

Civil Society position on the IMF and World Bank Debt Sustainability Framework Review, June 2016

This position has been written and agreed by:

International Networks:

African Forum and Network on Debt and Development (Afrodad)
Red Latinoamericana sobre Deuda, Desarrollo y Derechos (Latindadd)
European Network on Debt and Development (Eurodad)
Society for International Development
Third World Network

National organisations:

11.11.11-Coalition of the Flemish North-South Movement (BELGIUM)
All We Can: Methodist Relief and Development (UK)
Both ENDS (NETHERLANDS)
Bretton Woods Project (UK)
Budget Advocacy Network (SIERRA LEONE)
CAFOD (UK)
Caritas Honduras (HONDURAS)
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Centre of Concern (USA)
Centro de Iniciativas en Políticas Ambientales (NICARAGUA)
Centro de los Derechos del Campesino (NICARAGUA)
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Corporación de Investigación y Acción Social y Económica CIASE (COLOMBIA)
Debt and Development Coalition Ireland (IRELAND)
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Fundación Jubileo (BOLIVIA)
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Fundación SES (ARGENTINA)
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Integrated Social Development Centre (ISODEC) (GHANA)
Jesuit Centre for Theological Reflection (ZAMBIA)
Jubilee Debt Campaign (UK)
Jubilee Scotland (UK)
Jubilee USA (USA)
Jubileo 2000 Red Ecuador (ECUADOR)
Kenya Debt Relief Network (Kendren) (KENYA)
Malawi Economic Justice Network (MALAWI)
Movimiento Tzuk Kim-Pop (GUATEMALA)
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Background

The IMF and World Bank are conducting a review of their Debt Sustainability Framework (DSF) for low income countries. Under the DSF Debt Sustainability Assessments (DSAs) are conducted for all countries which can and are borrowing from either the IMF's concessional lending fund (the PRGT) or the World Bank's concessional fund IDA. This is all low income countries plus some lower middle income countries which have recently graduated (eg, Ghana) and some middle income small states (eg, Grenada).

The DSAs assess whether governments are at low, moderate or high risk of debt distress or in debt distress. Debt distress is defined as not being able to pay external government debts. The DSAs are supposedly used by lenders to guide their lending:

- The World Bank is meant to give all loans to low risk countries, a mix of half loans and half grants to moderate risk, and all grants to high risk and in debt distress (though it has not always kept to this). The African Development Bank and Asian Development Bank are meant to do the same.
- The IMF uses the DSA to guide its limits on borrowing for countries following IMF economic conditions as part of an IMF adjustment programme
- Other multilateral lenders use it. For example, the Inter-American Development Bank uses DSAs to assess how concessional its lending is to the five countries in the region with DSAs.
- OECD governments are supposed to use it to guide their lending. For instance, they are not meant to give non-concessional loans to moderate and high risk of debt distress countries (though it is not clear that they always keep to this).
- It is unclear how much other government lenders, such as China, use it.
- Private sector lenders have no rules, but the risk rating would be expected to influence how willing they are to lend, and at what interest rate, along with other analysis such as that conducted by private ratings agencies.

Introduction

Both borrowers and lenders are responsible for ensuring loans are sustainable and used well. Borrowers should conduct rolling debt sustainability assessments, linked to transparent and accountable national development plans. All major public borrowings should be consistent with these up-to-date assessments and plans. For lenders to act responsibly, they should be guided by country-owned plans and assessments. If no such plans exist in a particular country, they should question whether it is responsible to lend.

Debt sustainability assessments conducted externally should be done by independent but accountable bodies such as UN agencies. External assessments should not be used as a means to impose economic policy conditions on a country. However, they should ensure that lenders act responsibly, which might mean restricting lending where it would be irresponsible.

Debt sustainability assessments should also be used to guide whether a government is in need of debt cancellation and help in indicating how much. Assessments for these purposes should be conducted by a body independent of lenders and borrowers but accountable, such as a UN agency.

