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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/7-2

10:08 a.m., January 22, 2020

2. The Evolution of Public Debt Vulnerabilities in Lower Income Economies

Documents: SM/19/292, and Cor. 1, and Cor. 2, and Sup. 1

Staff: Flanagan and Hakura, SPR

Length: 2 hours and 5 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	I. Mannathoko (AE)
M. Raghani (AF)	
	J. Di Tata (AG)
N. Ray (AP)	
	B. Saraiva (BR)
	Y. Zhao (CC), Temporary
L. Villar (CE)	
L. Levonian (CO)	
	C. Just (EC)
A. Buisse (FF)	
R. von Kleist (GR)	
	P. Dhillon (IN), Temporary
	M. Psalidopoulos (IT)
T. Tanaka (JA)	
J. Mojarrad (MD)	
H. Beblawi (MI)	
A. De Lannoy (NE)	
	J. Sigurgeirsson (NO)
	L. Palei (RU)
M. Mouminah (SA)	
A. Mahasandana (ST)	
P. Inderbinen (SZ)	
S. Riach (UK)	
M. Rosen (US)	

G. Bauche, Acting Secretary
J. Morco, Summing Up Officer
R. Smith Yee, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
African Department: I. Razafimahefa. Asia and Pacific Department: E. Kvintradze. Communications Department: P. Kunzel. European Department: R. Chawani. Fiscal Affairs Department: P. Dallari. Institute for Capacity Development: R. Nord. Independent Evaluation Office: C. Collyns. Middle East and Central Asia Department: I. Lukonga, K. Mathai. Monetary and Capital Markets Department: P. Breuer, T. Jonasson. Strategy, Policy, and

Review Department: M. Flanagan, J. Gold, D. Hakura, A. Hosny, Y. Khairi, J. Saito. World Bank Group: L. Bandiera, M. De Moura Estevao Filho, D. Doemeland, S. Essl. Executive Director: A. Bevilaqua (BR), Z. Jin (CC). Alternate Executive Director: M. El Qorchi (MD), A. Guerra (CE), Y. Indraratna (IN), W. Nakunyada (AE), O. Odonye (AE), D. Ronicle (UK), P. Rozan (FF), F. Sylla (AF), C. White (AP). Senior Advisors to Executive Directors: J. Damgaard (NO), I. Fragin (GR), B. Jappah (AE), S. Keshava (SA), Z. Mahyuddin (ST), M. Maidi (AE), T. Sitima-wina (AE), C. Wehrle (SZ). Advisors to Executive Directors: A. Abdullahi (AE), P. Al-Riffai (MI), E. Cartagena Guardado (CE), D. Cools (NE), T. Iona (AP), H. Koh (GR), R. Lopes Varela (AF), M. Merhi (MI), L. Nankunda (AF), K. Nelson (UK), A. Olhaye (AF), E. Ondo Bile (AF), K. Osei-Yeboah (MD), T. Persico (IT), B. Rankin (CO), A. Ribeiro Mateus (IT), S. Senich (US), D. Susiandri (ST), N. Vaikla (NO), S. Yoe (ST), E. Comolet (FF).

2. THE EVOLUTION OF PUBLIC DEBT VULNERABILITIES IN LOWER INCOME ECONOMIES

Mr. Sigurgeirsson and Mr. Damgaard submitted the following statement:

We welcome the extended analysis and update on the public debt vulnerabilities in LIEs. The high public debt levels and vulnerabilities constitute a key challenge for LIEs. We agree that LIEs face a difficult trade-off between the urgent need for funds to finance the 2030 Sustainable Development Goals and the mounting challenge to contain debt vulnerabilities. We broadly agree with the conclusions of the report and wish to state the following points for emphasis.

While it is reassuring that public debt accumulation has slowed down, it should be noted that this masks extensive heterogeneity as LIEs constitute a very diverse group of countries. Public debt to GDP has declined mainly in oil-exporting countries while others have mostly not succeeded in curbing the pace of increase in public debt levels. Worrying trends, especially in frontier economies, warrant close monitoring. These trends include increasing interest burdens and exposure to shifts in global conditions due to the broader use of bond market financing as well as deteriorating debt dynamics due to shorter maturities, large fiscal deficits, and muted growth. An additional cause of concern in LIEs is rising contingent liabilities related to government guarantees, SOE debt, and PPP projects.

We recognize that new challenges are emerging with the evolving creditor composition with larger shares of public debt being held by non-Paris Club official bilateral creditors and commercial creditors. The IMF, along with Paris Club and other creditors, must continue working together to enhance cooperation on debt issues, including modalities for debt restructuring in an increasingly complex landscape of lenders. To widen the work on sustainable lending to include more countries, and strengthen the multilateral institutions' potential to engage, global principles on sustainable borrowing and lending should be developed and adopted, and their implementation monitored. This could build on the G20 Operational Guidelines for Sustainable Financing. In light of the changes in the creditor landscape and worrying signs of debt resolution frameworks not being effective enough, carefully considering ways to improve engagement of all creditors in sovereign debt resolution could be warranted. Could staff provide additional information about the potential review of the architecture for sovereign debt resolution? What would be the primary scope, expected timeline, and who would conduct the review?

In "Global Waves of Debt", published by the World Bank, the current wave of debt build-up is compared with the three previous waves – the Latin American in the 70's and 80's, the Asian debt crises in the late 90's and early 00's, and the third wave starting with the GFC in 2007/8, which all ended in financial crises. While there are many similarities, the current wave stands out as being larger, faster, and deeper as it is more global in nature, has seen a more rapid accumulation of debt, and also has the potential to affect the private sector significantly. These characteristics need to be taken into account when evaluating the prospects of the unwinding of the current debt accumulation.

Changes in the structure of debt portfolios include increasing reliance on international bond markets. While better access to market-based finance provides benefits, it also produces challenges, particularly related to exchange rate, interest rate, and liquidity risks as well as higher vulnerability to external shocks and shifts in global sentiment. The poorest and fragile countries should be ensured sufficient concessional financing to manage risks.

Increasing public debt transparency in LIEs is crucial to allow closer monitoring of the related risks. Specifically, it is important to get a better understanding of potential contingent liabilities arising from collateralization of debt as well as debt contracted through SOEs and PPPs. In addition, information about currency and maturity breakdowns and more detailed investor information on both domestic and foreign debt would be useful to support a more comprehensive assessment of debt vulnerabilities. Could staff provide information about the status of the IIF private creditor database and its potential usefulness for LIEs debt monitoring?

The projections that envisage a slight decline in the public debt of LIEs hinge on assumptions of sustained fiscal consolidation and strong growth, which may turn out to be overly optimistic. The realism of the underlying assumptions should be carefully considered. It should be stressed that the risks to the favorable debt trajectories are internal as well as external, large, and firmly skewed downwards. A debt-at-risk look at the projections could give more insight on the distribution of possible developments. The assessment should also include analysis of climate-related risks to LIEs' debt burdens and fiscal positions. Could staff provide a range of alternative projections, assuming e.g. no fiscal consolidation, lower economic growth, or tighter financial conditions?

We welcome the initiatives taken to better manage debt vulnerabilities and encourage the authorities of borrowing countries to continue to improve their debt management, fiscal frameworks, and debt transparency. Strengthening governance and operations of SOEs and improving transparency of fiscal risks related to SOEs is also warranted. Moreover, we stress that concerted efforts from the multilateral community and country authorities to build capacity, strengthen debt sustainability analysis, and improve data coverage are needed to bring debt to sustainable levels. Debt sustainability risks need to be managed carefully to avoid another large-scale sovereign debt crisis in LIEs. Could staff elaborate on the experience with the joint IMF-WB multi-pronged approach (MPA) so far?

The IMF country surveillance and programs need to be strong and clear on debt sustainability. Efforts to ensure traction of IMF policy advice on debt issues, including ensuring adherence to public debt limits in program countries, and sound macro-economic policies in general is important. The IMF should consider the distributional consequences and the impact on poverty in their analysis.

We urge country authorities with significant debt burdens to focus on strengthening domestic revenue mobilization, and ensuring sustainable financing practices and fiscal policies, while pursuing increased economic resilience, sustainable and inclusive growth, and long-term prospects in mind. The muted growth response to debt-creating public expenditure and investment registered in many countries underscores the critical need to increase the efficiency of spending and ensuring that debt is channeled to economically or socially productive investments. Areas that should be prioritized include building capacity, upgrading infrastructure, and mitigating the effects of climate change. At the same time, we recognize that the challenges faced by the LIEs are as diverse as the countries themselves. Thus, policy advice should be carefully tailored to support the best possible outcomes given the macroeconomic reality of each economy.

Capacity development (CD) in the field of fiscal policy and debt management will continue to play an important role. We emphasize the need for the Fund to fully integrate CD with surveillance and lending activities. This is particularly important as lower income and fragile countries often have limited absorptive capacity and face resource constraints. Capacity development activities should be country specific and proper oversight by the Board should be ensured.

Ms. Mahasandana, Mr. Tan, Mr. Mahyuddin and Ms. Latu submitted the following statement:

We thank staff for the insightful report which provides a comprehensive and timely update of the debt situation in lower-income economies (LIEs). Debt that are well-managed provides an important means to finance the development objectives of LIEs including the pursuance of the 2030 Sustainable Development Goals (SDGs). The evolution of the debt structure towards more commercial borrowing and bond issuance also presents an opportunity to deepen the capital markets and support the strengthening of monetary policy transmission. Nonetheless, these come with risks and therefore robust debt management strategies are warranted to effectively mitigate these risks. In particular, it is important for public debt vulnerabilities to be kept well-contained. This enables countries to create sufficient fiscal space to implement countercyclical fiscal policies in response to shocks and meet priority needs such as the protection of the vulnerable. Fiscal discipline is also crucial for ensuring that debt, when put to good use, is beneficial for LIEs' economic activity and well-being by boosting potential growth. We broadly support staff's update and policy recommendations and offer the following comments for emphasis.

Half of the LIEs are assessed to be at high risk of debt distress or at debt distress and downside risks to the outlook on debt remain high. With fiscal deficits being a key source of debt accumulation in almost all country groups, fiscal consolidation is a top priority to containing debt at sustainable levels. To some extent, the current trend is reminiscent of past debt crises, with the exception that the LIEs and the global community at large may be less well placed than before to deal with the potential fallout given the high vulnerabilities identified in the paper. Drawing lessons from past crises where appropriate, can staff comment further on what more can the Fund do to help LIEs in dealing with longer-term policy trade-offs (such as achieving development goals without building up debt excessively) vis-à-vis building resilience in the near term against the ensuing market corrections that may arise from a sudden tightening of global financial conditions?

Strengthening of debt management and data transparency is crucial to effectively curb the high public debt vulnerability and build fiscal resilience to shocks. We welcome the update of country experiences in managing debt vulnerabilities. Lessons learnt from these initiatives including the operational strategies to manage debt risks would be useful in shaping policy advice that is tailored to country circumstances, political economy and implementation capacity. We also take positive note of the joint World Bank/IMF multi-pronged approach (MPA) to help LIEs address debt vulnerabilities. Can staff comment on whether the current surveillance activities identify the specific gaps in debt management capacity and debt transparency that need to be addressed for all LIEs using the DeMPA or similar methodology and how is the progress towards addressing these gaps being monitored? From the experience to date, can staff comment on the effectiveness of the MPA in reducing countries' debt vulnerabilities? We also note the update on LIEs' experience with debt restructuring, including the increasing number of restructurings outside of the IMF program frameworks and that some of these have been protracted, incomplete and non-transparent. In this context, is there scope for the Fund to play a bigger role in helping LIEs on debt restructuring including economic adjustment to address the underlying root causes of the debt problem?

We encourage continued technical assistance from the Fund and other relevant IFIs to help LIEs address gaps in debt management and debt data transparency. Capacity constraint is a key challenge that calls for continued technical assistance and support from the Fund and other relevant IFIs. With the expansion of credit sourced from commercial lenders and bond markets, we encourage staff to assist in ensuring LIEs are well-equipped with the appropriate tools to manage the potential risks and consequences associated with such debt sources. This includes assisting LIEs to develop appropriate debt management strategies and risk management system to effectively access such sources and manage the corresponding risks through diversification of creditors, instruments, maturities profile etc. We welcome the debt instruments with state-contingent risk-sharing features such as the climate-resilient debt instruments and bonds with extendible maturities that would facilitate better management of climate-related risks. Capacity development in developing these debt instruments particularly for small states would be required.

While we see merit in encouraging creditors to adopt sustainable financing practices, further guidance on how these would be operationalized would be useful. This would shed light on the Fund's role in supporting the effectiveness of these policy recommendations. To this end, how does the Fund intend to proceed in ensuring these policy recommendations are followed through? The Fund's analysis and assessment, jointly with other institutions such as the World Bank, to reflect the potential "outward spillover" effect of "unsustainable" financing practices, is important to advocate greater adoption of sustainable financing practices by creditors.

Mr. Psalidopoulos, Mr. Spadafora, Ms. Mateus and Mr. Persico submitted the following statement:

We thank staff for an informative report, which clearly documents the evolution of public debt vulnerabilities in Lower Income Economies (LIEs). We acknowledge the concerns flagged in the report, although we believe that a holistic perspective is warranted in evaluating public debt dynamics. The international community should step up efforts to help countries in need come closer to attaining SDGs. To address the overarching tradeoff between financing for development (including SDGs) and debt sustainability, it remains of clear importance to improve domestic revenue mobilization and spending efficiency.

While the evolution of public debt-to-GDP ratios and debt distress assessments is somewhat concerning, particularly in HIPC and fragile countries, it should not be assessed on a stand-alone basis. Same debt-to-GDP ratios can hide different creditworthiness and debt efficiency levels. For this reason, debt-to-GDP ratios should be accompanied by debt sustainability and efficiency assessments. The analysis on debt composition should be complemented taking into account debt contribution to growth, decrease in inequalities and poverty reduction.

Even if 20 percent of HIPC recipients have debt levels higher than pre-HIPC and are at severe risk of distress, debt restructuring proved to be helpful for the poverty reduction strategy (Box 1). While acknowledging the role of new creditors in future debt restructuring, we consider the Paris Club to be still a relevant forum in providing funding to LIEs and discussing solutions for dealing with protracted arrears cases.

Authorities in LIEs should continue strengthening fiscal and debt management frameworks. The impact of contingent liabilities, notably guarantees for investment, PPP projects and State-Owned Enterprises (SOEs), deserves utmost attention as a key driver of debt accumulation. Increased transparency and coverage of public debt is a most welcome development. However, the gaps highlighted in Paragraph 25 raise specific concerns. Further efforts are required to ensure adequate debt data are available and cover all government levels (including regional and local) and potential sources of contingent liabilities.

