INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 09/39
FOR IMMEDIATE RELEASE
March 30, 2009

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Discusses Changing Patterns in Low-Income Country Financing and Implications for Fund Policies on External Financing and Debt

On March, 23, 2009, the Executive Board of the International Monetary Fund (IMF) discussed changing patterns in low-income country financing and implications for Fund policies on external financing and debt. The discussion was based on a report prepared by the staff of the IMF.

Background

Low-income countries (LICs) face significant challenges in meeting their development objectives while maintaining a sustainable debt position. The international community's main answer to this dilemma has been to promote recourse to concessional external resources. The practice in Fund-supported programs in LICs has generally been to avoid nonconcessional external borrowing while not restricting concessional financing, although flexibility has continued to be applied on a case-by-case basis to allow some nonconcessional borrowing when warranted.

While the principles of the current policy on debt limits remain valid, various factors warrant a review. First, the situation of LICs has evolved and patterns of financing of LICs have changed substantially in recent years: a number of them have made good progress in strengthening macroeconomic management; debt burdens have been relieved; official financing has become available from a broader group of creditors; and external private creditors' interest in LICs had been on the rise. Second, the debt sustainability framework (DSF) has been introduced since the last review of the debt limits policy. Third, the current policy raises a number of implementation issues, such as the distinction between external and domestic debt, which require reconsideration as LICs become more integrated into the international financial system.

The ongoing financial crisis will likely affect significantly the size and composition of financing flows to LICs in the near future. This review is part of the Fund's efforts to make sure that its policies and instruments remain adapted to the needs of its members is in these turbulent times.

Executive Board Assessment

Executive Directors welcomed this review of the policy on external debt limits in Fund arrangements. They emphasized the important role of the policy in preventing the build-up of unsustainable debts in low-income countries (LICs), while allowing for adequate external financing. Noting that many LICs continue to be in fragile debt situations, while their development and financing needs remain large, Directors considered that recourse to external concessional resources, including grants, remains highly desirable for these countries. Improved availability and predictability of concessional financing are crucial in this regard, especially now that the global crisis is starting to have a severe impact on LICs.

Directors welcomed the fact that many LICs have made good progress in strengthening macroeconomic and debt management, and that several of them have had access to new sources of financing. At the same time, debt vulnerabilities remain significant in a large number of LICs, including in some countries that have benefited from debt relief. In view of the diverse characteristics of LICs and the substantial change in the patterns of their financing in recent years, most Directors saw merit in modifying aspects of the debt limits policy to take greater account of today's reality. Other Directors, however, felt that the current policy already allows for flexible implementation and has not posed any undue constraints on LICs' financing.

Most Directors agreed that the extent of a country's debt vulnerabilities and its macroeconomic and public financial management capacity are the appropriate dimensions to determine the type of limits on nonconcessional financing to be used in Fund arrangements. Directors generally agreed that debt sustainability analyses (DSAs) provide an appropriate basis for assessing vulnerabilities. In view of the proposed greater role of DSAs in the new approach, Directors emphasized the need to refine their analytical underpinnings further. In particular, some saw merit in pursuing work on assessing the impact of additional public investment on growth and exports. Assessing the capacity dimension would also require objective, credible criteria. In this regard, some Directors expressed reservations about the use of the overall Country Policy and Institutional Assessment index as a criterion for assessing a country's management capacity. Directors therefore encouraged staff to do further work on the design of the assessment methodology.

Most Directors considered that the options for debt concessionality requirements presented in Table 2 of the report provide a useful starting point. For countries with either lower debt vulnerabilities or higher capacity, all the options are more flexible than current practice. For countries with higher debt vulnerabilities and lower management capacity, nonconcessional borrowing should remain truly exceptional, and the minimum concessionality requirement may need to exceed 35 percent. A few Directors, however, expressed concern that this might reduce the availability of external financing for those countries needing it most, and, in this context, suggested that sufficient consideration be given to individual country circumstances and the growth impact of public investment projects. Some Directors also called for flexible application of the zero limits on nonconcessional borrowing for countries with higher debt vulnerability and lower management capacity.

While many Directors welcomed the idea of exploring average concessionality requirements or targets on the present value of debt for higher-capacity countries, a number of Directors pointed to various practical challenges in designing and implementing them, and called for simple approaches. Directors also underscored the importance of maintaining donors' incentives to provide highly concessional financing, and stressed the need for adequate safeguards in the implementation of options that depart from the current debt-by-debt approach to computing concessionality requirements.

Directors generally saw merit in moving to targets on total public debt. Given related implementation issues, such targets could be tried in specific cases where the potential problems are considered manageable, followed by an assessment of experience after a period of time.

Directors observed that the increasing role of nonresidents in domestic debt markets in a number of LICs has blurred the distinction between external and domestic debt. To address this issue, they broadly agreed that debt limits should be defined on the basis of the currency of denomination, rather than the residency criterion, where appropriate. Several Directors saw scope for further improvement in the definition of debt subject to concessional requirements. Directors broadly welcomed the proposed clarification of the coverage of debt limits with regard to public enterprises and other official sector entities.

Directors looked forward to a follow-up paper, elaborating on the approach discussed today and proposing new guidelines on debt limits, for further consideration before the 2009 Annual Meetings.