Changes to the Debt Sustainability Framework

Below are the changes we think should be made to the Debt Sustainability Framework (LICs) and so included in the review:

Summary

- 1) Independence of assessments**
- 2) Based on the Sustainable Development Goals**
- 3) Help encourage useful, productive investment**
- 4) Stop including irrelevant criteria**
- 5) Debt service to government revenue is the most important indicator**
- 6) Include currently hidden liabilities**
- 7) Include domestic debt but maintain distinction with external debt**
- 8) Conduct more work on external private debt**
- 9) Review stress tests**
- 10) Include all countries**

1) Independence of assessments

External debt sustainability assessments should be carried out by a body which is democratically accountable, but independent of creditors and debtors. The IMF and World Bank are both significant lenders, and so therefore have a conflict of interest. For instance, they have an incentive to be overly positive about the debt prospects of countries which are large borrowers from them and have closely followed their economic policies. In contrast, the IMF and World Bank also have an incentive to be overly negative about the debt prospects of countries which have ignored their 'advice'. The World Bank and IMF currently hold 30% of external debt of governments covered by the Debt Sustainability Framework, and 40% of external debt of low income country governments.¹

Assessments should therefore be moved to be implemented by an independent but accountable body, such as a UN agency.

2) Based on the Sustainable Development Goals

The history of the last 40 years is that governments tend to continue to pay debts for too long after they have become a large drain on resources, leading to economic stagnation and increasing poverty through cutting social spending rather than debt payments. Rather than judging based on ability to pay, whether debts are sustainable should be based on an assessment of whether the debt is preventing the meeting of basic needs. Basic needs have been defined by the international community in the Sustainable Development Goals for the period from 2015 to 2030.

3) Help encourage useful, productive investment

At present, DSAs are based on overall debt figures. This means no distinction is made between countries where investment through debt can be shown to be productive. It is important for overall figures to be continue to be used. However, a case can be made that where a particular investment can be shown both before and during that it will improve the debt situation through the government revenue it generates, with positive impacts on

¹ Calculated from World Bank. World Development Indicators database.

reducing poverty and inequality, then for debt linked to that project, it can 'sit outside' the debt sustainability framework.

However, a high bar would need to be met for such investment to ensure that it genuinely does improve the debt situation and reduce poverty, including for:

- All documents concerning the project to be publicly released prior to contracts being signed so it can be scrutinised by the media, civil society organisations and other concerned media
- The national parliament in the country concerned to have specifically scrutinised and approved the project
- The project to be independently evaluated before, during and after the project, and for some or all of the debt to be cancelled if there are failures on the part of the lender
- The project is part of a transparent debt strategy plan and national development plan

4) Stop including irrelevant criteria

The one way the current DSF seeks to address the quality of borrowing and lending is through the use of World Bank Country Policy and Institutional Assessment (CPIA) scores. A higher CPIA score increases the threshold levels at which a country moves to a higher risk rating. However, most of the 16 criteria used in the CPIA are irrelevant for how well debt will be used, with some of them pushing particular economic policies including:

- Trade liberalisation
- Deregulation
- VAT as the main source of tax income

At the least, the Public Investment Management Assessment should be used rather than the CPIA.

5) Debt service to government revenue is the most important indicator

At present five different debt statistics are assessed to work out the risk rating. There is concern that this has contributed to DSAs being overly complicated and used less by borrower governments. However, no one indicator can capture all debt risks so a range of indicators do need to be used. Flow indicators which capture actual costs cover more of the risks of both principal, interest and timing of payments, than stock.

The most important statistic within DSAs is how much government revenue is being spent on debt payments, both external and domestic separately, and combined. This actual cost of debt is far more important than the overall stock of debt, even when measured in Net Present Value terms. External debt service compared to exports is also vitally important as this captures the balance of payments income out of which external debt payments must be made.

The importance of these figures mean DSAs continue to need to project several decades into the future to capture the flow over time.

6) Include currently hidden liabilities

DSAs need to include all future obligations on a government as far as possible. One such of these is payments arising from public-private partnerships. Many public-private partnership schemes follow a UK designed model, where private companies are guaranteed payments

over a specific proportion of time in return for building infrastructure. This has kept the debt off the books and out of DSAs. In contrast, if the same investment had taken place through government borrowing, it would be fully included.

There is a risk that this incentivises governments to actually undertake investment through public-private partnerships, even if they are ultimately much more expensive, as has been the case in the UK.