The Fund should intensify strengthening capacity development to LIEs on fiscal frameworks, debt management and building resilience to natural disasters. Sustained debt management capacity development is needed to contain the risks from debt escalation due to re-occurring shocks.

Furthermore, considering the increased frequency and severity of climate shocks, many LIEs are often unable to cope with the consequences of such shocks on their own, due to very limited fiscal space. Developing strategies to build resilience to natural disasters and create fiscal space to absorb the impact of shocks is of the essence.

Achieving the SDGs should be a collective effort. We continue supporting the authorities' initiative to mobilize revenues and channel them for attaining SDGs. However, we take note of the dismal picture that research puts forward regarding the very large commercial borrowing needed to finance the SDGs. For this reason, the international community needs to step up efforts to help those most in need. Similarly, addressing the impact of climate change should also be a collective effort.

Mr. Kaya, Mr. Just and Mr. Mehmedi submitted the following statement:

We thank staff for the well-written report on the evolution of public debt vulnerabilities in Lower Income Economies (LIEs). The assessment gives a sobering account of the debt vulnerabilities and developments facing LIEs despite the current stability of commodity prices and continued accommodative monetary policies in advanced economies, which in turn have facilitated a continued flow of financing to LIEs. We underscore that the findings of the paper and the policy recommendations should inform the granular analysis and policy advice within the regular bilateral surveillance, as well as the technical assistance aimed at improving the institutional frameworks and debt management capacities in LIEs. At the same time, several workstreams under way in the Fund, including the upcoming Review of Debt Policies, should incorporate the issues raised and the recommendations in the Report.

The increasing debt vulnerabilities in LIEs call for urgent actions to put debt on a downward trajectory and avoid another "lend and forgive" cycle. We note that debt related risks remain very high in LIEs, with half of them assessed at high risk of external debt distress or already in debt distress, while the debt-to-GDP ratios have continued to rise especially in non-oil exporting LIEs, reflecting increased commercial borrowing, which has worsened interest-growth differentials. Public debt ratios are estimated to have increased by more than 5 percent since 2017 in 20 countries, and we note that incomplete reporting on SOE debt as well as other contingent liabilities, including from public private partnerships, also raises significant concerns about hidden direct and contingent liabilities. Regrettably, HIPC/MDRI recipients' interest-to-revenue ratios have also steadily increased, in some cases to above pre-HIPC levels, indicating that many of the LIEs did not use the benign environment and the debt relief to strengthen their policy buffers. Against this backdrop, there is a pressing need for many LIEs to reassess their fiscal strategies and commit to policies to ensure the sustainability of public debt and the health of public finances, including through mobilizing domestic revenue, improving spending efficiency and enhancing public investment management while also strengthening debt management and governance. In light of the World Bank's warning on the biggest buildup in borrowing in the past 50 years and the risk of a fresh global debt crisis, we are wondering how the Fund could better assist countries, both through surveillance, program work, and technical assistance, in tackling debt accumulation and strengthening buffers.

We acknowledge staff's baseline debt projections, which envisage LIEs' public debt declining slightly over the next five years, but we are concerned about the potential projection biases. For the majority of LIEs, staff assumes a larger contribution from the negative interest-rate differential over the next five years to the debt reduction as compared to the recent past. At the same time, the projected growth impact of fiscal adjustment may also have an optimistic bias as 17 countries are projected to attain higher than historical growth in the context of a fiscal adjustment that is large by international standards. Against this backdrop, and in view of the downside global risks, a comprehensive analysis of projection biases and employment of tools that ensure the realism of macroeconomic projections, especially in program countries, remains essential.

The evolution of debt structure, including creditor composition and structure of debt portfolio, has increased debt vulnerabilities which calls for enhanced debt management. We note that commercial lending is outpacing other financing sources while debt owed to non-Paris Club creditors has increased in recent years. In parallel, local currency debt financing continues to surge, especially in frontier markets, as the creditor base for resident local-currency funding is also diversifying. While we acknowledge that the shift in the composition of LIEs' debt has expanded access to credit and provided opportunities for borrower countries to accelerate development, provided that the additional funding is used effectively, the increased reliance on funding on commercial or near-commercial terms has raised the exposure of LIEs to interest rate, exchange rate, and rollover risks – which will need to be carefully managed through enhanced management of debt vulnerabilities.

Enhancing debt management capacities and improving debt transparency remain critical components in addressing debt vulnerabilities, in line with the IMF-WB multi-pronged approach (MPA). We note that most countries do not meet minimum debt management standards and more concerted efforts are needed to match the increasing complexity and volatility of debt flows, particularly in frontier economies that have tapped international debt markets. To this end, we underscore the need to address the outcomes of audits, improve cash flow forecasting and implement debt management strategies. At the same time, the coverage of non-PCC financing is very limited with very few LIEs publishing data on the amounts and terms of financing. More transparency is therefore urgently needed. The coverage and reporting of non-PCC financing clearly should be expanded to better understand risks and detect vulnerabilities. We reiterate our call that both debtors and creditors should ensure sustainable financing by following global principles, including the G20 operational guidelines for sustainable financing. In this context, LIEs should be encouraged and incentivized to report their general government debts, rather than the central ones, while enhancing the availability, coverage, and quality of data, including risks from extra-budgetary activities, state-owned enterprises, public-private partnerships, and collateral requirements on loans. In order to incentivize progress toward better external debt governance and more systematic data reporting efforts, we wonder whether Fund policies need to be adapted, for example by having assessments of debt governance and requiring more comprehensive data reporting in a program context.

Changes in the composition of creditors and debt instruments make the potential debt resolution process challenging. We note that since 2015, non-PC bilateral creditors, regional development banks, Eurobond holders, and commercial lenders had a leading role in LIEs debt restructuring, reflecting their exposures in relevant cases. However, the comprehensive restructurings that have taken place have been protracted, incomplete and non-transparent and many have taken place outside of IMF program frameworks. This, in turn, calls for a prompt review of the architecture for sovereign debt resolution. Staff's comments on whether non-PC creditors have employed the sustainable financing practices identified in the G20 operational guidelines for sustainable financing in recent debt restructuring cases are welcome.

Mr. Inderbinen and Ms. Wehrle submitted the following statement:

We thank staff for this very instructive report that helps shed light on important debt-related developments and drivers in lower income economies (LIEs). The fact that half of the LIE are now assessed to be at high risk of, or already in, debt distress is cause for concern. Public debt in non-oil exporting countries continues to be on the rise, while most LIEs remain commodity-dependent. That said, we recognize some improvements in domestic revenue mobilization, the progress in strengthening debt management frameworks in a number of countries, a moderation of the pace of downgrades, and some improvement in debt transparency indicators.

We believe that elevated debt levels remain a key concern and caution against being overly optimistic with respect to future trends. The slower pace of public debt accumulation over the past two years should not distract from the rising debt trajectory since the global financial crisis, higher liquidity risks, reduced fiscal buffers due to higher debt servicing costs, and greater complexity in the debt structure. Staff's projected decline in public debt over the next years is based on ambitious fiscal consolidation and growth expectations, which may prove optimistic. The current subdued global economic performance and the prevalence of downside risks call for caution. In a context of low interest rates and enhanced access to different sources of finance, including international markets, the trend in contracting new debt is likely to persist. In this regard, we cannot stress enough that further efforts are needed to build sound debt management capacities at the country level.

The Fund should continue to stress the need to implement a broad set of policies and measures aimed at containing the buildup of debt vulnerabilities in surveillance. The LIEs should undertake concrete steps to improve their domestic frameworks geared at contracting public debt and issuing guarantees, leading to more productive, efficient, and sustainable investments. Growth can and should increasingly be triggered through cost-neutral or even fiscally positive measures, such as improving the environment for the private sector, transforming loss-making public enterprises, and redirecting costly and market-distorting subsidies toward sectors with growth potential and positive externalities. We were particularly struck by the finding that widening fiscal deficits were not always associated with higher public investment. We would welcome more research on the underlying reasons for such adverse outcomes, and on how Fund surveillance could play a role in averting such situations in the future.

We support further actions to improve debt management and transparency. Proper recording and transparent reporting of debt are essential, including through expanded debt coverage, to keep up with the shift in the composition of LIE's debt portfolio. We agree with staff that we should not overestimate the magnitude of "hidden debt", but this phenomenon does deserve more scrutiny. Debtor countries hold the primary responsibility to provide data to staff and to make public finances transparent to all stakeholders. We note that LIEs face gaps in key debt management functions, with more than one third of frontier market economies assessed as not meeting all minimum requirements across debt management indicators. The Fund should continue to support efforts already underway in many countries to significantly improve debt management strategies. More generally, we reiterate our strong support for the IMF/WB multipronged approach for addressing emerging debt vulnerabilities.

We encourage further work on a more predictable and effective framework for debt restructurings. Recent restructurings have often been drawn out and not always fully effective in restoring sustainability. Complexity of debt resolutions has also risen in light of the increased importance of non-traditional lenders and instruments. Thus, we agree with staff that further efforts are needed to enhance the architecture for sovereign debt resolution.

Mr. Villar, Mr. Tabora Munoz and Mr. Cartagena Guardado submitted the following statement:

We thank staff for its report on “The Evolution of Public Debt Vulnerabilities in Lower Income Economies”. We broadly share the staff’s analysis and want to emphasize the following points.

On average, Low Income Countries (LICs) have achieved good economic performance during the past few years, despite signs of a global economic slowdown. LICs benefitted from a relatively high pace of growth, averaging 5 percent during 2018–19, an increase in remittances and contained inflationary pressures. Capital flows (both debt and investments) aimed to higher returns in a context of low international interest rates also affecting LICs’ performance.

Achieved economic growth played an important role in LICs’ average reduction of public debt. At the same time, however, we note with concern the vulnerabilities arising from a high number of LICs showing unsustainable debt dynamics; the report assesses that half are at high risk or currently in debt distress.

Heterogeneity across LICs makes the periodic and insightful assessments of public debt vulnerabilities by country groups particularly relevant as sudden supply/demand shocks or political conditions may affect the debt trajectory of a specific set of countries. Also, given the increased foreign exchange and refinancing risks, and the projected bunching of external loan repayments, it will be important to continue the efforts to reprofiling the external debt burden in many LICs. We agree with staff on the importance of working on the design of debt instruments with state-contingent risk sharing, like the climate-resilient debt instruments. We call on the IMF to help LICs and regional efforts in this regard.

Revenue mobilization and fiscal consolidation are important elements for LICs to be better prepared and resilient to face shocks. We note with concern that the average interest rates on revenue ratio is increasing for LICs, reflecting the higher pressures and vulnerabilities that servicing debt pose for their fiscal stance. Therefore, increasing revenue mobilization and controlling the pace of expansion of fiscal expenditures are key factors in protecting the well-being of people and achieving more resilience to shocks.

We agree that LICs should continue strengthening debt management and transparency. We point out the persistent problems in accounting debt of state-owned enterprises in some LICs. It is also essential that the scope of the Debt Sustainability Analysis be clearly delimited in order to avoid perverse incentives. The need to measure economic benefits and impacts on debt of the large public investment projects should be highlighted, especially where high debt levels are not accompanied by improvements in growth or productivity.

Technical assistance provided by IFIs on both debt management and debt statistics is very important for LICs. It is also relevant to continue encouraging the development of debt markets in local currencies to reduce the exposure of these countries to foreign exchange risk.

Mr. Ray and Mr. David submitted the following statement:

We thank staff for the informative paper on the evolution of debt vulnerabilities in Lower Income Economies (LIEs). Debt plays an important role in funding the development process for LIEs, given their limited capacity, resources, and access to finance. We therefore welcome staff's ongoing research and analysis in this area. We broadly agree with the thrust of staff assessments and offer the following comments.

The underlying debt dynamics for LIEs have changed over time and continued support from the Fund is valuable for authorities. Staff assessment is that debt dynamics has worsened with volatile primary fiscal deficits, negative interest-growth differentials and rising interest costs. The full impact is however masked by incomplete information on debt by State Owned Enterprises, and from public-private partnerships and other contingent liabilities. The result also varies between LIEs that are commodity exporters and diversified exporters, and between fragile states, developing markets, frontier markets and high-income small states. We encourage staff to continue assisting the authorities with training and technical assistance to improve their debt management framework and data collection.

The changing creditor composition and debt portfolio presents new challenges, opportunities and risks for LIEs. Commercial borrowings from international capital markets, new bilateral lenders, and domestic sources have reduced borrowings from others, including Paris Club creditors. We agree that while lending arrangements by some bilateral and plurilateral creditors can be opaque and expensive, LIEs do find these sources easier to access with less stringent borrowing requirements. We note with interest the findings that access to international markets often coincided with worsening debt dynamics and increased vulnerabilities. This is interesting because a major reason given for accessing financing through international markets is to allow for increased scrutiny over transparency and governance of economic and debt management by international investors. Could staff comment on the reasons for the worsening debt dynamics experienced by frontier economies? We agree on the need to improve the effectiveness of debt resolution frameworks between lenders and creditors.

LIEs face challenging trade-offs between debt sustainability and undertaking critical development programs and the Fund can play a role in assisting authorities in sequencing reforms and access to finance. The fiscal-growth nexus presented by staff indicates similar or smaller returns on public capital compared historically. For many LIEs, investing in capital infrastructure would help reduce debt vulnerability in the long term. Many do not have adequate fiscal space to finance critical infrastructure needs, undertake climate change resilience projects and address natural disaster threats. We see a role for the Fund and other international financial institutions in assisting LIEs develop their domestic capital markets and secondary market for government securities, and their access to funding from global climate funds and other funding sources.

Mr. Beblawi, Mr. Mouminah, Mr. Keshava and Ms. Merhi submitted the following joint statement:

We thank staff for this timely report that provides valuable insights and updates on recent debt developments in Lower-Income Economies (LIEs), in line with the Board request to enhance monitoring and reporting of the debt situation in LIEs. We broadly share the staff analysis; agree with the main messages on the outlook, risks, and vulnerabilities; and have a few additional comments for emphasis.

Among the key policy challenges are the need to find the right balance of scaling up public investment to meet the significant development needs, especially in the context of meeting the SDGs, while containing debt vulnerabilities. In this context, improving domestic revenue mobilization and increasing spending efficiency, including through better prioritization and selection of projects, remain crucial. There is also a need to continue improving debt management and transparency, as well as debt resolution frameworks, to safeguard macroeconomic and financial stability and strengthen resilience. In addition, the vulnerability of many LIEs to natural disasters places additional burden upon them for which preparedness and adaptation strategies might be needed.

