the Executive Board of the IMF and the WB will discuss the review in early 2017.

2.2 Improving public debt management

The IMF and the World Bank have provided a range of public debt management technical assistance and training to over 50 developing countries during the past year, with the help of generous financial support of several bilateral donors. The training covered primarily the areas of developing a medium-term debt management strategy (MTDS) and conducting debt sustainability analysis, the latter mainly through the joint IMF/World Bank debt sustainability framework (DSF). The training was conducted both regionally and bilaterally. In addition, MTDS and DSF training was also provided to officials from developing countries through the publicly available IMF online debt sustainability analysis (DSAx) course. Donors have noted progress made so far and the evidence to-date of their impact on improving debt management capacity in recipient countries and strengthening their debt functions. In fiscal year 2017, the IMF plans to provide the same number of DSF training as in the previous year. Technical assistance was also provided in the context of developing domestic debt markets and debt management reform plans, and debt management performance assessments (DeMPAs) were also conducted using the World Bank's methodology.

2.3 Towards responsible sovereign borrowing and lending

Debt limits under IMF PRGT-supported programs have changed significantly over the past year to align them with the IMF's new debt limits policy. The IMF reformed its debt limits policy in December 2014 and has implemented it since end June 2015.[2] The reform took place in an environment where social and investment needs of developing countries were high and the financing landscape has been changing. In particular, new financing opportunities have emerged while the supply of traditional concessional financing has become more limited. Against this backdrop, the aim of the new policy is to provide countries with greater flexibility to finance productive investments, while safeguarding debt sustainability. Since end June 2015, limits on government debt were removed from the IMF-supported programs in all LICs with a low risk of external debt distress—Kenya, Rwanda, Senegal, Tanzania, and Uganda. And in other countries where the risk of debt distress is moderate—Honduras, Kyrgyz Republic, Liberia, and Sierra Leone—, debt targets under the IMF-supported programs are now in the form of limits on present value of government external debt.

2.4 Innovative instruments for managing debt burdens

Against the backdrop of renewed interest in state contingent financial instruments (SCFIs), the IMF will take a fresh look at their role in prevention and resolution of sovereign debt crisis. Despite the long-standing interest in SCFIs as a way of preventing debt crises, sovereign issuances of SCFIs in normal times have generally been limited. It was mainly confined to commodity-linked instruments and instruments linked to natural catastrophes. The use of SCFIs by sovereigns, thus far, has been generally limited to restructuring contexts. Certain types of SCFIs have been commonly used as "sweeteners" in all of the three major debt restructurings of the past decade— Argentina 2005, Greece 2012 and Ukraine 2015. The IMF plans to examine the role of SCFIs in prevention and resolution of debt crises in early 2017.

2.5 Improving debt data and reporting

The ongoing IMF's work could contribute to improvement in debt and debt restructuring data. In the context of the LIC DSF review, new debt data requirements for LIC DSF are expected to be defined. In the context of the work on reviewing debtor-creditor engagement in sovereign debt restructurings and IMF's Lending-into-Arrears policy, the IMF has been collecting information on recent sovereign debt restructurings. Both reviews are expected to be completed by early 2017. The collection of such data is an important step towards the IMF's

For a comprehensive coverage of the IMF's debt limits policy, see a summary page on public debt limits in IMF-supported programs: http://www.imf.org/external/np/spr/2015/conc/index.htm.

creation of a central debt data registry at the Fund in response to paragraph 96 of the Addis Agenda.

3. Policy options and recommendations for corrective action

The work currently undertaken by the IMF appears to be on track and no corrective actions are required.