Some public-private partnerships create a clear annual liability to the government in terms of the guaranteed payments or lost earnings. These could be easily included in the flow of debt service and revenue figures, which, as argued above, should be the main criteria. Other forms of public-private partnerships create contingent liabilities; payments which will need to be made under a certain set of circumstances. These payments should also be included in DSAs, for instance through an additional modelled 'shock' of the liability having to be paid, on top of (rather than instead of) the other modelling of shocks. Other contingent liabilities should also be included, such as the risk of having to bail out domestic banks.

7) Include domestic debt but maintain distinction with external debt

Domestic debt began to be included in DSAs following the last review, with risk ratings changed if it is particularly high. However, Debt Sustainability Assessments still need to do more to take into account the impact of domestic debt, including through specific ratios to analyse domestic debt. Both domestic and external debt need to be assessed as both present risks to the local economy. However, it is right to maintain the distinction between external and domestic debt as:

- External debt leads to flows of resources out of a country, domestic debt is the move of resources within a country, from taxpayers to lenders
- External lending is more likely to be volatile, based on financial changes elsewhere in the world
- It is easier for a government to regulate domestic debt during a financial crisis, but harder to default on it given the domestic financial impact
- External debt is more likely to be owed in foreign currency, and so have exchange rate risk (though this is not its defining feature), but domestic debt can have a more expensive nominal interest rate, depending on the strength of the local market

There are concerns that not all domestic debt is actually domestic debt, but rather local currency debt being bought by external actors. Therefore, more assistance should be given to ensure debt is properly being defined as domestic or external.

8) Conduct more work on external private debt

Another welcome change during the last review of the DSF was the inclusion of external debt owed by the private sector. This is now being reported in more countries, though in others reported levels are suspiciously low. This review should restate the importance of including external debt owed by the private sector in the monitoring, and amending risk ratings where large risky external private debts exist.

9) Review stress tests

Ahead of the last review in 2012, IMF and World Bank research stated that *“in only 7 out of 60 cases did the actual level of debt in 2010 exceed the level projected by the most extreme stress test”*.² The emphasis here seemed far too complacent about 12% of cases being worse than the most extreme stress test. A similar review should be conducted to see whether DSA stress tests continue to fail to deal with negative economic changes, and whether they adequately model when more than one negative change happens at a similar time, such as falls in commodity prices at the same time as an increase in the value of the dollar.

For instance, the June 2013 DSA for Ghana said under the most extreme stress test, the worst external government debt service to revenue would get in 2015 would be 10%.³ The most recent December 2015 DSA says it was actually 38.4%.⁴

Similarly, Zambia’s May 2012 DSA said with the most extreme shock, external government debt service in 2016 would be 6% of revenue.⁵ The June 2015 DSA now says it will be over 10%.⁶

10) Include all countries

Debt crises can arise in any country, no matter what their income level. Moreover, the financial crisis of 2007-08 showed that private sector ratings agencies can have severe failures. Furthermore, the DSAs that are conducted for low income countries provide far more transparent data, such as on government debt service compared to revenue, than the less extensive DSAs that are conducted for middle and high income countries.

Whilst the risk ratings may take in different factors, full DSAs should be conducted for all countries, rather than singling out low income countries. Whilst the methodology for risk ratings might differ, all DSAs for all countries should include debt service to government revenue, external debt service to government revenue and external debt service to exports.

² IMF and World Bank. (2012). Revisiting the Debt Sustainability Framework for Low-Income countries. IMF and World Bank. 12/01/12.

³ <http://www.imf.org/external/pubs/ft/dsa/pdf/2013/dsacr13187.pdf>

⁴ <http://www.imf.org/external/pubs/ft/dsa/pdf/2015/dsacr15245.pdf>

⁵ <http://www.imf.org/external/pubs/ft/dsa/pdf/2012/dsacr12200.pdf>

⁶ <http://www.imf.org/external/pubs/ft/dsa/pdf/2015/dsacr15152.pdf>



DSF Review Commentary

erlassjahr.de welcomes the IMF's request for commentaries with regard to the DSF review and is happy to contribute with the present submission. Still, we feel that the consultations and review processes must not be confined to re-consider endogenous technical aspects of the present framework. As we try to explain below, the DSF also needs to be revised with regard to its purpose and status in the relationship between the Fund and its members as well as between the member undergoing a DSA and the entirety of its creditors.