Even though the pace of debt accumulation in LIEs has slowed since 2017, LIEs face particular challenges posed by weak debt management and lack of transparency, as debt dynamics have worsened over the last decade. The public debt-to-GDP ratio continues to decline for fuel-exporting LIEs, as a result of the recovery in international oil prices, fiscal consolidation efforts, and debt restructuring in some cases. At the same time, the situation is more worrisome for HIPC and frontier economies which continue to experience an increase in public debt. Moreover, it is concerning to note that half of the LIEs assessed in this report are at a high risk of/or already in debt distress, and that for non-fuel-exporters, debt has risen by at least 5 percentage points of GDP in recent years. Similarly, it is worrisome that 20 percent of HIPC/MDRI recipients have public-debt-to-GDP ratios larger than those observed one year before the HIPC completion/MDRI point and that interest-to-revenue ratios have steadily increased affecting fiscal flexibility, as noted in Box 1.

To help address debt vulnerabilities, in particular given the past substantial efforts to relieve low-income countries from unsustainable external debt, the Fund-World Bank multi-pronged approach (MPA) provides a useful framework. This is especially relevant in light of substantial development needs. Indeed, despite the progress made in improving public infrastructure and access to education over time, infrastructure in LIEs remains inadequate and continues to be a key impediment to sustainable growth in many countries. In fact, in many developing countries, public investment has been falling even as debt burdens rise. Moreover, delivering on the SDG agenda will require an additional spending of 15.4 percentage points of GDP, so the implied increase in commercial borrowing that would be needed to supplement the financing for achieving the SDGs would be very large.

Moreover, many governments need to be more effective in investing the loans in physical and human capital. This is also highlighted in Figure 20 of the paper. Therefore, higher levels of public investment need to be directed at the right priorities and executed efficiently. To meet the objectives of scaling up public investment and containing debt vulnerabilities, we concur with staff that lenders and borrowers need to engage in sustainable and transparent financing practices. Indeed, the focus should be on debt sustainability, while avoiding debt traps, especially through providing financing on more concessional terms.

As many LIEs face capacity challenges in different aspects of debt management, debt transparency, and debt resolution, as well as managing currency and rollover risks, the Fund should strengthen its technical assistance and advice in these areas. For small states, in particular, capacity development for risk sharing debt instruments is required. Likewise, sustained debt management capacity development is needed to contain the risks from sharp debt accumulation due to recurring shocks. Given that the quality of the debt sustainability analysis depends on the quality and availability of public data, we reiterate the importance of addressing data gaps in LIEs. As noted in footnote 6, the lack of reporting of SOEs liabilities may not necessarily constitute hidden debt, but rather a lack of capacity of these countries to collect the required information, as well as limitations in their legal frameworks. We therefore encourage LIEs to take advantage of Fund capacity development in order to strengthen national capacity in these areas. We are pleased to note that there have been some improvements in the coverage of public debt in the countries where the LIC-DSF has been applied, as shown in Figure 24. However, more efforts are needed to better capture information on SOEs and contingent liabilities in order to help the countries better assess and manage debt risks in a forward-looking manner. Does staff see merit in consolidating both IMF and WB databases on public debt to have a more complete information on public debt liabilities?

Finally, the majority of LIEs are vulnerable to large scale natural disasters, due to inadequate investment in required infrastructure and in well-developed disaster response frameworks. Given that debt-related risks are particularly high for such countries, we welcome in this regard the efforts to intensify the focus and engagement with countries prone to natural disasters. To this end, we welcome the emphasis in the paper on climate-resilient debt instruments or bonds with extendible maturities and official loans with extendible features, given the increasing frequency and severity of natural disasters. We look forward to future discussions on how to improve the resilience of LIEs to natural disasters.

Mr. Bhalla and Ms. Dhillon submitted the following statement:

We thank staff for the excellent analysis on debt and its dynamics in Low Income Economies.

The emerging debt architecture of non-traditional lenders, new instruments, complex structures, access to markets, mostly on non-concessional terms is magnifying the high debt related vulnerabilities. Against this backdrop and despite a slowdown in the pace of debt accumulation, we note the staff assessment that the risk of a near-term widespread debt crisis is somewhat mitigated. Alongside, staff has projected a decline on the public debt. Given the heterogenous nature of LIEs and that this projection hinges on LIEs growth performance, (ambitiously projected at above historical averages), stability of commodity prices and the risks stemming from global slowdown, increased uncertainty, trade tensions and geopolitics, we would urge continued caution on debt management and debt servicing. Given the record high level of Global debt at US$ 188 trillion, with a third of this being public debt both for advanced and developing economies, we would like more details to better appreciate the debt landscape for LIEs. In this context, could staff offer an assessment on a) LIEs private debt levels scenario vis a vis the public debt levels b) To what extent could the high debt levels of the lender country themselves amplify the vulnerabilities amidst slowing growth, especially where governments step in to extend bailouts for private debt?

Exhaustive debt data necessary to assess the evolution of debt is missing, leaving us with a situation of assessing the vulnerabilities amidst many unknowns. Recent academic studies cited in the paper, point to hidden debt, possibility of lending being channeled through State Owned Enterprises and even higher debt levels than the official data reported to the IMF, the BIS or the World Bank's Debtor Reporting System. We are struck with these alarming assessments and do wonder what is constraining International organizations from addressing these data gaps. Off budget data and labyrinthine structures do add to growth challenges and deliver unproductive solutions to address the debt structuring, resolutions and debt payments. Particularly as DSA breeches are best monitored with robust data. Without doubt, a clearer picture of changing creditor composition and magnitudes of debt is essential, even to manage foreign currency debt and associated risks. In this scenario of data fragilities, absence of comprehensive data on collateralizations, which in recent times have shown an increasing prevalence, may further destabilize the debt dynamics. We do note staff suggestion for expanding debt coverage and limiting risks from contingent liabilities, especially from government guarantees, SOEs' debt and PPPs. We appreciate the progress made through the World IMF multipronged strategy on debt. But with the global architecture for debt still operating in silos and would like to hear staff assessment on whether there are any proposals to converge the multiple debt data sources from academic institutions, think tanks and other international institutions? If so, do we have any timelines for this?

With half of the LIEs in this report at high debt risk levels or already in distress, the challenges to balance debt vulnerabilities and development needs are considerable. We encouragingly note the progress on management of debt risks and development of debt frameworks. We welcome the efforts to intensify the focus and engagement with countries prone to natural disaster as debt related risks are particularly high for such countries. The HIPC and related Multilateral Debt Relief Initiative (MDRI) programs have relieved participating countries of over $90 billion in debt. Staff mentions that 20 percent of HIPC/MDRI recipients have public debt-to-GDP ratios larger than those observed one year before the HIPC completion/MDRI point. Considering this observation, does staff envisage further debt relief requirements in the medium term?

On managing debt for borrowers and lenders, we would pitch for sustainable and transparent debt practices and terms. Addressing of debt drivers, a focus on fiscal spending efficiencies, better quality projects, and robust domestic resource mobilization should take centerstage. Many lower income economies face capacity challenges in different aspects of debt management, and therefore, the Fund should strengthen support in this area. For small states, capacity development for risk sharing debt instruments is required. Likewise, sustained debt management capacity development is needed to contain the risks from debt escalation due to re-occurring shocks.

We would also urge the Fund Staff to continue efforts to collate the data on debt levels, structures, conditionalities and the solutions for prudent debt management

Mr. von Kleist and Ms. Koh submitted the following statement:

We thank staff and the coauthors from the World Bank for a well-written and informative report. The report adequately highlights the existing sustainability risks in connection with elevated public debt levels in many "lower-income economies" (LIEs). Many LIEs, especially non-oil exporting countries, face deteriorating debt dynamics, fueled by excessive fiscal deficits and facilitated by greater access to borrowing increasingly from non-Paris

Club creditors. The related trend towards non-concessional financing adds to already high debt servicing costs, further diminishing scarce fiscal space for productive investment. At the same time, future revenues are oftentimes constrained through problematic collateral agreements.

On the back of quite favorable assumptions, staff projects slowly declining debt levels over the medium term. According to these projections, growth is expected to be a stronger driver for a more favourable debt development over the next few years compared to the past. We welcome staff's qualification of these optimistic projections as laid out in the risk assessment matrix.

The overall current situation and outlook remain highly worrying, not least as downside risks are substantial (including an increase in risk premia) which would especially affect countries already at high risk of debt distress. That said, we acknowledge staff's view that in the near-term accommodative international financing conditions act as pressure release valves, reducing the risk for a near-term widespread debt crisis. In view of staff's assessment that risks to baseline projections disproportionately affect countries already at high risk of debt distress, we would welcome a more balanced assessment over the short-, medium and long-term perspective on the downside risks resulting from prolonged globally low interest-rate environments inducing search-for-yield on (hidden) debt accumulation and debt-servicing capacity. To what extent would baseline projections change in response to a prolonged period of accommodative global financing conditions?

Against this background, we reiterate our strong call for decisive, sustained action to bring debt levels on a firm downward path – especially by raising domestic revenue and cutting non-priority expenses, improving the efficiency and efficacy of debt-financed public spending, avoiding non-concessional borrowing, enhancing debt transparency and appropriate due diligence both on the debtor and the creditor side, and improving the overall efficiency of public financial management.

We would like to offer following comments for emphasis:

Horn, Reinhart, Trebesch (2019) "China's overseas lending"

Regarding the creditor composition, we note staff's statement that the scale of China's lending has increased but the precise magnitude remains uncertain. This, together with staff's rather vague assessment of the findings in HRT (Box 2), makes us wonder how more transparency can be achieved, both on the borrower and creditor side. More specifically: What is staff's estimation of the difference between official debt data and actual debt levels? How does staff plan to address the acknowledged differences in the statistics? How does staff handle the uncertainty regarding debt data in the context of program conditionality/Debt Limits Policy/LIC-DSF/MAC-DSA? Would a continuous PC on debt transparency be warranted/feasible?

We would further welcome additional staff comments on the findings in HRT (2019). We note staff's skepticism about HRT estimates with regards to the magnitude of "hidden debt". However, staff does not elaborate further on HRT's assertion of a sharp increase in the incidence of sovereign debt restructurings since 2011 outside of the public domain. As this finding could well suggest an underestimation of debt overhangs, we would welcome additional staff comments on the issue of "missing defaults" or "hidden restructurings". Especially if hidden restructurings coincide with an IMF-supported program, the lack of transparency over terms and conditions of any such restructuring would raise important policy questions for the Fund.

On contingent liabilities, we have the same comments with regards to creditor composition, given staff's statement that "contingent liability risks may still be significantly under-assessed" and "better coverage would be meaningful".

Collateralization

We would have highly welcomed a more comprehensive assessment of collateralization practices in the staff report. Staff points out that comprehensive data on collateralization of official bilateral loans and commercial lending is not readily available and international debt statistics do not collect information on collateral features of loans. This topic and its treatment in the document raise the same questions as with creditor composition and, additionally, the issue of potential implications for the Fund's preferred creditor status (PCS). Could staff outline avenues to overcome these information asymmetries in international debt statistics commenting on the main limitations such as confidentiality clauses? How does staff deal with collateralization in the program context, in particular in GRA cases, with a view to protect its PCS? Would a continuous PC on collateral (ceiling) or a disclosure requirement be warranted/feasible?

Box 3 does not address the IFI/WB aspect (Negative Pledge Clause), which might not only be relevant in LIE cases. In this context we look forward to the joint IMF-WB Staff Note for the G20 IFA-WG referenced in the report and its upcoming discussion in the Board.

We would also like to emphasize the preferred creditor status of the Fund, which is necessary for its lending operations and unique financing mechanism.

State-Contingent Risk-Sharing Agreements

On state-contingent debt, staff finds that "uptake remains limited" and "costs of issuance are high". How reliable is the empirical evidence for this statement? Could staff elaborate further on the extent to which described state contingent instruments and counter-cyclical loans for project financing came into effect at what costs and benefits? We think that the benefits in case of an adverse event should also be adequately acknowledged, while it goes without saying that insurance costs are usually greater than zero. Higher costs have had also been feared in the case of CACs, which did not materialize. Could staff elaborate further on the identified „gaps in the existing architecture for debt resolution" and what they have in mind regarding a "review of the architecture for sovereign debt resolution"?

Mr. Rosen, Ms. Pollard and Ms. Crane submitted the following statement:

We thank the staff team for this excellent paper updating the situation on debt in lower-income economies, including PRGT-eligible low-income countries, as well as frontier economies. We welcome that this paper was done jointly with World Bank staff and that it will be the subject of a technical briefing at the World Bank Board. The findings of this paper resonated well with the group of U.S. Treasury resident advisors providing hands-on advice on debt management on the ground in a number of developing countries, which gives us further confidence in the paper's relevance. This analysis provides important context for upcoming work on the IMF's Debt Limits Policy and the review of the MAC-DSA, and points to the ongoing importance of a broad, multi-pronged work agenda across the Fund and Bank to address rising debt risks in LIDCs.

The overall picture remains very worrying, with rising interest burdens (which fall most heavily on sub-Saharan African countries), inadequate visibility of risks stemming from SOEs and PPPs, and limited progress on improving debt management. Forward-looking trends show that improvements will materialize only if robust fiscal consolidation is combined with above-average growth. Staff judges that three-quarters of countries at moderate risk of debt distress face significant risks to the baseline that could push them into high risk. In addition, debtor countries and creditors that have engaged in debt restructuring have faced a messy, protracted, opaque process with, at times, limited results.

We would like to focus on several policy implications that we draw from the evidence in this paper.

The IMF and World Bank have key roles to play in both supporting and constraining LIDC borrowing to help countries strike the right balance between development goals and debt sustainability. On the supporting side, the IMF's advice and technical assistance should focus on improving debt transparency and debt coverage, enhancing debt management capacity, and improving the quality of public investment to boost the growth impact of public borrowing. The IMF should work cooperatively with the Bank and other MDBs in these areas. On the constraining side, the IMF's Debt Limits Policy (for program countries) and its advice to non-program countries should provide clear markers for when borrowing needs to be slowed, and guidance on appropriate terms, including under what circumstances collateralization or accessing the private market is (and isn't) advisable.

