

INTERNATIONAL MONETARY FUND

**Debt Limits in Fund-Supported Programs—Proposed New Guidelines—
Supplementary Information and Proposed Decision**

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(In consultation with other departments)

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August 20, 2009

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I. INTRODUCTION

1. This supplement summarizes the reforms proposed in IMF (2009a, b)¹ to the existing framework governing external debt limits in Fund-supported programs, and presents the proposed decision that is needed to implement these reforms. The supplement is organized as follows: Section II provides a brief commentary on the proposed decision, emphasizing key aspects of the proposed reforms set out in IMF (2009a, b)¹. Section III contains the proposed decision approving the new guidelines on external debt in Fund arrangements. The proposed new guidelines are included in the Attachment to the decision.

II. PROPOSALS FOR REFORM

2. In the March 2009 Executive Board discussion of SM/09/56, Directors acknowledged that the current policy allows for the flexible implementation of external debt limits. However, they also broadly supported staff's proposals to ensure more systematic and consistent implementation of this flexibility by moving away from a single design of concessionality requirements towards a menu of options that would establish debt limits on the basis of members' debt vulnerabilities and macroeconomic and financial management capacity.² Directors also encouraged staff to undertake further work on the design of the methodology for assessing members' financial management capacity, elaborate further on the approach discussed in IMF (2009a)¹ and propose new guidelines on external debt limits. Staff's further work, clarifications and elaborations on the above-mentioned subjects are discussed in IMF (2009b)¹.

3. The key reforms proposed in IMF (2009a)¹ and IMF (2009b)¹, and the related provisions of the proposed decision and revised guidelines, may be summarized as follows:

¹ IMF (2009a) "Changing Patterns in Low-Income Country Financing and Implications for Fund Policies on External Financing and Debt," <http://www.imf.org/external/np/pp/eng/2009/022509a.pdf>.

IMF (2009b) "Debt Limits in Fund-Supported Programs – Proposed New Guidelines."

Please note that references to both documents are used throughout the supplement..

² As discussed in IMF (2009b), "concessionality requirements" is used for purposes of the proposed reforms to refer to both the approach under the current guidelines on external debt of generally distinguishing between concessional and nonconcessional debt, and the related practice that has developed in a majority of cases of precluding LICs from borrowing on nonconcessional terms (or limiting such borrowing while not constraining concessional borrowing).

a. **To move away from a single design of concessionality requirements particularly for PRGF-eligible members, toward a more flexible approach involving a menu of options** (proposed revised guidelines subparagraphs 8(f), 8(g) and 8(i)). Under this approach, the establishment of debt limits in Fund arrangements will take into account members' debt vulnerabilities and macroeconomic and public financial management capacity. Members will be assessed on the basis of these criteria in accordance with the methodology discussed in IMF (2009b)¹. Consistent with the universal scope of the guidelines, the considerations relevant for members to whom concessional financing is available would potentially cover both PRGF-eligible and non PRGF-eligible members, although in practice—and as noted in IMF (2009b)¹—non PRGF-eligible members would be expected to have limited or no access to concessional financing, given their higher incomes. No member would be subjected to more stringent requirements under the revised guidelines than under the current framework, and there would in fact be greater flexibility in all cases other than where debt sustainability is a serious concern and the member's macroeconomic and financial management capacity is limited.

b. **To include within the menu of options the use of present value (PV) targets or average concessionality requirements in appropriate cases, but with transitional arrangements for an initial phase** (proposed revised guidelines subparagraphs 8(g)(iii) and (iv), and 8(i)). Setting these targets requires many assumptions and is significantly more complex than setting debt limits tied to specific projects. Moreover, while targets in Fund-supported programs, particularly for PRGF-eligible members, are typically set semi-annually to coincide with six-monthly program reviews, PV or average concessionality targets would preferably be set on an annual basis as they derive from DSAs that use annual data. To allow time for staff and members to gain more familiarity with the use of these targets, it is proposed that PV and average concessionality targets would generally be established as annual indicative targets (rather than performance criteria) under Fund arrangements for a transitional period of 3 years following adoption of the revised guidelines.

c. **To include within the menu of options the use of nominal external debt limits in appropriate cases even for members to whom concessional financing would normally be available** (proposed revised guidelines, subparagraph 8(g)(v)). This would signify the elimination of concessionality requirements for such members. Nominal debt limits would also remain the relevant variables for members to whom concessional financing is normally not available (subparagraph 8(h)).