Therefore this submission is divided in three parts: In (1) we outline the necessary changes to the status and purpose of the DSF at large; in part (2) we address some of the endogenous issues raised in the staff's review paper, and in (3) we make a suggestion with regard to an improved environment between the parties involved in the DS analysis process.

erlassjahr.de is part of the EURODAD network, and as such has endorsed the joint submission made earlier by colleagues from several networks and co-ordinated by EURODAD. The present paper does not repeat points raised there.

1. The purpose and status of the DSF and individual DSAs

1.1. The link between the DSA on the one side and IMF lending and debt relief on the other

The stated purpose of the DSF is to assess debt vulnerability of a borrowing country in order to inform IMF (and other lenders') lending decisions. A semi-mechanical relationship between the LIC-DSF categorization and lending from the Bank and the Fund has been established and is being broadly observed. Other public lenders occasionally use the DSA as guidance for their own lending policies.

The Bank/Fund arrangement leaves some leeway for flexibility, which may be useful in individual cases. Flexibility may, however, also become an inroad for external intervention in cases where important Fund members have special stakes in the country in question.

Even more important than a clearer definition of staff/board manoeuvring space for individual lending decisions is the (re-)establishment of a link between DSA assessments and debt relief.

In the pre-DSF times there was an immediate relationship between the debt sustainability analyses undertaken by the Bank and the Fund in the HIPC initiative and the relief, which the initiative has ultimately brought about. This link was a fairly coarse instrument functioning in mechanical ways with a series of parameter changes through the lifetime of the initiative. Its merit, however, was that through the data work done in Washington, it was clear to all stakeholders, which overall amount of relief the country needed and consequently which amount of losses creditors *grosso modo* would have to face. This does not mean that after a HIPC debt sustainability analysis, there was no room for negotiation. Still, the fact that relief was necessary (or not) was firmly established.

Present DSAs, even in cases where signalled over-indebtedness is not far from levels, which had qualified countries for relief under HIPC, lack this kind of clear messaging with the

consequence of severely indebted countries being encouraged to postpone relief efforts, even when it is clear that timely debt restructuring would ultimately benefit all parties.⁷

This does not mean that again a mechanical relationship between analysis and debt relief has to be defined. Rather, a pre-defined risk definition through a DSA should trigger a process, which would allow the debtor to stay payments and oblige him to seek consultation with the entirety of all its creditors and under the guidance of a competent third party in order to negotiate a timely debt restructuring (or conclude that despite the DSA this is not necessary).⁸

1.2 The problematic differentiation between LIC and MAC-DSAs

With the exception of SIDS being added to the LIC group for DSA purposes, the two types of Debt Sustainability Frameworks for Low Income and Market Access Countries (LICs vs. MACs) has been defined along an arbitrary per capita income threshold. No lower limit of minimum market access has been defined for the distinction of MACs from Non-MACs; so the income threshold remains as the only traceable distinction. Despite the unclear group definitions, the consequences of such distinctions have been severe: Beside some technical differentiation (see below) and the access to Fund resources⁹, the most important distinction between the two frameworks with regard to their policy implications has been the strength with which the IMF has interfered into borrowing opportunities of countries.

As stated above, we are of the opinion that the overall link between a DSA and the borrowing and lending policies should be strengthened and not weakened. However, the arbitrary distinction between these two groups is not serving any good purpose to that end.

After their HIPC relief more and more LICs have become MACs, while their pc incomes have remained below the pre-defined thresholds. On the other hand there have been MACs, whose market access was seriously hampered through their debt situation, other economic factors or political circumstances. So, we are far away from seeing any merit in maintaining the distinction of LICs versus MACs as it presently is.

This is not a plea for sharpening or clarifying the distinction, e.g. by re-defining the income threshold. We rather suggest to have a uniform process for any country that is borrowing from the Fund and/or potentially in need of relief. If everybody is faced with the same type of implications after a DSA, this will lead to a more even-handed approach and consequently enhance the Fund's credibility. As presently LIC- and MAC-DSAs exclude different analytical elements, a uniform approach for all countries should cover the broadest possible database rather than the smallest one.

We understand that years ago the Fund would have shied away from making the same type of recommendations to powerful G20 members such as Brazil or Turkey, which it made to relatively powerless LICs in Sub-Saharan Africa. However, after years where even DSA's of EU members have led to strong - although in their status rather vague - recommendations of

⁷ See the "too little too late" discussion taken up in the IMF (2013) paper "Sovereign Debt Restructuring - Recent Developments and Implications for the Fund's Legal and Political Framework"; April 26th 2013.