Debt transparency. We appreciate the analysis of gaps in debt coverage and urge continued IMF staff attention to flagging and addressing debt data gaps, including those related to SOEs, PPPs and other contingent liabilities. Regarding the analysis of Horn, Reinhart and Trebesch, even if their estimates are unlikely to constitute a lower bound, their analysis helpfully shines a light on the broader set of borrowing commitments that IMF staff need to be probing and taking into account. Even if baseline DSA figures understandably do not include commitments, DSA's should include a qualitative discussion of what is and isn't known about large umbrella agreements, and not focus narrowly on disbursements only. We wonder what the experience has been with the tailored contingent liability stress tests in DSAs (which is typically where SOE and PPP uncertainties are captured), and the extent to which they have helped flag forward-looking risks for the authorities. We also wonder why the contingent liability stress test is stand-alone, and not included in the combined risks scenario. Staff comments would be welcome. The IMF's toolkit of DSAs, debt limits, policy advice, TA, safeguards policies and data standards need to work together to improve the transparency of fiscal and debt data. Risks that aren't visible can't be appropriately managed.

Growth. The logic of scaling up public borrowing is that it can finance increases in public investment (in physical and human capital) that are needed to support growth. But these associations cannot be assumed – they must be carefully nurtured and strengthened. The paper points out that increases in public borrowing are not always associated with higher public investment, and the impact of investment on growth varies widely. IMF country documents – Article IVs and program reviews – should proactively flag where higher borrowing is not leading to increases in high-quality public investment with decent prospects for boosting growth.

Success stories. The paper cites thirteen countries that achieved significant debt reduction thanks to growth-friendly fiscal consolidation. Can staff comment on some of the lessons that can be learned from these positive stories, and whether broader adoption of such lessons is feasible and could meaningfully bend the curve of debt risks?

The IMF also has an important role in incentivizing prompt and orderly reprofiling and restructuring when needed to restore debt sustainability. In cases of IMF programs, the IMF should require a return to debt sustainability over the course of the program, and avoid large debt repayment cliffs at the conclusion of a program. IMF resources should not be used to inadvertently bail out official or private creditors that lent into unsustainable situations, particularly when such lending was opaque, inappropriately collateralized and/or insufficiently concessional. We recognize that there are limits to the IMF's influence over the debt resolution framework. Emerging creditors – non-Paris Club bilateral creditors, especially China, as well as plurilateral creditors that (unlike the major regional development banks) do not have grant-making capacity for countries at high debt risk – need to also shoulder their responsibility by adopting the kind of practices that the Paris Club and major IFIs developed based on their decades of experience. Private sector creditors also need to be more attentive to debt sustainability issues when making their lending decisions.

Sovereign debt resolution. We agree with staff that, in light of the shifting debt landscape, the debt resolution frameworks are no longer effective in promptly and adequately restoring debt sustainability. The cases of Mozambique, the Republic of Congo and the Gambia are key examples. We look forward to receiving the upcoming G20 Note on Sovereign Debt Resolution and believe that further Board engagement on this topic is merited.

Sustainable lending guidelines. We greatly appreciate IMF staff's work in fleshing out operational guidelines for sustainable lending practices for official creditors and call on all creditor countries to work toward improving their practices against these metrics. When debt reprofiling and restructuring is needed, creditors that don't meet minimal lending standards need to be prepared to accept responsibility for poor lending decisions.

Mr. De Lannoy and Mr. Cools submitted the following statement:

We thank staff for this highly informative report, including the deeper dives on external commercial borrowing. The report clearly demonstrates that enhanced monitoring and reporting of debt in LIEs is of crucial importance. It also underlines the importance of the IMF-WB Multipronged Approach for Addressing Emerging Debt Vulnerabilities.

Outlook and Risks

We are surprised to read that, according to staff's projections, a gradual decline in debt levels is envisaged over the next five years, while in the paper on macroeconomic developments and prospects in LICs, staff pointed to the fact that debt levels will continue to rise and will remain at high levels, especially given the risks that loom at the horizon. Could staff elaborate on the projections which we think are too optimistic, especially in light of paragraph 21 of the Staff Paper, stating: "Risks to the baseline debt projections also arise from global risks, and these appear to disproportionally affect countries already at high risk of debt distress".

The overall picture remains diverse across various groups of LIEs, and points at two disconcerting trends. First, the current trend of increasing alternative non-concessional borrowing by some countries is not likely to be sustainable without further measures to safeguard debt sustainability. Second, the amount of financing needed for achieving the SDG's in most LIEs is not a feasible or realistic target, in particular in the absence of substantially higher private investments at sustainable terms and conditions.

As staff notes, the 5-year debt projections for LIEs are based on a continuing real growth of 5%, stable exchange rates and the absence of external shocks over the projected horizon. This seems to be an optimistic assumption and is likely to be realized only in part of the LIEs. Risks to debt sustainability remain elevated, in particular since debt (service) levels relative to GDP are already moderate to high in many countries and global risks remain prominent. In addition, interest burdens continue to rise. In some LIEs interest to revenue ratios are higher than before HIPC.

Staff observes the increased vulnerability of several LIEs to interest rate, exchange rate, and roll over risk, and underscores the need to assist LIEs in limiting and managing those risks. Given the importance of stable exchange rates underlying staff's debt projections, reducing exchange rate risk is crucial. Local currency swaps and forward contracts could help in managing those risks, as provided for example by TCX.

Debt Transparency and Debt Management

While indicators of debt transparency have improved over time, further efforts to strengthen debt recording are important. Recent country cases suggest that contingent liability risks may still be underassessed, and that non-central government debt is rarely collected by the debt office. We would like to stress the importance of improving SOE debt reporting to overcome concerns of hidden direct and contingent liabilities. In the same vein, we are concerned about the rise of contingent liabilities resulting from public-private partnerships. We encourage staff to draw lessons from their continued efforts on contingent liabilities, such as the granular approach to debt conditionalities in the Angola program.

Productive Investments

In order to create a sustainable reduction in public debt, LIEs should focus on stimulating growth by enhancing productivity. This is particularly relevant for those countries that increasingly rely on non-concessional borrowing, since these loans demand relatively high interest rate payments. To safeguard debt sustainability, linking non concessional borrowing to productive investments is required as well as a strengthening of a country's domestic investment climate and further revenue mobilization.

Debt Resolution

We support staff's recommendation to review the architecture for sovereign debt resolution, given that recent restructuring cases have shown to be very complicated given the changed composition of creditors.

Small States

We welcome the efforts to intensify the focus and engagement with countries prone to natural disaster as debt related risks are particularly high for such countries. Considering the increased frequency and severity of climate shocks, small states are often unable to cope with the consequences of such shocks on their own. With very limited fiscal space, small states often devise countercyclical fiscal policy to deal with weather-related shocks. To this end, we welcome the emphasis in the paper on climate-resilient debt instruments or bonds with extendible maturities and official loans with extendible features, given the increasing frequency and severity of natural disasters.

Many lower income economies (LIEs) face capacity challenges in different aspects of debt management, and therefore, the Fund should strengthen support in this area. For small states in particular, capacity development for risk sharing debt instruments is required. Likewise, sustained debt management capacity development is needed to contain the risks from debt escalation due to re-occurring shocks.

Mr. Buisse, Ms. Levonian, Ms. Riach, Mr. Ronicle, Mr. Rozan, Ms. Nelson and Mr. Rankin submitted the following joint statement:

We thank IMF and World Bank staff for this insightful and timely report on the Evolution of Public Debt Vulnerabilities in Low Income Economies (LIEs).

LIEs have substantial financing needs to achieve the SDGs; the estimate cited by staff suggests that delivering the SDGs will require additional spending of USD2 trillion. However, ODA flows are limited, and we agree with staff that improvements in revenue mobilization, spending efficiency, and FDI will not be sufficient. Borrowing for development is therefore likely to be necessary for many LIEs. As recent experience and the staff report highlights, borrowing must be carefully managed and creditor action is also needed to ensure responsible, transparent, and sustainable financing. We offer the following additional comments.

We note that public debt has risen significantly in recent years across a broad section of LIEs, due to a combination of shocks, expansive fiscal policies, and poor debt management. Debt vulnerabilities have also risen, with the majority of LIC-DSA countries now at high risk of (or in) debt distress. While the median Heavily Indebted Poor Country (HIPC) recipient has seen GDP per capita rise 30 percent since completion point and absolute poverty fall from 53 percent to 41 percent, we note that half of the countries that benefited from the HIPC initiative now have worse interest-to-revenue ratios than before comprehensive debt relief. Although the pace of debt accumulation has slowed since 2017, we view risks to the debt outlook in LIEs as tilted to the downside with some likelihood that ambitious fiscal adjustment and growth projections fail to materialize, global financial conditions tighten, and/or undisclosed contingent liabilities emerge. Going forward, we strongly support continued collaboration between the Fund and Bank on debt issues and encourage active coordination between the Fund, World Bank and others on debt-related technical assistance.

The emergence of new creditors and instruments represents important sources of financing for development, but also presents risks to debt sustainability, transparency, and crisis resolution. While many lower income countries have increased commercial borrowing, we caution that investor sentiment could reverse suddenly, notably in the case of a tightening of international financial conditions. Reliance on commercially-priced debt has also translated into higher debt servicing costs, which reduces fiscal space and limits the scope for countercyclical fiscal policy. We are also concerned that the continued maturity decline on new loans has increased rollover risks in many lower income countries. We encourage all official creditors to be transparent about their lending to other sovereigns, in line with internationally-agreed standards, including the G20 Operational Guidelines for Sustainable Financing. We underline staff findings that collateralized debt can reduce budget flexibility, impair access to non-collateralized financing, raise the risk of debt distress, and greatly complicate debt restructurings. Further work is needed to map the risks and better sensitize borrowers and creditors to such risks.

A key objective should be to boost public debt transparency by providing accurate, comprehensive, and timely data. Despite some improvements, coverage of public sector entities is often too narrow, while contingent liabilities are often not adequately captured, resulting in “debt surprises”. We stress that timely and accurate debt transparency is critical in building trust with investors, ensuring sound and predictable public finance management, supporting domestic capital markets, and reducing debt servicing costs. Improved transparency is also critical to ensuring effective risk assessments that support sustainable borrowing and lending practices, and to ensure policy accountability. We call on the Fund to continue to help monitor and report debt in lower income countries and small states. Could staff comment on opportunities for official creditors to improve disclosure of the terms and conditions of borrowing? /// Can staff provide an update on their work with the Institute of International Finance (IIF) on operationalizing the "Voluntary Principles for Debt Transparency", particularly efforts to publish private sector lending data?

State-contingent debt instruments could help borrowers better manage risks. In particular, we highlight climate-resilient debt instruments. These valuable financial instruments allow vulnerable countries to meet their borrowing needs, while freeing up much-needed resources for post-disaster recovery. We note that delaying debt-service on an NPV-neutral basis should help keep the cost comparable to "plain vanilla" instruments. We encourage creditors and debtors to consider including climate-resilient features in their lending and borrowing operations wherever appropriate. Going forward, how can the Fund improve familiarity and promote uptake of climate-resilient debt instruments among vulnerable countries?

The sovereign debt resolution framework must be reinforced. Recent bilateral restructurings outside the Paris Club framework have been protracted and proved largely ineffective in putting debt on a sustainable trajectory. This poses major challenges for the Fund's ability to support its members when they enter crises. When debt restructuring is required, timely and comprehensive resolution is critical, and this requires efficient creditor coordination. Moreover, prior agreement among official creditors on the general "rules of the game," including principles for sharing information and approaches to burden-sharing, can greatly facilitate work-outs. We therefore encourage all major official bilateral creditors to work with the Paris Club as the principal international forum for restructuring official bilateral debt. We welcome the participation of China, India, and South Africa as ad hoc participants to the Paris Club and hope that they will continue their fruitful and constructive engagement with the Paris Club. Efficient creditor coordination ultimately lowers costs for debtors and creditors alike. On the commercial creditor side, we welcome the inclusion of Collective Action Clauses (CACs) in new international sovereign bond issuances but caution that much of the outstanding debt stock still lacks modern CACs, which may complicate future debt restructurings. We look forward to early staff engagement on the G-20 Note on Sovereign Debt Resolution.

Debtors and creditors must work together to prevent and resolve unsustainable debt situations. We recognize that countries with significant debt burdens face a difficult trade-off between scaling up public investment to meet development objectives and containing debt vulnerabilities. We encourage countries with elevated debt risks to focus on raising domestic revenue, increasing spending efficiency, improving debt management and transparency, and limiting non-concessional borrowing to investment projects with credibly high rates of return. As emphasized in the Addis Ababa Action Agenda, creditors also have a responsibility to lend in a way that does not undermine a country's debt sustainability. To this end, we encourage creditors to follow sustainable lending practices, such as those identified in the G20 Operational Guidelines for Sustainable Financing diagnostic tool. We also underline the importance of concessional financing in helping borrowers meet development objectives while maintaining debt sustainability. Can Staff indicate how the review of the DLP could help countries balance the tradeoff between scaling up public investments to meet development objectives while containing debt vulnerabilities?

Technical assistance has a key role to play to develop debt management capacity in LIEs. We welcome the Fund and Bank's continued efforts in this regard, particularly through the DMF. We encourage the Fund, Bank, and other international partners to continue to collaborate closely on the analysis and identification of debt risks, and to jointly tackle challenges.

Mr. Palei and Mr. Tolstikov submitted the following statement:

We thank staff for the informative overview of the recent debt-related developments in lower income economies (LIEs). We share staff's concern about the substantial increase of LIEs public debt since 2012. Staff assessment shows that the SDGs cannot be achieved only through mobilization of domestic resources, FDI and ODA, which require the use of borrowed resources. Global search for yield and increasing capacity of non-traditional lenders provide an opportunity to mobilize additional resources on relatively favorable terms. However, in order to avoid the repetition of the previous debt crises in LIEs, public debt management must be strengthened, and international coordination improved.

Substantial increase in public debt levels in LIEs since 2012 is alarming. Ten LIEs are already in debt distress. 20 percent of HIPC/MDRI recipients have public debt-to-GDP ratios larger than those observed before the HIPC completion point. Gross fiscal financing needs are rising. Although the average debt level has stabilized since 2017, it is mostly explained by improved external conditions for fuel exporters, while public debt in many other LIEs continued to grow steadily. We note staff's cautious forward-looking optimism, as they expect a moderate decline in the average LIEs debt over the next five years. These predictions are based on the assumptions of ambitious fiscal consolidations, more favorable interest rate-growth differentials and stable exchange rates. These assumptions may prove optimistic, for example, in case of substantial deterioration in global economic conditions.