d. **To move away from the exclusive use of a residency criterion for purposes of defining external debt, and use instead the currency of denomination as the relevant criterion where appropriate** (proposed revised guidelines, paragraph 2). The residency criterion would continue to be used where appropriate, however, particularly in cases of members with still relatively closed capital accounts or very limited financial integration with the rest of the world. Moreover, the residency of the creditor would remain the relevant

criterion for purposes of other Fund policies involving external debt, including policies concerning external payment arrears.

e. **To clarify the coverage of the debt limits with regard to public enterprises and other official sector entities** (proposed revised guidelines, paragraph 8(c)). Specifically, public enterprises and other official sector entities would be covered within the external debt performance criterion established under Fund arrangements unless an explicit selective exclusion were to be made. Normally, the performance criterion would exclude those specific enterprises or other official sector entities that are considered to be in a position to borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government, taking into account factors such as the criteria set forth in paragraph 41 of IMF (2009a)^{1,3}

f. **To clarify the permissibility of performance criteria on total public debt (i.e., that include both external and domestic debt) in appropriate cases** (proposed revised guidelines, paragraph 8(b)).

4. **The revised guidelines also include a number of additional technical and presentational modifications.** These include the numbering, streamlining and more systematic ordering of some text.⁴ As contemplated in IMF (2009b)¹, it is proposed the Fund review the application of the revised guidelines within two years of their adoption (proposed decision, paragraph 3).

5. **The decision would have a delayed effectiveness date, as it is proposed that it would only enter into effect on December 1, 2009** (proposed decision, paragraph 2). This would allow staff to put in place the methodology and procedures described in IMF (2009b)¹. All performance criteria to be established after this date would be expected to use the new approaches set forth in the amended guidelines. However, the effectiveness of the decision would not automatically change the scope or coverage of external debt performance criteria that had already been established in Fund arrangements; rather, existing performance criteria would need to be changed in line with the revised guidelines, for example, in the context of the completion of a future review under the relevant arrangement.

³ As noted in IMF (2009a)¹, the more automatic coverage of official sector entities under the revised guidelines is not meant to modify the approach under other Fund policies wherein case-specific determinations are normally made as to whether official entities, including public enterprises, are part of the public sector.

⁴ As the recently adopted LIC facilities reforms are not yet effective, the guidelines refer in a couple of places to the PRGF-ESF Trust, rather than the proposed Poverty Reduction and Growth Trust (PRGT). These references would automatically become references to the PRGT once the facilities reforms become effective, by operation of the terms of the facilities reform decision.

III. PROPOSED DECISION

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

1. Decision No. 6230-(79/140)⁵ on Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements, adopted August 3, 1979, as amended, shall be amended to read as set forth in the Attachment to this decision.

2. This decision shall become effective on December 1, 2009. Any performance criteria on external debt that are in place when this decision becomes effective shall continue to apply in accordance with their terms unless and until such criteria are amended consistent with the revised Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements.

3. The Fund shall review the implementation of the revised Guidelines on Performance Criteria with Respect to External Debt in Fund Arrangements by December 1, 2011.

⁵ Selected Decisions and Selected Documents of the IMF (<http://www.imf.org/external/pubs/ft/sd/index.asp>).

**Guidelines on Performance Criteria With Respect to External Debt
in Fund Arrangements**

1. When the size and the rate of growth of external indebtedness is a relevant factor in the design of an adjustment program, a performance criterion establishing a limit on official and officially guaranteed external debt will be included in Fund arrangements in the upper credit tranches or under the PRGF-ESF Trust.
2. For purposes of this performance criterion, 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 residency of the creditor would normally be used as a criterion for defining external debt in the case of members with relatively closed capital accounts or very limited financial integration with the rest of the world. Each external debt performance criterion will specify which of these two criteria is being used for purposes of the definition of debt in the particular performance criterion.
3. As specified in further detail in paragraph 9 of these guidelines, the external debt performance criterion will include all forms of debt, including loans, suppliers' credits and leases, that constitute current, i.e., not contingent, liabilities, which are created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which require 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 discharge the principal and/or interest liabilities incurred under the contract.
4. The external debt performance criterion will include external debts with maturities of over one year, and, in appropriate cases and where specifically provided, other financial instruments that have the potential to create substantial external liabilities for governments.
5. The external debt performance criterion will usually be formulated in terms of debts contracted or authorized. However, in appropriate cases, it may be formulated in terms of net disbursements or net changes in the stock of external official and officially guaranteed external debt.
6. Flexibility will be exercised to ensure that the establishment of an external debt performance criterion will not discourage capital flows of a concessional nature, particularly for members to whom such concessional flows would normally be available, including members eligible for assistance under the PRGF-ESF Trust.