⁸ The eventual design of such a process has been drafted in UNCTAD (2015): Sovereign Debt Workouts: Going Forward. Roadmap and Guide, http://unctad.org/en/PublicationsLibrary/gdsddf2015misc1_en.pdf, along with an institutional proposal for a "third party".

⁹ IMF: „Review of the Policy on Debt Limits in Fund-supported Programs“; March 1st 2013.

debt relief, the Fund should have the courage to stand to its assumed mandate as the most prominent adviser with regard to debt sustainability.

2. Endogenous aspects for revision

2.1 Stress tests too conservative

As the staff paper suggests in pt.9, stress tests have indeed been generally too conservative and should be re-calibrated. This process needs to give due regard to the special situation of SIDS, which as particularly small economies can and do easily suffer external shocks, not experienced by others (see 2.6. below).

2.2 Broaden the scope of obligations, which are being analysed

During the last DSF review in 2012, IFIs, along with others, have already pointed to the risks stemming from so called "contingent liabilities", which are not regularly part of DSAs or even of national and international debt reporting. These include liabilities stemming from the private sector and carry no formal state guarantee, implicit potential commitments through special risks such as over-exposed banks, historical effects of natural disasters and others.

As an immediate first step, debt stock-based indicators should use total external debt rather than PPG external debt as long as they describe the relationships between debt and the overall performance of the economy in question. PPG debt is a meaningful indicator-base only where other official sector parameters are the reference.

2.3 Granulating the "moderate risk of debt distress" category?

This question can only be answered in relation to the purpose of the categorization. A differentiation that would be analogous to the "debt re-profiling" distinction recently introduced by the IMF, could have merit in better tailoring a debt restructuring process or re-designing lending policies.

However, we do not see such sophistication as the most urgent problem to resolve, as the present three categories scheme goes a long way in suggesting policy responses. A sophistication of that category should therefore be discussed in the context of the reformed link to policy responses at large, suggested in para (1) above

2.4 Heat Maps

The regular heat maps, which are being produced for MAC-DSA's are in our view a very useful instrument for the analysis and presentation of debt risks. We see no reason, why this instrument has been confined to MAC-DSAs and suggest that all DSAs in the future should present debt risks in such manner.

2.5 Opaque waiver practice

Quite often a country under IMF surveillance fails to comply with all established conditions under a given program. As it would often be counterproductive to subsequently exclude the country from further IMF lending or halt disbursements, staff has the option of providing waivers of such conditions. While such flexibility is understandable and appropriate, there seem to be no guidelines as to the granting of such waivers.¹⁰

¹⁰ Since 2012 erlassjahr.de' has repeatedly asked staff and ED's for such guidelines or at least a systematic monitor of when and why waivers have been granted; we have not received any substantial response.

Given the severe consequences, which the granting or denial of such waivers has for the individual country, there should be a more clearly defined rule as to when they are provided.

2.6 Alternative definitions

Existing LIC-DSF threshold values have been defined through regression analyses of past debt events. This is a possible but certainly not the only way to define such thresholds. Particularly with regard to defining debt sustainability as a benchmark for restructuring decisions, alternatives to the existing threshold values should be considered. IMF staff, among others, have time and again discussed alternative ways of defining thresholds, either globally or with a focus on a specific country group. One such alternative, which we found useful in concrete cases undergoing restructurings recently has been the definition of "Natural Debt Limits", which lead to far more conservative estimations regarding how much debt can be borne by vulnerable Caribbean SIDS.¹¹

3. An additional recommendation: Second opinions

So far DSA are being produced by the IFIs and then presented to the governments in question as well as the broader public. Data normally come from the treasury, central bank and/or national statistical office of the country under scrutiny. The compilation, processing and interpretation of data are in the hands of the IFIs.

In the political process about the individual DSA there is regularly some space to discuss the IFIs findings and suggestions. However, this space is normally proportional to the country's technical capacities and political manoeuvring space, leading to a de-facto monopolistic position of the IFIs analysis in poorer and more severely indebted countries. Given the rightful critique of the assumptions and conclusion of past DSAs, which also the staff issues paper reflects in part, we suggest that there should as a rule be a second opinion on debt sustainability sought from an independent third party, which is neither creditor- nor debtor-related in any way.