In view of the heightened public debt vulnerabilities in LIEs, the Fund should emphasize the need to implement policies aimed at containing debt accumulation, improving public debt management, and strengthening monitoring of debt vulnerabilities. Debt management capacity in LICs, while improving, remains weak. Debt Management Performance Assessments show underperformance on all dimensions of debt management. We note that the analysis of the "hidden debt" issue has shown that its magnitude could be overestimated. This discussion, however, highlights the need for stronger reporting systems and improved transparency in the debtor countries. Debt reporting coverage in most LIEs is insufficient, especially with regard to state and local governments operations and contingent liabilities. Therefore, the Fund in collaboration with other partners should increase its support for the authorities' efforts to strengthen debt management, improve debt transparency, and develop necessary institutional capacity.

Recent experience with debt resolution in LIEs exposed growing weaknesses in this process. As the Paris Club is no longer has a leading role in most LIE debt restructuring cases, the process is often more cumbersome and protracted. Overall, we agree with staff on need for a review of the architecture for sovereign debt resolution.

Ms. Mannathoko and Mr. Sitima-wina submitted the following statement:

We welcome this well written update on public debt vulnerabilities and the coverage of the report, including the discussion of both debtor and creditor roles. The debt-growth nexus remains a critical concern for low income and developing countries tackling large poverty rates. We see it as a core challenge that the IMF needs to address to safeguard macroeconomic and social stability going forward. The 2015 IMF/World Bank Global Monitoring Report indicated that without the faster per-capita income growth needed for poverty reduction, by 2030 over three quarters of the world's poor will live in SSA. At the same time, this report estimates substantial additional investment spending requirements needed to meet the infrastructure-related Sustainable Development Goals (SDGs) by 2030. Thus, even as the Fund seeks to promote debt sustainability in SSA, the sizable investment needed to raise per capita GDP growth, and so limit poverty rates, social unrest, instability, and negative global spillovers, cannot be ignored.

We encourage SPR to think outside the box as it tries to resolve the debt-growth conundrum and as it frames new ways to secure affordable long-term pro-growth infrastructure financing and helps countries design sustainable debt profiles. We also ask RES to conduct analysis that will inform a meaningful global solution to the problem of frequent, recurring spillovers and related shocks faced by developing countries. These shocks curtail growth and exacerbate debt. Staff thoughts on exploring new ideas and solutions are welcome.

Trends: Regarding the latest debt trends, it is encouraging that the pace of debt accumulation has slowed in recent years. The findings this year confirm the general experience in our constituency, where the average LIC debt ratio has stabilized since 2016 and where the weighted average debt ratio for mineral exporters is now significantly lower than that for more diversified non-mineral economies. We also find that the countries that are currently in debt distress in our constituency are all characterized by fragility;[1] furthermore, half of these are commodity dependent and vulnerable to commodity price shocks, and half have to contend with repeated climate shocks. Thus, work being done by the Fund focused on debt sustainability in FCS remains especially important. Could staff elaborate on progress in this regard?

Country specifics: While the generalizations in this report provide a useful broad-brush overview of debt-related developments, we find that generalizations tend to hide the significant heterogeneity in our countries, and that caution is required in the application of findings or policy lessons at the country level. An example is the ongoing debate and conflicting findings in the literature on debt and its causal relationship with growth. This also extends to debt limit thresholds where the literature shows there can be significant heterogeneity between countries even at similar levels of development. It is important therefore, to model country level parameters and ensure that recommendations do not overlook important country specific factors. We appreciate the country specificity in DSAs and in staff's bilateral discussions with authorities and encourage more emphasis on enhancing this and allowing adequate modeling flexibility to accommodate differences. Staff views are welcome.

Debt and data coverage: We recognize the need for ongoing measures to expand the coverage of public sector debt data for all countries. This is critical for policy analysis, comparability and ultimately, effective

[1] Mozambique was removed from the FCS group in 2018, however it is still characterized by fragility.

management of debt vulnerabilities. In this context, we would appreciate a clarification on the differences in the definitions of public debt in the LIC DSF and the WEO as noted in footnote 1 on page 5 of the report. Ideally, we would urge consistency in the definition. We also thank staff for the clarification in the analysis in Box 2 for 14 LIEs that are top borrowers from Chinese entities, that any hidden debt as implied by HRT (2019) would in fact be lower than alleged. Inaccurate messaging such as that discussed for HRT (2019) is of concern as it unfairly exacerbates risk perceptions in markets and can lead to higher borrowing costs. The role that Fund communications play to deter this remains central.

On collateralized debt, we appreciate the information provided in Box 3 featuring the use of escrow accounts, pre-purchase agreements related to natural resources, and commodity barter transactions. There is also merit for both creditors and borrowers to engage in a multi-stage vetting process before concluding collateralized agreements. That said, we look forward to the G20 overview paper and to the guidance on collateralized debt that will arise from upcoming discussions of the multi-pronged approach to addressing debt vulnerabilities.

Risks and debt vulnerabilities: Given that shifts in the structure of debt have led to further increases in the interest burden faced by countries, and that the likelihood of interest rate normalization in the medium term is high, we would welcome advance planning through analytical work by SPR and RES to inform both the least disruptive approach to interest rate normalization that will limit negative spillovers to LIDCs, as well as the optimal preparation and response path for indebted LICs once interest rates normalize. The possibility of a widening interest rate-growth differential and resultant fiscal sustainability challenges is worrisome. Staff views are welcome. Related to this, while we acknowledge the work that has been done to reduce optimism bias in GDP projections, we still see the need for attention to this issue and note its implications for borrowing decisions and actual versus projected interest-growth differentials.

Debt and the SDGs: Going forward, we agree that countries with space to borrow will have to strike a delicate balance between the benefits and risks of commercial borrowing as they plan and manage their debt profiles in pursuit of the SDGs. As the report notes, the implied increase in commercial borrowing that would be needed to finance the SDGs is very large. Given this challenge, we see merit in the IMF exploring ways to motivate long-term concessional financing supported by grants with repayment profiles closely aligned to the timing of related infrastructure investment returns. The absence of such a long-term financing mechanism has resulted in expensive non-concessional debt being used to finance infrastructure development. Staff comments are welcome.

Debt and climate shocks: We welcome the efforts to intensify the focus and engagement with countries prone to natural disasters, where debt related risks are particularly high. Considering the increased frequency and severity of climate shocks, affected countries, including small states are often unable to cope with the consequences of such shocks on their own. With very limited fiscal space, they must often devise countercyclical fiscal policy to deal with weather-related shocks. To this end, we welcome the emphasis in the paper on climate-resilient debt instruments or bonds with extendible maturities and official loans with extendible features, given the increasing frequency and severity of natural disasters.

Capacity challenges: Many LIEs face capacity challenges in different aspects of debt management, and therefore, the Fund should strengthen support in this area. For small states in particular, capacity development for risk-sharing debt instruments is required. Likewise, sustained debt management capacity development is needed to contain the risks from debt escalation due to re-occurring shocks.

In LIDCs, capacity development on climate resilient debt management strategies and long-term debt management for the SDGs remains essential. Furthermore, to help manage risks related to the evolving structure of debt, we urge the Fund to do its part in building capacities to address gaps that remain in current debt management and debt data transparency. It is concerning that the Debt Management Performance Assessment (DeMPA) for 2008-18 shows that more than 30 percent of frontier market economies are still unable to meet all minimum requirements for performance indicators. We count on the multi-pronged approach framework to help address debt vulnerabilities and close these gaps. Steps that the authorities can take to benefit should be clearly communicated.

Finally, on debt resolution, we underscore the need for official creditors to reconsider the debt-growth nexus in the context of recurring shocks, and the importance of grant and concessional financing to facilitate debt restructuring when needed.

Mr. Tanaka, Mr. Harada and Ms. Mori submitted the following statement:

We thank staff for the comprehensive analysis paper on the evolution of public debt vulnerabilities in Lower Income Economies (LIEs). While the pace of debt accumulation has slowed somewhat since 2017, severe debt situations in many LIEs still warrant continued monitoring. The international community should work together to address this issue so as not to repeat a debt crisis. We expect the Fund to continue to closely engage with this issue, on which we request the staff to regularly update.

While it is crucial for LIEs to ensure necessary investment finance with keeping debt sustainability, new challenges on public debt of LIEs have been engendered. As pointed out in the staff report, financial landscape surrounding the public debt has been fundamentally changing. Firstly, the structure of creditors has become altered. Lending from commercial creditor and Non-Paris Club official creditors has been expanding. Secondly, on this backdrop, increased non-concessional borrowing has led to raising interest burden and shortening the average maturity. Lastly, the diversifying creditor base and types of debt instruments can complicate the process of debt restructuring. In some cases, collaterals of untied loans to commodity exporters include revenue stream from natural resources. Such loans could have adverse effect on sustainable development of LIEs.

Under these challenges, there are growing concerns on the public debt situations of LIEs. Half of LIEs and more than 40 percent of LIDCs are currently assessed at high risk of debt distress or already in debt distress. Public debt level has arisen in HIPCs that are benefited from significant debt relief in the past. In half of the HIPCs, the interest burden has risen above the pre-HIPC Completion Point level.

Given these environmental changes regarding public debt of LIEs, we would like to make a few comments as follows:

Domestic revenue mobilization efforts in LIEs are crucial to bring the debt downward trajectory. We note the large financing gap to achieve SDGs. While the baseline projections envisage a slight public debt decline over the next five years, it assumes ambitious fiscal consolidation and strong growth. We encourage LIEs to decisively implement fiscal consolidation efforts including domestic revenue mobilization and improving spending efficiencies. Given the trade-off between scaling up public investment and containing debt vulnerabilities, enhancing investment efficiency is indispensable. We encourage the LIEs to improve infrastructure governance with support from the Fund's TA including PIMA and its follow-up.

Efforts not only by the borrowers but also by the creditors are crucial to address the abovementioned new challenges. In this context, under G20 Japanese presidency last year, Japan enhanced joint efforts by borrowers and both public and private creditors and consequently created tangible deliverables. It is highly important to continuously follow up these initiatives going forward. For the creditor's side, it is important to ensure that their lending is compatible to borrower's debt sustainability, in compliance with G20 Operational Guidelines for Sustainable Financing (OGSF). As recommended in the staff report, we strongly encourage the creditors to improve lending practice through self-assessment by using the OGSF diagnostic tool. For the borrower's side, we expect the Fund, in collaboration with the World Bank, to implement technical assistance to improve their capacities of debt management and of debt transparency, under the framework of the IMF-WB multi-pronged approach. From a view point of supporting the activities, Japan made funding contribution to the Data for Decision Fund and Debt Management Facility as toolkits under the framework. We look forward additional contribution from other donors.

More progress in improving debt transparency is needed. While we welcome the improvement of debt transparency indicators, more needs to be done to increase transparency. Especially, expanding debt coverage is essential given contingent liability risks arising from incomplete SOEs debt data and from increase in arrangements of PPP. We also emphasize the importance of transparency of collateralized borrowing as it is indispensable to plan development strategy of a country.

Mr. Jin and Ms. Zhao submitted the following statement:

We thank staff for the informative report, which clearly documents the evolution of public debt vulnerabilities in Lower Income Economies (LIEs). We would like to offer the following comments.

LIEs' increasing borrowing from non-Paris Club creditors could be understood in a broader context. Since the global financial crisis, Paris Club creditors and multilateral creditors have provided declining support to low-income countries due to the creditors' own difficulties or changes in their lending policies. At the same time, the shares of non-Paris Club creditors in the world economy have risen, and their economic complementarities with low-income countries are also higher. Meanwhile, the excessive liquidity generated by some developed countries flowed partly to emerging economies, which was in turn used as loans to low-income countries, reflecting the second round of the spillover effect. Therefore, the increasing financing from non-Paris Club to LIEs, which has contributed to accelerating development and diminishing the financing gap urgently needed by LIEs, has its own rationale.

We take positive note that the median public debt in LIEs appears to have stabilized since 2017. We also welcome staff's' projections that point to a gradual decline in debt levels over the next five years. On analyzing debt related risks, we encourage staff to use the balance sheet approach when conducting LIC DSAs. Could staff elaborate on the progress made so far in adopting the balance sheet approach in conducting DSAs?

The analysis on debt issues needs to be growth-oriented and should differentiate between debt issued for productive investment and for non-productive expenses. Debt sustainability cannot be achieved by just restricting debt growth. Sound and sustainable economic growth plays the key role for low-income countries to finally escape the debt distress. Page 23 of the report states that the countries that received financing from the international bond market did not improve their economic growth in the next five years, which further highlights the importance of distinguishing productive and non-productive debt. Those projects that generate more revenue than needed to cover the debt services should be encouraged and better managed, so that the positive externality of the project could be reflected by the government revenue and the project's profitability in a timely manner. Staff's comments are welcome.

On collateralized debt, we encourage staff to take a growth-oriented approach and make case-by-case analysis. For collateralized debt which is backed by a project's own revenues and/or does not have an adverse impact on the country's repayment to other lenders, undue restrictions should be avoided. Even for projects that are not directly related to the collateral, the collateralized borrowing is still not necessarily inappropriate. Financing the infrastructure with the natural resource as collateral is essentially a goods for goods trade, based on countries' comparative advantage. In this regard, the collateralized borrowing, when the collateral is not hard currency but a commodity whose value is subject to market condition, will not necessarily crowd out the borrowing country's resources to repay other lenders. Meanwhile, while some infrastructure projects might not be profitable on their own, they will generate significant positive externality and overall economic returns. If carefully managed, the collateralized borrowing may help a country fully tap the potential of the otherwise under-mobilized resources for the much-needed capital spending, and therefore strengthen rather than weaken the countries' budget flexibility.

On financing terms, we encourage staff to grant more flexibility in categorizing different types of loans. The dichotomy that dividing loans into the concessional loan and the commercial loan has caused more concerns, given that the financing demands from LIE have become more various and continuous rather than dichotomous and discrete. In this regard, the borrowing countries should have some flexibilities to choose semi-concessional funding. Whether the loan is concessional, semi-concessional, or even non-concessional should not be the most important factor as long as the debt could generate positive returns. We encourage staff to do more research in this regard.

We welcome the improvements made so far on most dimensions of debt management by LIEs. Going forward, more needs to be done in this field, including enhancing consolidated or coordinated financing across sectors by the authorities. We encourage the Fund to provide countries with related technical assistance to develop this cross-sector coordination capacity if necessary. We also encourage lower income economies to enhance sustainable financing, including raising domestic revenue and increasing spending efficiency.

Mr. Mojarrad, Mr. Raghani, Mr. Lopes Varela and Mr. Osei Yeboah submitted the following joint statement:

We thank IMF and World Bank staffs for an informative report and commend them for their close cooperation in addressing debt issues of critical importance to lower-income economies (LIEs).

