DEBT SUSTAINABILITY ANALYSIS WORKSHOP
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THE JOINT BANK-FUND DEBT SUSTAINABILITY FRAMEWORK FOR LICS

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The Debt Challenges of LICs

- Low-income countries (LICs) face large financing needs but their capacity to carry debt is relatively limited
  - Narrow tax bases
  - Shallow domestic financial sectors
  - Small, vulnerable export sectors
- Excessive levels of debt (external and domestic) can undermine macroeconomic stability and constrain fiscal policy
- Debt crises are very costly, economically and socially

An Altered Landscape

- LICs also face a new international financial environment:
  - Debt relief for the most indebted
  - Scaling up prospects from traditional creditors
  - The emergence of new private and official creditors
- These changes provide *opportunities* for faster progress towards the MDGs…
- … But they need to be *managed* in order to avoid too rapid a build-up of debt

The Joint Bank-Fund DSF

- The Bank and Fund have jointly developed – and recently strengthened – an instrument to address the analytical challenges of prudent borrowing:
  - The Debt Sustainability Framework for Low-Income Countries (DSF)
- The DSF is designed to detect early debt vulnerabilities and help design strategies to address them.
- The DSF is not the framework used in the context of the HIPC Initiative; it serves a different purpose.

Main Objectives

- Improve World Bank and IMF assessments and policy advice in these areas and guide provision of needed technical assistance
- Support LICs in achieving development objectives and Millennium Development Goals, while maintaining sustainable levels of debt
  - Assess risk of future debt distress so that preventive action can be taken
  - Guide new borrowing decisions to match financing with ability to repay debt
  - Encourage creditors to ensure long-term debt sustainability when providing loans and grants to LICs

Analytical Foundations

- Need broad-based analysis and long-term perspective to detect early debt vulnerabilities and allow for correction (e.g., low debt service may hide future problems)
- LIC vulnerabilities differ from that of richer countries: Exogenous shocks larger and longer, weaker institutions, incomplete information
- Empirical analysis shows that the likelihood of debt distress is linked to the size of the debt burden, exogenous shocks, and the quality of policies and institutions

Three "Pillars"

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

Other DSF Features

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

Avoiding Unsustainable Debts

- Recent developments make maintenance of debt sustainability even more challenging
- Addressing this challenge will require:
  - Better analysis (DSF strengthening)
  - Raising awareness of debt sustainability risks among borrowers and creditors
  - Fostering broader exchange of information between borrowers and creditors, and among creditors
  - Continued emphasis on concessional finance

Raising Awareness of Debt Sustainability Risks

- The DSF has already had an impact on Bank and Fund policies
  - IDA financing terms
  - IMF policy advice and program design
- However, the DSF will be effective in preventing new crises only if *both* other creditors *and* borrowing countries act in broad harmony with it

Creditor Outreach

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

Medium-Term Debt Strategies

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

First Steps Towards MTDS

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

Building Debt Management Capacity

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