A timely consideration of an obligatory debt assessment produced by an institution, which would, say, be inversely constructed than the IFIs (which are dominated by creditors), such as UNCTAD with its strong bias towards positions of the Global South, or which would be entirely independent such as a private rating agency, a renown academic or an international NGO, could serve as a useful and timely challenge to the unhealthy present day IFI-monopoly. If we look at, e.g. the extremely unrealistic debt sustainability assessments conducted by Bank and Fund as their inputs into the pre-HIPC Paris Club negotiations, it is obvious that the most gruesome errors and subsequent delays in debt relief could have been avoided by an instrument like an obligatory second opinion.

Jürgen Kaiser, erlassjahr.de, Sept. 13th 2016

¹¹ Amo-Yartey,C, M.Narita, G.P.Nicholls, J.C.Okwuokei, A.Peter, T. Turner-Jones: The Challenge of Fiscal Consolidation and Debt Reduction in the Caribbean; IMF WP/12/276

Jubilee USA

On behalf of the 650 faith communities and national religious institutions that Jubilee USA represents, thank you for the opportunity to comment on the International Monetary Fund's Consultation on the Low Income Country (LIC) Debt Sustainability Framework (DSF).

We believe the current DSF is an important component of international efforts to promote debt sustainability and responsible lending and borrowing. Strengthening this framework can further the IMF's goal of promoting inclusive prosperity for all.

Jubilee USA recommends the following:

1. **Factor Debt Service Into a Country's Sustainability Analysis** - The IMF should consider a country's current debt service levels and any recent trend in debt servicing to assess debt sustainability.
2. **Assessing Ability to Meet Basic Needs** - The Sustainable Development Goals address the provision of basic needs as a priority for sovereign governments. The IMF should consider whether a country is providing or on track to provide basic needs for all its citizens as determined by the sustainable development goals to determine whether its debt is sustainable.
3. **Transparency** - We urge the IMF to consider how transparent a particular nation is with public fiscal and budget activity to determine the risk of corruption or misappropriation of funds. The IMF could benefit from the input of civil society organizations, independent but politically accountable institutions and others to develop a process for determining the openness and transparency of a potential or ongoing borrower.
4. **Existing Loans and Positive Investment** - We recognize that some existing debt may be funding the development of projects which ultimately lead to positive revenue to the government. The IMF could consider calculating such debt differently, so long as proper controls are in place to guarantee revenue is (or will) be collected by the government and used to benefit the common good. Such controls would require considerable input and agreement from a broad array of stakeholders and the ability to enforce any agreements.
5. **Audits of DSAs** - While we appreciate the work the IMF does in assessing the risk of debt distress in the countries to which it provides funding, the credibility of the process would be enhanced by review from an independent, politically accountable institution. Doing so would lend the DSF greater credibility and reduce the perception of conflicts of interest.

Thank you for the opportunity to provide our feedback on this process. We wish you the best as you refine this important framework.

Sincerely,

Eric LeCompte
Executive Director
Jubilee USA
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The OPEC Fund for International Development (OFID)

Consultations on the IMF Debt sustainability framework: the views of OFID

1. The OPEC Fund for International Development (OFID) welcomes the opportunity to contribute to the consultation regarding the DSF and share its views.
2. OFID advocates a balance between development and Debt dynamics and works at project level, and pragmatically, to reconcile the two sets of dynamics. OFID promotes and funds investment that adds to the economic potential of countries emphasizing economic returns and the minimising of debt overburden. OFID relates to a closely-knit group of sister development finance institutions (the Arab coordination group) which are largely owned by the same funding countries and target broadly common beneficiary countries. OFID and the coordination group have contributed their share of debt alleviation under the HIPC initiative.
3. The risks of debt overhang are real and their prevention and mitigation is one of the major safeguards of all development stakeholders, lenders and borrowers in a first instance. OFID recognizes the need for an effective debt management and encourages the low income countries in particular to set a debt policy and a debt operation framework consistent with their development needs and their debt servicing capacities.
4. The policy and the operational framework need to be government formulated and nationally owned to reflect the countries development needs and the evolutions of the many factors which influence the policy and operational profile. The Heavily indebted Poor countries (HIPC) and the Multilateral Debt Relief Initiative (MDRI) have contributed not only to significant debt relief but importantly they contributed systems and procedures and best practices which should allow countries to enhance their technical and institutional capacities with the help of debt providers and non-lending stakeholders as necessary
5. The IMF and many development stakeholders have recently observed important trends in the debt undercurrents of the low income countries; i) a growing official and private debt ; ii) an expanding share of non-OECD debt providers ;iii) poor outlooks for export revenues and economic growth. At the same time the flows of official assistance has stabilised at less than half the 0.7% of GNI expected and its allocation has favoured the middle income countries.
6. The international community has formulated ambitious Sustainable Development Goals which require “Trillions rather than billions”. The Addis Ababa third development finance conference has issued the Addis Ababa Action Agenda which emphasizes mobilisation of domestic and global savings.
7. OFID, the IMF and other stakeholders are also aware of development of “fragilities” such as aspiration for rapid improvements in living standards, burgeoning unemployment of outspoken educated youth, forced migration and cross countries overflows of less and less localised armed conflicts