We take positive note of the decelerating pace of public debt accumulation in LIEs since 2017 and are comforted to note that the risk of a near-term widespread debt crisis in LIEs is still muted. However, cases of debt vulnerabilities should be tackled in a holistic and timely manner. There is a heterogeneity of circumstances facing those countries. We would like to stress that sweeping generalizations should be viewed with caution, given the wide differences of countries' debt experiences and outlooks. For instance, public debt-to-GDP ratio for oil exporters has declined due to gradual recovery, progress in fiscal consolidation, higher global oil prices, and improved debt management. On the contrary, debt dynamics in non-oil exporting LIEs have deteriorated, and vulnerabilities remain high, given their large fiscal deficits and the increase in adverse interest rate-growth differentials. We concur that these vulnerabilities need to be addressed in a timely manner through the multi-pronged approach advocated by the Fund and the Bank staffs.

Recent debt developments in LIEs also highlight the need to further strengthen not only public debt management but also financial integrity. We note that LIEs are resorting to more expensive sources of financing given the increased scarcity of official development assistance (ODA). In addition, with the rise in the share of foreign currency loans and floating rate loans in total borrowing, LIEs are more exposed to exchange rate and rollover risks in addition to interest rate risks. At the same time, the rising share of non-resident holdings of domestic debt in some countries has increased their exposure to volatile capital flows. Furthermore, we should also not loose sight of the negative impact of illicit financial flows (IFFs), given the close connection between IFFs and public debt that raises the importance of enhancing anti-money-laundering frameworks and tackling IFFs.

There has also been a change in the structure of lenders from traditional development partners to non-Paris Club creditors and commercial sources, bearing both opportunities and risks. With increasing diversification of funding sources, the level, range and complexity of borrowings have risen. While the diversification in principle presents opportunities for LIEs to address their public investment gaps--and that should be harnessed--the attendant risks and vulnerabilities also deserve urgent attention. In the context of limited buffers to respond to shocks, we share the view that in addition to reinforcing debt management, policy priorities for LIEs should include boosting domestic revenue mobilization, improving spending efficiency, and strengthening governance.

There is a need to strike the right balance between meeting important development needs and safeguarding debt sustainability. There could be instances of optimism about projected debt trajectory and financing availability. We also acknowledge that growth forecasts have been historically sanguine and tend to be associated with higher borrowing, and that risks to the global outlook remain elevated. However, the report also suggests that debt forecasts have been more accurate in recent years. In this context, LIEs need to ensure that their borrowing is used efficiently to finance public investment, which has a strong positive impact on growth in the long-run, while preserving debt sustainability.

That said, the availability of appropriate financing remains a daunting challenge for many LIEs. The report's findings that, despite the best efforts by LIEs to mobilize domestic revenue, attract FDI and enhance expenditure efficiency, achieving the 2030 SDGs is becoming increasingly more challenging and may already be beyond the reach of most LIEs. Moreover, the scale of implied non-concessional borrowing to finance the additional SDG-related expenditure is simply unrealistic even under the most optimistic assumptions, as LIEs will need to continue to rely on concessional loans and grants.

The IMF and the World Bank should also play a more pro-active role in helping LIEs to strike the right balance in development-indebtedness nexus. In this regard, we would appreciate a more in-depth analysis on how the IMF and other development partners could help LIEs mobilize more concessional resources to better finance the transformation of their economies in addition to their efforts to increase domestic revenue mobilization.

We welcome the increased focus of the Bretton Woods institutions on the challenge of climate change and, more specifically, the ongoing analysis of climate-resilient debt instruments. We encourage the IMF and the World Bank to continue with their efforts to accommodate these challenges with tools to fortify the countries' resilience to natural disasters and mitigate climate-related shocks, particularly in small states with minimal fiscal space. To this end, we would appreciate exploring the degree to which weather-related shocks have contributed to debt distress in these countries.

We agree with staff that debt transparency and comprehensive coverage of public sector obligations--including guaranteed and unguaranteed debt, and SOE and-PPP-related contingent liabilities--are important initial building blocks of an effective debt management strategy. LIEs have made important progress in these areas but more needs to be done. In this regard, IMF and World Bank's technical assistance (TA) is critical in strengthening LIEs' debt institutions and debt management capacity and in addressing data shortcomings.

We concur that the current debt resolution framework is not entirely practical and should be reviewed. This calls for a holistic approach to address, among others, the effectiveness of some instruments and debt restructuring hurdles. Preventing or minimizing the risk of future debt crises require emergency measures, sustainable lending practices, and, indeed, a new debt restructuring mechanism. We see merit in official creditors paying appropriate attention to helping maintain debt sustainability in borrower countries, including by providing financing on more concessional terms. Improved coordination among between creditors on this front can also prove very helpful.

Mr. Bevilaqua, Mr. Saraiva and Ms. Florestal submitted the following statement:

We thank staff for the timely update on the Evolution of Public Debt Vulnerabilities in Lower Income Economies (LIEs), which is an invaluable input for the upcoming discussion on the Debt Limits Policy (DLP). The persistence of weaknesses, such as gaps in debt management and data transparency, is well underscored. At the same time, the progress registered in reporting as well as in the expanded coverage of guarantees and contingent liabilities are acknowledged. While the pace of debt accumulation has slowed, the underlying debt dynamics of LIEs have worsened over the past decade. Overall, rising interest costs, decreasing maturity of new external debt, diminishing interest-growth differentials, hidden direct and contingent liabilities and the efficiency of debt-financed public spending remain widespread concerns. That said, caution is warranted in drawing general conclusions given the diversity of country experiences.

Increasing the availability of concessional loans and grants, complementing the domestic resource mobilization efforts, will be critical to enhance the likelihood of LIEs meeting the SDGs while mitigating the risk of unsustainable indebtedness. In the context of diminishing fiscal space, countries continue to face the difficult tradeoff between containing debt vulnerabilities and increasing investments, particularly to achieve the SDGs. Mobilizing domestic revenues continues to be the policy of choice to sustainably support investment capacity. However, the gap to social and investment needs to meet the SDGs cannot conceivably be covered by domestic sources in most LIEs. The call to official creditors to adhere to sustainable financing practices and to provide financing on more concessional terms is therefore appropriate. Furthermore, better prioritization and selection of public investment projects towards greater efficiency as well as improving the attractiveness to foreign direct investment remain of the essence. That said, part of the gap will most likely have to be met by commercial lending, requiring the adherence to sustainable practices. Accordingly, a continuous hardening of debt terms in average would be expected for LIEs – even as favorable global liquidity and financial conditions lessen the immediate risks of a generalized debt crisis.

Even with the recent stabilization in indebtedness, debt indicators have remained high and, while sources and levels of vulnerability vary, countries in fragile situation (FCS) and small states remain among the most vulnerable. Not surprisingly, at end-2019, FCS constitute the bulk of LIEs in debt distress, reinforcing the importance of Fund's deeper strategic engagement with such countries. Meanwhile, on average, small states have somewhat reduced indebtedness in the past few years. However, out of ten LIEs in debt distress, two are small states very vulnerable to natural disasters and climate change. Hence, we welcome the attention given in the report to climate-resilient debt instruments or bonds with extendible maturities, as well as on official loans with extendible features. Together with risk-transfer instruments, these can be very valuable for small states and countries in fragile situations in addressing risks linked to natural disasters or other external shocks. As LIEs' familiarity and knowledge of these instruments may be limited, we encourage the Fund to help disseminate information about them and strengthen the capacity of small states and FCS countries to use them. Having said that, we wonder whether there are lessons learned from recent developments and trends in debt vulnerabilities that suggest the need for readjusting the multi-pronged approach (MPA) or changing specific aspects of the debt limit policy in gestation. Conversely, we wonder if any measures taken within the framework of the MPA would have contributed to recent developments?

While debt restructuring in LIEs has become more complex and, in some recent cases, have not led to restoring sustainability, we are not convinced that a change in the framework is warranted. Perhaps the current debt restructuring framework had been developed with the "emerging market paradigm" as a background without devoting sufficient attention to issues that are more pertinent to the case of LIEs. That said, the framework must retain its generality and not be reshaped in a particular way to address the specificities of LIEs, while risking losing relevance for other cases. The disseminated use of collective action clauses (CACs) in LIEs bonds is welcome. However, the impact of CACs in debt restructuring would be limited due to the relatively small share of bonds in total debt for most LIEs. In addition, the fact that many restructurings have taken place outside of an IMF program contributed to the underlying causes of the debt problem not being addressed. We wonder if, in the absence of a program, the IMF engagement in LIEs' debt restructuring could be strengthened by enhancing TA or a more targeted surveillance work?

The findings in Box 2 about "hidden debt" are thought-provoking and call attention to the need to enhance the coverage of debt data and adequately assess contingent liabilities of SOEs and PPPs, while distinguishing between debt commitments and debt outstanding. At the same time, as underscored by staff, a fair picture of debt servicing capacity requires proper accounting of SOEs' and other public entities' own revenues. Although the report confirms that PPPs only concern a handful of countries, given LIEs' rising interest in them, wider dissemination of information and greater technical support may be warranted to ensure they do not become a source of debt vulnerability.

Authorities should remain focused on making progress on debt management and governance, and the Fund should stand ready to support such efforts. Increased sophistication in debt management is registered in some countries while the strengthening of basic debt management capacity is needed in others. Overall, the Fund and the Bank should help LIEs improve debt management capabilities to reduce the likelihood of entering unsustainable debt paths, while fostering the financing of high-return development projects. In particular, greater exposure to and understanding of new instruments – their potential and risks – would be highly valuable. In the case of collateralized debt, since it can either help or hinder development outcomes, the Fund could play an instrumental role in supporting the vetting process and facilitating proper access to this additional source of financing when warranted. In this regard, we wonder whether guidelines are being developed to provide staff with a clear institutional view on collateralized debt?

Mr. Chodos and Ms. Moreno submitted the following statement:

We thank staff for the comprehensive report. It addresses one of the serious sources of concern in lower income economies (LIEs), including debt coverage and disclosure, debt management, transparency and restructuring. We commend the authorities for their efforts to curb the debt accumulation trend, to foster domestic revenue mobilization, and to attract more foreign direct investment. Nevertheless, more needs to be done as the underlying debt dynamics have worsened and key additional risks to the outlook have emerged. The Fund should continue supporting LIEs through capacity development and training, as well as data building, including on collateralization.

Despite a decrease in the median debt-to-GDP ratio, 49 of the 76 LIEs and 41 of 59 low income developing countries (LIDCs) have experienced an increase in the ratio. Baseline projections envisage that LIEs' public debt will decline slightly over the next five years—by 3 percent of GDP over 2019-23, and by 2 and 9 percent of GDP respectively for LIDCs and non-LIDCs—assuming sustained fiscal consolidation and strong growth. Moreover, the interest burden has continued to rise, and 37 percent of LIEs remain at high risk of debt distress (14 percent already in debt distress) as of end-October 2019. In a previous staff paper, countries under Fund-supported programs were reported to have better performance on debt vulnerabilities than the overall group. Comments on the role of program conditionality are welcome.

We take note and welcome the increasing role of commercial creditors as a source of bond debt. Foreign-currency denominated bonds have been the fastest growing source of financing in LIEs, although concentrated in only 22 countries -the top 10 account for 90 percent of the borrowing since 2004. Eurobond issuances have almost tripled from an average of 6 billion dollars per annum during 2012-16 to about 16 billion dollars per annum in 2017-18. Even though the resulting portfolio of creditors is more diversified, it might be a worrisome development considering the high share of countries with high risk of, or in, debt distress, who would benefit from concessional borrowing. Moreover, this trend has coincided with worsening debt dynamics and greater vulnerabilities as growth rates have typically not picked up. Can staff comment whether there is a causality relation from buildup in non-concessional debt to lower growth? Can staff further elaborate on the reasons behind the expected decrease of the share of concessional debt?

Staff notes that lending by China could be higher than indicated by official data reported to the IMF, the BIS, or the World Bank's Debtor Reporting System, distorting sovereign debt risk assessments. The evidence described in Box 2 suggests that the magnitude of the "hidden debt" is not as large as the Horn, Reinhart and Trebesch (HRT, 2019) study suggests. Could staff elaborate further on how the exposure to China—hidden or not—affects sovereign debt risk and to what extent it distorts the risk assessment?

Regarding the structure of the debt portfolio, we note that the shifts in the composition of debt have further affected interest rate, exchange rate, and rollover risks. The latter mainly because of the continued decline in the average maturity on new external commitments, and despite lengthening in maturity in several economies' local currency debt. Could staff comment on the capacity of LICs to build foreign exchange reserves? We commend the steps that many countries have been taking to better manage currency and rollover risk, like for example, using debt buybacks to ease near-term financing risks and reprofile external debt. We encourage the authorities to continue exploring ways in which these risks can be contained.

While we acknowledge that progress has been made, we agree with staff that further improvements in debt management and transparency are needed. There is a need to keep up with the increasing complexity of public debt and the prevalence of large contingent liabilities whose risks may be significantly underassessed. In addition, it is worrisome that debt resolution frameworks do not appear to be effective enough. This has prevented effective restructurings and, if not addressed, it might put at risk future needed restructurings. Having said that, we encourage the authorities to underscore the importance of the use of funds, highlighting the importance of growth-friendly investment and balance of payment-consistent debt.

As this chair has previously highlighted, the main challenge faced by LIDCs is to achieve and sustain higher inclusive growth. In this regard, the needed efforts to improve public debt and investment management, transparency, coverage, disclosure, and statistics, should be embedded in a framework that complements the additional steps needed to boost economic growth and the continuous efforts to achieve the Sustainable Development Goals for 2030.

The Acting Chair (Mr. Zhang) made the following statement:

As you know, this is the third report on the subject of The Evolution of Public Debt Vulnerabilities in Lower Income Countries, following the chapter that was dedicated to this topic in the 2018 report under the title Macroeconomic Developments and Prospects in Low-Income Developing Countries (LIDCs). This report is also the second joint report together with the World Bank. As you will recall, the last joint report with the World Bank was done in late 2015. This time around, this report covers a wider range of countries, beyond what we call the LIDCs. That is why we have a new name; low-income economies (LIEs).

Besides covering the evolution of debt vulnerabilities, this paper also aims to provide a deeper discussion of the ongoing evolution of the creditor space and the types of credit open to low-income economies.

Throughout the report, attention is given to difficult issues that have featured in the Bank and the Fund’s operational work, such as collateralized loans, the treatment of state-owned enterprise (SOE), et cetera.