7. Normally, the external debt performance criterion will include a subceiling on external debt with maturities of over one year and up to five years; additional subceilings may also be included on debt with specified maturities beyond five years.

8. In accordance with these guidelines, the following considerations will apply when establishing an external debt performance criterion 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 the Guidelines on Conditionality (Decision No. 12864-(02/102)⁶, adopted September 25, 2002, as amended.

b. The external debt performance criterion will be established in a manner that is mindful of the need to ensure consistency between external debt management policies and domestic financial policies. Where external debt per se is not a matter for concern, but adjustment programs have as a main objective to reduce excess demand pressures and restore overall balance to the public sector finances, arrangements may include a performance criterion on total debt, i.e., both domestic and foreign financing of the overall public sector deficit.

c. Normally the external debt performance criterion will relate to official and officially guaranteed external debt and will include all public enterprises and other official sector entities unless an explicit exclusion is made, as well as private debt for which official guarantees have been extended and which, therefore, constitute a contingent liability of the government. An explicit exclusion could be made for 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.

d. In cases where the member's external debt management policy covers private sector debt without official guarantee and there is an established regulatory mechanism to control such debt, the external debt performance criterion should be adapted accordingly.

e. The external debt performance criterion should include short-term debt of a maturity of less than one year, while allowing some flexibility in light of the different institutional reporting procedures employed by members and the statistical difficulties of recording that category.

f. The appropriate level and composition of external debt for purposes of the external debt performance criterion will be determined based on an assessment of existing

⁶ Selected Decisions and Selected Documents of the IMF (<http://www.imf.org/external/pubs/ft/sd/index.asp>).

and prospective developments in the member's external payments situation, the member's external debt vulnerabilities as assessed in debt sustainability analyses and its macroeconomic and public financial management capacity.

g. For members to whom concessional financing would normally be available, the following specific considerations shall apply in establishing the external debt performance criterion, taking into account the assessment and classification methodologies set forth in IMF (2009b) ¹:

- (i) For members with lower capacity and higher debt vulnerabilities, the performance criterion would generally preclude any accumulation of nonconcessional external debt. Concessional external debt would be excluded from coverage of the performance criterion. For these purposes, concessional debt is defined as debt with a grant element of at least 35 percent, although a higher grant element may be required on a case-specific basis for members in this category. Concessional debt would generally be determined on a debt-by-debt basis, using currency-specific discount rates based on the OECD commercial interest reference rates. Decision No. 11248-(96/38)⁷, adopted April 15, 1996, shall apply for purposes of determining the method of calculation of the discount rate.
- (ii) For members with lower capacity and lower debt vulnerabilities, the performance criterion would generally set a ceiling on the accumulation of nonconcessional external debt. Concessional external debt would be excluded from coverage of the performance criterion. For these purposes, concessional debt is defined as debt with a grant element of at least 35 percent, and would be determined as specified in subparagraph (g)(i) above.
- (iii) For members with higher capacity and higher debt vulnerabilities, the performance criterion would generally be set on the present value (PV) of external debt.
- (iv) For members with higher capacity and lower debt vulnerabilities, the performance criterion would generally be set on the average concessional debt of new external debt, based on the most recent debt sustainability analysis.
- (v) For members covered under subparagraph (g)(iii) or (g)(iv) above that also have a strong track record of macroeconomic and public financial management,

⁷ Selected Decisions and Selected Documents of the IMF (<http://www.imf.org/external/pubs/ft/sd/index.asp>).

significant market access, and experience in dealing with nonconcessional financing, the performance criterion could be set on nominal external debt.

h. The external debt performance criterion in arrangements of members for whom concessional financing would normally not be available will not distinguish between concessional and nonconcessional debt, but rather would be set on nominal external debt.

i. Notwithstanding subparagraphs (g)(iii) and (g)(iv) above, for a transitional period of three years following the effective date of Decision No. (-----), targets on the PV of external debt or on the average concessionality of new external debt may be established as annual indicative targets, rather than as performance criteria.

j. In principle, a performance criterion on external debt will incorporate by reference the definition of debt set forth in point No. 9 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 performance criterion where appropriate, in which case they would be explicitly specified.

9. (a) For the purpose of this guideline, 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 the guideline, the debt is the 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.

(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.