8. This summarily described landscape highlights the challenges of the debt – development nexus and the need for a sustained dialogue on the many issues underlying it. The proposed codification of the debt sustainable framework is important but only one of the issues. It should be clear that this codification implies a great deal of hypotheses and judgement values and eventually it will crowd in or crowd out borrowing and lending opportunities
9. In OFID opinion, the proposed revision of the debt sustainability analysis will add value if it is set out clearly as not a revamped IMF conditionality but an insight and a guideline for a country- led dialogue among Debtors and creditors in the context of the 2030 development agenda

David Mihalyi, Economic Analyst, Natural Resource Governance Institute

Comments for consultation on the review of the
IMF-World Bank debt sustainability framework for low income countries
23rd September 2016

I welcome the opportunity to contribute to the consultation initiated by the IMF on its debt sustainability framework for low income countries.

Of the 70 countries where the IMF conducts debt sustainability analysis for low income countries,¹² 13 were classified as resource rich and an additional 11 as prospective natural resource exporters by the IMF in 2012.¹³ At the time, the majority of them had low debt burdens as a result of HIPC debt relief initiative and a favourable economic outlook due to rising commodity prices. But following the recent sustained decline in commodity prices many of them now face grave debt sustainability challenges. Out of the 24 resource rich and prospective countries only 3 are characterized as facing low levels of debt distress risks according to the latest debt sustainability analysis undertaken.¹⁴ Hence the review of the IMF-WB debt sustainability framework is timely to better incorporate the specific challenges these countries are facing.

Resource rich developing countries have important characteristics which warrant special attention when analysing their debt sustainability: larger vulnerability to terms of trade shocks, the depletion of finite subsoil wealth, weaker governance and in particular an opaque resource sector. The following comments provide recommendations on how the IMF-World Bank's debt sustainability framework for low income countries could take these considerations better into account. The note also provides suggestions on making the IMF debt sustainability framework (DSF) more accessible for reuse.

1. Addressing volatility

All countries are vulnerable to terms-of-trade shocks but non-renewable commodity exporters even more so, given the magnitude and persistency of oil and mineral price shocks. Measures of volatility in resource-rich developing economies (e.g. the variation of export revenues) typically exceed those of non-resource-rich countries by 50 percent for mineral-rich countries and more than 100 percent for oil-rich countries¹⁵. Lower commodity prices typically squeeze export earning, government revenue and result in lower FDI. These risks are generally taken into account when conducting debt sustainability analysis by adjusting the outlook proportionately to the size of the terms of trade shock. But in many cases, especially in countries labelled prospective, the result of the price drop has been that

¹² <https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>

¹³ <https://www.imf.org/external/np/pp/eng/2012/082412.pdf>

¹⁴ <https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>

¹⁵ <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.30.1.161>

large mining projects were cancelled or closed down, dramatically altering the outlook. The Simandou project in Guinea and the Tonkolili project in Sierra Leone were both projected to double their countries' GDP.¹⁶ By now development on both of these transformative projects has been halted. In Tanzania and Mozambique, major LNG projects have stalled for many years waiting on a final investment decision by the petroleum companies. The problems and delays in executing these projects partly stems from the governance challenges these countries face.¹⁷ In all of these cases the IMF-WB staff faces the difficult decision on whether to include or exclude these projects from the debt sustainability analysis (it included the mines in Guinea and Sierra Leone and the LNG project in Mozambique but not in Tanzania). The analysis would greatly benefit from presenting alternative (or risk) scenarios with and without the project or assuming project delay. Clear and transparent criteria on when the effects of such transformative extractive projects are included in DSF calculations would also increase the credibility and transparency of the analysis.

