SU/20/157

November 4, 2020

The Acting Chair's Summing Up
Reform of the Policy on Public Debt Limits in IMF-Supported Programs
Executive Board Meeting 20/103
October 28, 2020

Executive Directors welcomed the opportunity to revisit the Debt Limits Policy (DLP), which guides the use of quantitative limits on public debt in Fund-supported programs. They observed that this review is taking place when many countries are experiencing heightened debt vulnerabilities, aggravated by the COVID-19 shock, and a changing creditor landscape, with concessional financing becoming scarcer relative to countries' investment needs.

Directors agreed that, since the last DLP review in 2014, the policy has generally worked well, while noting that there is room to improve its effectiveness. They noted that public debt vulnerabilities have been contained within Fund-supported programs but recognized that challenges to the effectiveness of the policy remain. These include: (i) the migration of debt-related risks off balance sheet and general debt transparency issues; (ii) unwarranted impediments to a broader use of debt limits set in present value (PV) terms by countries normally relying on concessional financing that are at moderate risk of debt distress; (iii) some design weaknesses for countries that normally rely on concessional financing but have recently started accessing international financial markets on a significant scale; and (iv) issues with the definition of concessionality. Directors saw a need for reforms that would provide countries with more flexibility to manage public borrowing to finance development needs, with appropriate safeguards to preserve or restore debt sustainability. In this context, they underscored the important role of capacity development (CD) and encouraged continued collaboration with CD partners, including the World Bank.

Directors concurred with the need to enhance debt data disclosure to the Fund to improve program design, including regarding the specification of debt limits. They supported the introduction of an explicit expectation that critical debt data disclosure gaps should be addressed in Fund-supported programs upfront, premised on a risk-based approach. Directors agreed that disclosure to Fund staff would only be expected to lead to conditionality if the vulnerability revealed by such disclosure is deemed critical for achieving the goals of the Fund-supported program or for monitoring its implementation. They also noted that information on creditor composition can help strengthen program design and contribute to the broader goal of improving debt transparency. Directors therefore supported the requirement that program documents include a table with a profile of the holders of the country's public debt, calling for the provision of supporting technical assistance where needed. Many Directors called for the table to include debt service in addition to debt stock, wherever feasible. They also requested that debt subject to non-disclosure agreements be included in a special line item in the table. In addition, many Directors called for further work on clarity in defining the distribution of "commercial" and "official" creditors in the context of the upcoming review of the arrears policy. Directors agreed that missing elements would be expected to be filled in, at the latest, by the time of the second review of the program. Nonetheless, publication of such data must be consistent with the Fund's legal framework for the treatment of confidential information as well as the Fund's transparency policy. A few Directors considered that additional debt conditionality could be burdensome and underscored that it should be applied in an evenhanded manner and only if it is deemed critical.

Directors agreed that for countries that normally rely on concessional financing but have access to international financial markets on a significant scale, using a tailored approach and better alignment of conditionality with the country's financing mix and program design is needed. They supported the reform proposal that, where such countries are assessed to be at moderate or high risk or in debt distress, a performance criterion on the accumulation of public and publicly-guaranteed external debt, specified in present value (PV) terms, would be the default choice, with the possibility of alternative formulations where warranted to better address critical vulnerabilities. Directors agreed that, to be eligible for such treatment, countries should meet the requirements specified in SM/20/157 (page 29): having had significant access to international financial markets in recent years or access to these markets being a key element of the program, and also having a demonstrated capacity to manage significant levels of market borrowing.

Directors agreed that broadening the use of PV limits should be expanded for countries that normally rely on concessional financing and do not have significant access to international financial markets, and that are assessed at moderate risk of debt distress. In their view, most members can be expected to have adequate capacity to monitor conditionality on aggregate debt levels in a manner that allows use of debt limits specified in PV terms. Directors agreed that where the member's capacity to monitor debt conditionality on aggregate debt levels is not assessed to be adequate, the specification of debt conditionality as a limit on non-concessional borrowing (NCB) in nominal terms, and a memo item as a limit on concessional borrowing in nominal terms, should be retained. They agreed that capacity would be assessed in consultation with authorities and where relevant, informed by past experience on the quality of the member's debt monitoring. Directors supported higher scrutiny of borrowing plans for countries at moderate risk of debt distress with limited space as an additional safeguard.

Directors concurred that the presumption of a zero NCB limit should be retained for countries that normally rely on concessional financing without significant access to international financial markets and that are assessed to be at high risk of debt distress or in debt distress. They supported the proposals for providing greater clarity on the circumstances under which exceptions to the zero NCB rule would be accommodated. These include proposals on: (i) use of the signal-based approach for determining when a project is integral to the authorities' national development program and for which concessional financing is not available; (ii) debt management operations; and (iii) repeated NCB exceptions. Directors agreed with the requirement, in these circumstances, to include an indicative target on public external borrowing specified in PV terms to safeguard debt sustainability. Many Directors called for caution in granting exceptions, indicating that these should be limited to projects that credibly generate good social and economic return and contribute to reducing overall debt vulnerabilities.

Directors supported the proposed adjustments to the definitions of concessionality, including to help prevent circumvention of debt limits. They concurred that blended financing arrangements that include the provision of a financially significant amount of grants-in-kind be treated as non-concessional. A few Directors urged staff to exclude grants-in-kind where fair value has been assessed from this treatment. Directors agreed that financing involving unrelated collateralized debt—e.g., general budgetary borrowing collateralized with future commodity export revenues—should be treated as non-concessional and many Directors encouraged borrowers and creditors to carefully consider the hidden costs inherent in these financing arrangements. They concurred that this reform would address potential circumvention problems that could in turn lead to a build-up of debt vulnerabilities. Directors generally supported the application of a single definition of concessionality (35 percent) to all cases, agreeing that a higher concessionality threshold would still be allowed in cases when this is deemed to be an integral part of restoring debt sustainability.

Directors agreed that the reform proposals would provide incentives to improve debt management capacity. They encouraged the continued use of structural conditionality when significant weaknesses in debt management capacity are identified in consultation with authorities, in a manner consistent with the Fund's Guidelines on Conditionality. Directors noted that, in some cases, timely capacity development support (including through technical assistance provided by Fund staff or through other providers, where available), will be needed to improve debt management capacity.

Directors underscored the importance of close alignment between the Fund's DLP and the World Bank's Sustainable Development Finance Policy. They agreed that the DLP should take effect following the issuance of a staff guidance note as specified in the proposed decision, with expected effectiveness in March 2021. Directors noted that a review of the experience in implementing this new policy would be conducted no later than five years after the entrance into effect of the new policy, with an update to the Board on the implementation of this policy no later than two years after the date of effectiveness. In addition, they called for an effective outreach strategy to ensure that the reformed policy is clearly understood by stakeholders. Many Directors encouraged all official creditors to engage with Paris Club and to follow responsible and transparent lending practices.