A key aspect of the paper is that it examines the initiatives countries are taking and tries to strengthen the debt management frameworks and improve debt transparency, which is a joint international effort in recent years. The paper also covers reviewing the lessons learned from the recent debt restructuring experiences.

With that, I look forward to a constructive discussion this morning. Before I open the floor, let me give the floor first to the staff to address some of the issues which had not been addressed in the set of answers to the technical questions which has been circulated to you before the Board meeting. Staff, please.

The staff representative from the Strategy, Policy, and Review Department (Ms. Hakura), in response to questions and comments from Executive Directors, made the following statement:[2]

I thank Directors for their interest in the staff report. I would also like to take this opportunity to thank our colleagues from the World Bank for their collaboration on this report. You will have seen that we have provided written answers to the questions raised in the gray statements. Let me address two themes that arose in the questions raised by Directors.

First, several Executive Directors inquired about what the Fund can do to catalyze progress in addressing the issues raised by growing debt vulnerabilities. Of course, the main IMF-World Bank efforts are embodied in our joint multi-pronged agenda. As indicated in our responses, in May, there will be an informal Board meeting to brief Executive Directors on the multi-pronged approach, so I will not go into detail on that here. However, it is useful to remind that, on that occasion, we also intend to specify a monitoring framework for the multi-pronged approach.

One of our largest single initiatives over the last year has been the implementation of the new low-income countries Debt Sustainability Framework (DSF). There has been considerable progress. Let me highlight four aspects.

First, to date, the new LIC DSF has been implemented in 56 of the 69 countries that are eligible to use it. Already, debt coverage in 11 countries has been broadened.

Second, it is true that a lot of work remains to be done to further improve debt coverage in Debt Sustainability Analyses (DSAs). We highlight this in the report. But it is important to note that the implementation of the new LIC DSF has kicked off a dialogue between IMF country teams and the authorities on the coverage and the comprehensiveness of debt statistics. There are clear signs that this could be the beginning of a process to further enhance the transparency and monitoring of debt statistics.

A third thing to highlight is that we have expanded our capacity development and outreach efforts on the LIC DSF. The external training is funded from the Debt Management Facility trust fund, to which several countries have made key financial contributions.

[2] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

I would also like to point out the interest shown in our training on the LIC DSF by officials from creditor countries. This includes officials from key non-Paris Club creditors. In this context, it is worth noting that an important creditor, China, has adopted a version of the LIC DSF for its own use.

My final observation on the adoption of Debt Sustainability Frameworks pertains to some of the frontier economies covered in the report, like Pakistan and Nigeria. These lower income economies with market access have been using the Debt Sustainability Analysis for Market-Access Countries (MAC DSA). Following the review and upgrade of the LIC DSF, a similar review process for the market-access countries is now well advanced. We anticipate that many of the coverage and disclosure requirements in the new LIC DSA, including the enhanced assessment of contingent liabilities, will carry over. A March Board briefing is planned on this.

A second theme in Directors' questions pertains to the quality of macroeconomic projections. Some Directors expressed concerns that staff projections are too optimistic, and some expressed a concern about pessimism about investment returns.

Country teams use various methodologies and models to make their macroeconomic projections. There is no one best approach, and teams are free to use the approach that they feel is most relevant for their country case. There could, of course, be a case for a greater disclosure of the forecasting methodologies deployed, but that is another issue that would require careful consideration.

In any event, the new LIC DSF features some tools to gauge the realism of the macroeconomic projections. For instance, there is a tool that can be used to assess the realism of the implicit fiscal multiplier. There is also a tool that can be used to assess the realism of implicit public investment's impacts.

The realism tools can flag both relative optimism as well as relative pessimism in the projections. The guidance note for the LIC DSF stipulates that the findings of these realism tools should be discussed in the DSA write-ups.

The track record with using these tools in the LIC DSF is still short, but the experience with the realism tools in the MAC DSA has been encouraging, at least in the sense that errors, on average, have not come from the variable subject to realism tools. However, the LIC DSF's wider suite of tools will have an even wider impact.

I would like to end by noting that it is somewhat reassuring that there has been some stabilization in the DSA projections for public debt recently.

For instance, when we compare the 2019 World Economic Outlook (WEO) projections with the 2017 projections, the revisions in the debt projections have not been as large as those between 2013 and 2015. However, median public debt remains at a higher level than in 2013, and the report highlights that there are considerable underlying vulnerabilities.

Trends in the level and composition of public debt need to be carefully monitored. Further implementation of the LIC DSF, including with its enhanced public debt coverage, provides a key starting point for this enhanced monitoring.

Mr. Raghani made the following statement:

Let me reiterate our thanks to the IMF and World Bank staff for the informative report and the close cooperation on issues of such critical importance to lower income economies. We have issued a joint gray statement, and I would like to make the following remarks for emphasis.

On the debt risk assessment, we have cautioned against general guidance given the differences in countries' debt experiences and outlooks. In this connection, we share the view of other chairs, including Mr. Sigurgeirsson, who highlighted that the challenges faced by the LIEs are as diverse as the countries, themselves, and the need for the policy advice to be accommodative to the specificities of each economy. As Mr. Psalidopoulos and Mr. Spadafora also pointed out, the holistic approach in evaluating public debt dynamics is most warranted.

The efforts made by borrowing countries to improve debt management are welcome. However, like Mr. Rosen, Ms. Mahasandana, and other Directors, we see merit in the concerted efforts between the Fund and other relevant international financial institutions (IFIs) to help low-income economies address the gaps in debt management, transparency, and coverage through technical assistance (TA) and capacity building in those countries.

We welcome the increased focus of the Bretton Woods Institutions on the challenge of climate change and, more specifically, the ongoing analysis of climate-resilient debt instruments. Like Mr. Beblawi, Mr. Mouminah, and Mr. Villar, we concur on the need for proper preparedness and adaptation strategies for LIEs, as well as for the development of climate-resilient debt instruments.

On the Sustainable Development Goals (SDGs), we continue to stress that the IMF and the World Bank must play a more proactive role in helping LIEs strike the right balance in the development-indebtedness nexus. Like many other Directors, and as highlighted in many studies, we agree that the international community should step up its actions to help those members mobilize more concessional resources to complement their domestic revenue mobilization efforts in order to meet the Sustainable Development Goals. These goals cannot be reached without the complementarity of those actions.

Finally, effective coordination among official creditors remains critical to improve the current debt resolution framework.

Mr. De Lannoy made the following statement:

Let me start by thanking the Secretary for the Summing Up which will be available soon on the screen. I think that will be a great improvement.

I would like to thank the staff of both institutions for the joint World Bank-Fund efforts. We strongly endorse the conclusions of the report. They are very much in sync with the philosophy of the multi-pronged approach.

We have various work streams underway related to debt in the Fund, such as the debt limits policy. So we trust that these work streams will take today's conclusions onboard.

We have issued a comprehensive gray statement, so let me focus on five specific points.

First, on the difficult trade-off between debt sustainability, on the one hand, and the SDGs and the climate transition, on the other hand, we second Mr. Ray's suggestion that the Fund and the Bank can assist authorities in sequencing reforms and access to finance.

Second, enhancing debt transparency is crucial. I am quite intrigued by Mr. Beblawi and Mr. Mouminah's questions, whether it would be a good idea to consolidate the Fund and the Bank's databases on public debt. Staff comments on that would be welcome.

We feel that debt transparency is a responsibility of both creditors and debtors. So we wonder whether the international community should contemplate making registering external public debt mandatory in a central database and any external public debt that was not registered would, subsequently, not be enforceable. This would force creditors to be more transparent than they are today.

Third, on sustainable borrowing and lending, I would like to support Mr. Sigurgeirsson's call for elaborating global principles on sustainable borrowing and lending based on the G-20 Operational Guidelines for Sustainable Financing.

Fourth, in line with Mr. von Kleist's gray statement, there could have been more attention to collateralization in the reports and, more specifically, on the lack of information and collateralization in the international debt statistics and on the impact of collateralization on the Fund's preferred creditor status. We look forward to the Board discussion on the interaction of the World Bank's negative pledge clause and IMF program conditionality.

Finally, on debt resolution, we would be interested to hear from staff, what their ideas are to improve the architecture of debt resolution. At a minimum, we fully support Mr. Buissé, Ms. Levonian, and Ms. Riach's call for non-Paris Club members to work with the Paris Club as the principal international forum for restructuring official bilateral debt.

Mr. Rosen made the following statement:

We would like to thank staff for this excellent paper and very much support this work. We would like to highlight a few points from our gray statement, focusing on the role of the IMF.

On debt transparency, the IMF needs to continue to mobilize its full toolkit, including Debt Sustainability Analysis, program conditionality, technical assistance, safeguards, policies, and data standards to improve the quality and comprehensiveness of debt data.

The increased use of collateralization arrangements requires a greater analysis by staff. And we are looking forward to the upcoming IMF-G20 paper on collateralized loans coming soon.

Confidentiality agreements that constrain borrowers from disclosing the terms and conditions of borrowing to IMF staff are particularly concerning and should be discouraged, in our view. Transparency is also an important element of debt resolution. Restructurings should not be hidden. Emerging creditors need to adopt best international practices generally, particularly on information sharing and transparency in debt resolution cases.

Secondly, the IMF needs to persist with efforts to support improvements in debt management capacity. Data from the Debt Management Performance Assessments are disappointing, showing limited progress in many areas. Governments and central banks need to place a higher priority on improving debt management practices, and frontier market countries that are periodically tapping international markets need to urgently build this debt management capacity. Continuing capacity development advice from the IMF is critical in this area.

Finally, on debt resolution, when entering into a program with a country which has unsustainable debt, the IMF should require that debt restructuring, combined with adjustment, will restore debt sustainability with high probability and realistic assumptions.

On that point of assumptions, we heard from Ms. Hakura today that there is not necessarily a consistency about how assumptions are made between countries, which I am surprised to hear and think that it should be reviewed as to whether that is appropriate and even handed.

On the MAC DSA, this needs to be clearer in its signaling of unsustainable debt and in providing parameters for restoring sustainability. Creditors that lent into unsustainable situations or without adequate transparency need to bear a responsibility for their lending decisions and should not be bailed out with IMF resources.

The IMF also needs to be careful not to over-lend into situations of high debt risks which can inadvertently contribute to greater debt unsustainability, particularly for the poorest countries and fragile states, where grants would be more appropriate than loans.

Mr. Sigurgeirsson made the following statement:

We thank the staff of both institutions for this very useful report. It serves as a reminder of the current levels of high public debt and increased vulnerabilities. And given the search for yield, flows in markets have remained steady and continue to support growth in many countries. However, the tide can turn very quickly, as it has done before. Debt dynamics can change and rollover risks emerge, and ratings, which are usually behind the curve, can suffer rapid downgrades. I have personally experienced all of these things happen overnight.

While the picture that is drawn up in the report is somewhat mixed, debt levels in low-income countries have seen a rapid rise, and their detrimental long-term effects are worth considering. I will focus on three issues that our chair sees important for addressing the debt challenges in LIEs.

First, while it is not directly on the agenda, but as mentioned in our gray statement, we should keep in mind that fiscal prudence is key to ensuring debt sustainability.

Second, public debt transparency should be a cornerstone for all countries. This includes information about collateralization--especially collateralization--contingent liabilities, and debt contracted through SOEs and public-private partnership (PPPs). In addition, information about terms, currency, and maturity breakdowns, as well as information on debt holdings should be publicly available. Such transparency will support assessments of vulnerabilities for all parties involved.

Lenders also have an important role to play when it comes to transparency. And the initiative of the Institute of International Finance (IIF) and the outcome of the cooperation with the official institutions will be interesting to see.

Also, a consideration of the architecture for debt resolution may be needed, given the increasingly complex set of lenders and distressed debt migration, which has become more prevalent.

Third, and finally, public debt should be managed with a high degree of predictability and based on a comprehensive debt management strategy. Capacity development can play an important role in this respect, particularly for lower income and fragile countries with resource constraints and limited absorptive capacity. As we have said before, this chair emphasizes the need to fully integrate capacity development with surveillance and lending activities.

Ms. Riach made the following statement:

Let me start by joining others in thanking the staff from the IMF and the World Bank for the paper, which provides a useful picture of the evolution of public debt in low-income countries. The paper is an important part of the story on debt. We encourage the IMF and the World Bank to continue their strong collaboration, including to ensure consistency for the reviews of the IMF's debt limits policy and the World Bank's new sustainable development financing policy.

As others have said, I am sure that we are all concerned by some of the recent trends, as set out in the paper; in particular, that public debt has risen significantly in recent years across a broad section of low-income countries and that half of heavily indebted poor countries (HIPC) countries have worse interest-to-revenue ratios than before debt relief. And although it is comforting to note that the pace of debt accumulation has slowed in the past year or two, it is, nonetheless, a very concerning picture.

Low-income countries have huge challenges ahead to address their development needs and to meet the SDGs. For many countries, borrowing can and must remain an important part of the picture. But the paper demonstrates the impact that economic shocks can have and the importance of ensuring that borrowing is used well to support growth and to tackle development needs. The Fund can play an important role in supporting responsible and transparent borrowing and lending. I would like to make three specific points.

First, on official creditor standards. As others have said, it is really important that creditors take responsibility for their lending. This means being transparent, ensuring that lending is in line with the IMF's debt limits policy and the World Bank's sustainable development financing policy, and applying internationally agreed standards, such as the G-20 Operational Guidelines for Sustainable Financing. We welcome the progress reported by staff and encourage further work in this area.

Secondly, on collateralization, we look forward to the planned Board discussion on the G-20 note on collateralized sovereign lending. In the meantime, we agree with staff, that collateralized lending can reduce budget flexibility, impair access to noncollateralized financing, raise the risk of debt stress, and greatly complicate debt restructurings. So we support calls for further work to map out the risks and suggestions on how to better sensitize borrowers and creditors to such risks.

Finally, on debt restructuring, as we discussed in the context of the conditionality review, the evidence demonstrates that Fund programs are more likely to be successful if debt restructuring is timely and sufficient. Decisions around restructuring are never easy, and difficult political judgments have to be made. The increasingly complex financing landscape that has developed over the last decade has further complicated the international community's ability to deliver orderly and effective debt restructurings.

An expansion of the Paris Club to make it more representative and the Paris Club's commitment to work closely with nonmember associated countries will help, but we do see a need to strengthen the sovereign debt resolution framework and for the Fund to look closely at its own part in that.

The Board requested further work on this in the work program discussion in June of last year. We look forward to the discussion of the G-20 note on sovereign debt restructuring and suggest that, after that, the Board take stock of whether that meets the Board request for further work or whether more discussion is needed.