2. Non-traditional debt instruments and depletion of natural assets

We have seen an increased sophistication in means to collateralize future resource wealth. Rents from natural resources may take decades for governments to recover after discovery through production and taxation. Hence sophisticated ways are emerging in which they are securitized in return for investment, such as oil backed borrowing by state owned enterprises or resource for infrastructure deals. There has been a proliferation of such deals in recent decade across Africa often financed by Chinese and Korean Development Banks to build roads, power plants and railroads.¹⁸ These deals are hard to value and are often beyond the scope of DSFs for LICs if there are no financial flows. This creates a risk that resource rich countries finding it difficult to access traditional borrowing may be incentivized to favour such deals to avoid raising alarms of debt sustainability. The DSF should ensure that deals depleting or putting at risk future revenues from resources are incorporated into DSF calculation and subject to same scrutiny as regular external loans. A more comprehensive approach to measuring sustainability would account for the depletion of natural capital directly, although this may be beyond the scope of the DSF.

3. Transparency of resource sector

Resource rich countries tend to have lower overall institutional quality¹⁹ and 80% of them fall short of satisfactory standards of transparency and accountability in reporting on their oil and mining sector.²⁰ This lack of transparency in the sector poses a great threat for fiscal sustainability as institutions such as natural resource companies and natural resource funds manage very large assets and can accumulate long-term fiscal liabilities. These institutions often operate off-budget and provide limited reporting on their operations and balance sheets. Development banks and state owned companies also issue external debt with implicit

¹⁶ <http://www.imf.org/external/pubs/ft/scr/2011/cr11361.pdf>,
http://www.riotinto.com/documents/RT_Simandou_Economic_Impact_Report_EN.pdf.

¹⁷ See for example: <http://www.resourcegovernance.org/blog/miracle-became-debacle-iron-ore-sierra-leone>

¹⁸ <http://siteresources.worldbank.org/EXTPREMNET/Resources/EP123.pdf>

¹⁹ <http://www.imf.org/external/pubs/ft/fm/2015/02/pdf/fm1502.pdf>

²⁰ <http://www.resourcegovernance.org/resource-governance-index>

or explicit government guarantees on the back of future resource wealth, which in some cases goes unreported to statistical authorities. For example, in Mozambique the borrowing of a state owned Tuna Fishing company on the back of gas revenues, with a government guarantee, went unreported.²¹ The evaluating of resource sector transparency in these countries could be used as an input to derive ratings in the DSF. The IMF's recently revised Natural Resource Fiscal Transparency Code,²² to which NRGi provided detail comments,²³ could serve as a basis for identifying basic, good and advanced requirements. NRGi's Resource Governance Index²⁴ provides a detailed evaluation of transparency and accountability across 58 countries producing 85 percent of the world's petroleum, 90 percent of diamonds and 80 percent of copper.

4. Making the DSF more accessible to all

As stated by the IMF, "the effectiveness of the DSF in preventing excessive debt accumulation hinges on its broad use by borrowers and creditors." In order to make DSF more easily accessible for reuse, the IMF may want to consider publishing the results of the analysis in machine readable form. While it is encouraging that the excel template for conducting the debt sustainability analysis is available from the IMF website,²⁵ making the input and output data more easily accessible would allow actors within and beyond government (e.g. parliamentarians, fiscal councils, financial sector including borrowers and creditors, think tanks, NGOs,) to reuse the results, evaluate alternative scenarios or dispute findings more easily and more constructively.

²¹ <http://www.wsj.com/articles/tuna-and-gunships-how-850-million-in-bonds-went-bad-in-mozambique-1459675803>

²² <http://www.imf.org/external/np/fad/trans/>

²³ <http://www.resourcegovernance.org/sites/default/files/NRGISubmission-DraftResourceRevenueManagementPillar20150220.pdf>

²⁴ <http://www.resourcegovernance.org/resource-governance-index>

²⁵ <https://www.imf.org/external/pubs/ft/dsa/templ/dsatemp.xlsm>