Mr. Psalidopoulos made the following statement:

We thank the staff of both the IMF and the World Bank for preparing this very useful report.

We have issued a gray statement. I would like to stress two issues and ask a question.

The overall message of the report, in terms of debt distress in lower income economies, is somewhat concerning. However, we believe that we should follow a more holistic perspective when assessing public debt dynamics. This means analyzing not only the debt levels and their evolution but also how debt is being used. How sustainable is it? Is it helping finance productive projects? Does it contribute to growth? Does it help to address inequalities? What effect does it have on poverty reduction? All these are examples of questions that should complement our analytical framework of debt.

Second, the amount of commercial borrowing needed to finance the SDGs is massive and a worrisome symbol of how much more work needs to be done. For this reason, we continue supporting the authorities' initiatives to increase spending efficiency, mobilize revenues, and channel them for attaining SDGs. We also hope the international community steps up its efforts to help those most in need.

Finally, the question: Is there a reason underlying the choice of countries under analysis in this report? What led to the move from low-income developing countries to lower income economies? Is there a particular reason?

Mr. Inderbinen made the following statement:

I join others in thanking the staff for this very instructive report. It demonstrates that elevated debt levels do remain a key concern, and we caution against being overoptimistic with respect to future trends.

We would also call for caution in communicating the main findings of the report, as the slower pace of debt accumulation over the last two years does not, by any means, imply that debt vulnerabilities have ceased to increase.

We see risks continuing to build up, in fact, given the low interest rates and the enhanced access to various sources of finance. We also think that staff's projected decline in public debt over the next years may prove overoptimistic, as it is based on an ambitious fiscal consolidation and projections for growth outcomes.

Since this is a common exercise with World Bank staff that we are discussing today, we would welcome staff's further comments on the recent World Bank report on Global Waves of Debt which, in our view, seemed to convey a slightly greater sense of urgency for the need for proactive action on this front.

Second, we would encourage staff to use the findings of the report to examine whether Fund activities--be they surveillance, program design, or technical assistance--have been effective in containing debt vulnerabilities and whether changes in policies or the way that they are implemented may be needed to lead to better outcomes. In particular, we encourage staff to analyze whether the debt limits policy could be strengthened to improve debt sustainability going forward.

We would also stress the importance of technical assistance in strengthening public financial management, public investment efficiency, and debt management capacity more broadly.

Third, like others, we stress the need for greater debt transparency, expanding debt coverage and the shared responsibility both of creditors and debtor countries in ensuring debt sustainability. We welcome and encourage the continued implementation of the G-20 Operational Guidelines for Sustainable Financing, as well as the IIF principles for debt transparency.

Lastly, like others, we encourage further work toward a more predictable and effective framework for debt resolution. Recent restructurings, as is demonstrated in the report, have often been drawn out and are not always fully effective in restoring debt sustainability.

Also, debt resolutions have become more complex due to the increased importance of non-traditional lenders and non-traditional or new instruments. Like Ms. Riach, we would underline that further efforts are needed to enhance the architecture for sovereign debt resolution. We were wondering whether staff might like to take the opportunity this morning to indicate where they see the greatest potential for improvement in this important area.

Mr. Tanaka made the following statement:

We thank IMF and World Bank staff for the comprehensive analysis paper on The Evolution of Public Debt Vulnerabilities in Lower Income Countries. While the pace of debt accumulation has slowed somewhat since 2017, the severe debt situation in many LIEs still need continued monitoring, so this regular update by the staff is much appreciated.

There are new challenges. There are fundamental changes in the structure of the creditors for public debt. Non-concessional lending by commercial creditors and non-Paris Club official creditors has been expanded.

While there is a good sign to get access to the market, there are three implications to take note associated with this consequence.

One is that the interest burden has been raised, the average maturity has been shortened, and the rollover risks are getting high.

Secondly, the diversifying creditor base and types of debt instruments can complicate the process of debt restructuring.

Thirdly, there seems to be some questionable collateral terms which could have adverse effects on sustainable development for LIEs.

Given this environment change regarding the public debt of LIEs, under the G-20 Japanese presidency last year, Japan pointed out the importance of efforts by both borrowers and creditors.

On the borrower front, we encourage LIEs to decisively implement fiscal consolidation efforts, including domestic revenue mobilization and improving spending efficiency. Given the trade-off between the scaling of public investment and containing debt vulnerabilities, enhancing investment efficiency is indispensable. Efficiency means here, the borrower country should gauge the impact of both investment for growth and benefit in relation to the amount of borrowing, in short, cost-benefit analysis.

On the creditor front, it is important to ensure that the lending is compatible to borrowers' debt sustainability. As recommended in the staff report, we strongly encourage the creditors to improve lending practices through a self-assessment in compliance with the G-20 Operational Guidelines for Sustainable Financing. (OGSF) as joint efforts by borrowers and creditors. While we welcome the improvement of debt transparency indicators, more progress is needed to improve debt transparency. Expanding debt data coverage is essential, given the contingent liability risks arising from incomplete SOEs' debt data and from the increasing arrangement of PPPs. We also emphasize the importance of the transparency of collateralized borrowing, as it is indispensable to plan the development strategy of a country.

Lastly, as to the technical assistance under the framework of the IMF-World Bank multi-pronged approach, we expect to implement TA to improve their capacity of debt management and of debt transparency. Japan has made funding contributions to the Data for Decisions Fund and the Debt Management Facility as toolkits under the framework. We also encourage LIEs to improve their infrastructure governance with support from the Fund's TA, including Public Investment Management Assessment (PIMA).

Mr. Mouminah made the following statement:

We thank staff for the comprehensive work. I welcome the introduction and update by Ms. Hakura at the beginning of this meeting.

We issued a detailed gray statement with Mr. Beblawi. I will, therefore, focus on a few points. I am afraid I will not be brief.

The first point is on balancing borrowing with debt sustainability. One of the key policy challenges facing lower income economies is to find the right balance between scaling up public investment and containing debt vulnerabilities. The staff paper has underlined that improvements in revenue mobilization, spending efficiency, and foreign direct investment (FDI) alone will not be sufficient to meet the Sustainable Development Goals. Therefore, additional borrowing will remain essential for many LIEs to ensure Financing for Development, including for meeting the SDGs, as previously highlighted by Mr. Raghani. Against this background, it is important that both borrowers and lenders need to engage in sustainable financing practices. Indeed, the focus should be on ensuring debt sustainability, as Mr. Tanaka just highlighted.

The second is on capacity building. Many LIEs face capacity challenges. In this context, like Mr. Raghani and Mr. Inderbinen, we take positive note of the Fund's continued effort to strengthen capacity development work. In particular, we welcome the focus of work on helping LIEs raise domestic revenues, enhance public financial management, strengthen debt management capacity, and enhance debt transparency. We especially encourage continued close cooperation with the World Bank in the provision of technical assistance.

Coordination among creditors. We agree on the importance of effective coordination among official creditors to ensure timely and effective debt resolution, where needed. This is especially relevant in view of the high vulnerability, despite the slowdown in the pace of public debt accumulation since 2017. Again, this should be case by case, and creditors should coordinate with other creditors, whether with Paris Club and non-Paris Club members.

On the local currency debt markets, we welcome the work on the local currency debt markets, with the aim of helping countries reduce their reliance on foreign currency borrowing and enhance financial resilience. Here, we welcome the coverage of these issues in the paper, including the highlighting of risks arising from higher nonresidential participation in the market.

On natural disasters, a majority of LIEs are vulnerable to large-scale natural disasters due to inadequate investments, required infrastructure, and a well-developed disaster response framework. Given that debt-related risks are particularly high for such countries, in this regard, we welcome the effort to intensify the focus and engagement with countries prone to natural disasters.

Finally, on the coordination of work on debt at the G-20 and the IIF, a large number of work streams are ongoing, including to provide support to the G-20 International Financial Architecture Working Group and the IIF, which has been mentioned repeatedly in today's meeting. This includes diagnostic tools for sustainable financing, collateralized financing practices, debt data disclosure by private creditors, work on the multi-pronged approach and the debt limits policy. In our view, it will be good to bring together all of the notes and guidelines in a coherent manner so that the area departments and staff working on LIEs are well placed to provide consistent advice during surveillance, capacity building, and program engagement. If this takes a fragmented approach, it will be very complicated for both lenders and borrowers to implement. Staff's comments on this are welcome.

Ms. Mahasandana made the following statement:

We thank staff for the comprehensive and timely report, as well as the useful responses to our questions. We have issued a gray statement and would like to provide additional comments in three main points.

First, we underscore the need for the Fund's country surveillance and lending program to continue advocating the need to adopt a proper debt management practice and framework so that the debt is put to good use for productive investments and mitigates its corresponding risk, especially when the recent developments present more opportunities for the LIE countries to get financing for development objectives.

We associate ourselves with many Directors, that the Fund's policy advice should be sharpened to ensure that countries adopt sustainable financing practices. In particular, staff should proactively flag when higher debt is not resulting in an increase in high-quality public investments for long-term sustainable growth or whether gaps exist in debt management practices and data transparency.

We also support the use of success stories, as Mr. Rosen has mentioned in his gray statement, to encourage buy-in by low-income countries. Equally important is for country teams to follow up and engage in a productive dialogue with authorities on progress toward addressing the gaps identified.

Second, we welcome the collaborative efforts from the Fund and other relevant IFIs to support LIEs, including small states. Here, we support the other Directors' emphasis on reinforcing the need to integrate CD with surveillance and lending activities, taking into account the low-income economies' absorptive capacity and country specifics.

As Mr. Ray mentioned in his gray statement, the Fund can also play a role in assisting authorities in sequencing reforms and access to finance.

Finally, we thank staff for the useful written response on the effectiveness of the Fund encouraging creditors to adopt sustainable financing practices. We are pleased to note that 20 creditors have performed a self-diagnosis based on the IMF and World Bank's joint note on the G-20 Operational Guidelines for Sustainable Financing. The Fund and the Bank should communicate in encouraging developments to motivate more sustainable financing practices by creditors and to closely monitor the effectiveness of this effort.

Ms. Mannathoko made the following statement:

We thank staff for the well-written report and also for the opening remarks this morning, which were very helpful.

We have issued a gray statement, so in the spirit of the discussions at the retreat, I will try to keep within four minutes. I just want to highlight a few points.

First, we welcome the reporting, that there has been some improvement in debt accumulation ratios; but as we also mentioned in our gray statement, we see the rising interest rate burden as--that remains a challenge. As we see it, it is one that is likely to continue, given the fact that, in the medium term, there will be an interest rate normalization at some point. So we do welcome the attention being given to that and to help countries prepare in advance.

We wanted to highlight the issue of heterogeneity between countries. We know that LIEs are really a diverse group of countries. And this is more in reference to the press release. I felt that some qualifiers could be used, as an example, in the second and the third paragraphs of the press release, which referred to debt-to-GDP ratios rising for oil exporters. It sounds like you are saying this is a general trend. For example, in our constituency, it is mixed. For some, it does. For others, debt ratios are not rising. Also, in our constituency, we find that their ratios are actually lower than others. The same applies with the performance of non-oil exporters.

On the issue of the productivity of spending, we think this is key. We would welcome closer attention being paid to the issues around the productivity of investments.

Related to that, on the issue of SDGs and financing, we support those chairs that have called for a strengthening and a reviving of the concessional financing structures, both to support debt restructuring but also to support affordable SDG financing. In this context, there is also some need to look at where there is scope for the IMF to promote or to encourage better aligning the repayment schedules with return on investment in SDG financing, this long-term financing framework which accommodates that. We would encourage efforts along these lines.

We wanted to highlight the importance of strengthened support, especially efforts to meet the minimum debt management standards and efforts to develop capital markets as part of debt management strategies.

Finally, on climate shocks. We wanted to highlight the importance of designing systems that will help countries that are really struggling with the effects of what the IMF calls slow onset disasters. This, in particular, is with regard to climate change projections which point to major implications for parts of sub-Saharan Africa that are dealing with droughts. Droughts are expected to worsen over time, and advanced planning would be helpful in that regard.

Mr. Just made the following statement:

We would like to thank the staff of both the Bank and the Fund for the very informative and insightful report and the answers to our questions.

Over the past weeks, I have been discussing the Somalia debt relief with my authorities. The question has arisen whether we--or we have a specific problem in debt relief, whether we should go for a case-by-case approach, since there is only Sudan next in line, or whether we should have a more general framework because there could be more cases further down the road.

For a long time, I argued that there will not be another lend-and-forgive cycle. I am not so sure whether this is true any longer.

Today's report continues the sobering debt story. Public debt may have accumulated at a slower pace over the last years; still, there is an upward drift. While debt ratios on average may still be below HIPC levels, this time, instead of multilateral debt, we have more commercial debt with shorter maturities, high interest rates, and where the behavior of lenders may be more unpredictable than during HIPC times. Mr. Sigurgeirsson made a very valuable point, that the reassessment of risk can happen very quickly, and the tide is turning. We have the contingent liabilities and hidden debt problem, which complicate the picture.

While we agree that there is a diversity of country resilience; and, still, the debt levels are especially high and acute in fragile and conflict-affected states that have even less capacity to handle debt distress.

In the past, we supported calls for a comprehensive strategy to deal with this problem. We must avoid a return to debt crises and minimize lasting damage to the already challenging developmental processes in many LIEs.

The principal responsibility for preventing the reoccurrence of the debt crisis, of course, lies with the borrowing countries and not with the Bank or the Fund. It requires sustainable lending practices, where the G-20 principles are very helpful; but in our view, the Fund and the Bank have a fiduciary role to provide authorities with advice that errs often on the side of prudence. We wonder whether continuing to have debt projections based on improved policy scenarios is realistic and helpful. They may be even less realistic, given the environmental degradation and the climate crisis, which clouds economic prospects further, and when financial sector regulation will promote decarbonization, which will turn economies based on carbon and fossil fuels' growth increasingly into strength assets. So maybe we could explore whether growth-at-risk models could be useful to enhance fiscal risk management so that authorities get a better understanding of what it actually will mean for fiscal policy when revenue normalization does not deliver or when reforms take much longer than anticipated. This may also help them with ensuring the sustainability of public finances which will, of course, require an effort by the LIEs to do their part on improving public financial management, investment governance, and the like, and where the Fund, of course, has to deliver on capacity development.

Since we have not a lot of leverage over authorities, even in a program context, we would see scope and merit in considering changes to Fund policies, as has been expressed also by some other Directors, that are critical in the context of debt and with governance. We should, for example, include more comprehensive debt data reporting requirements, debt transparency, and adequate debt management capacities. This could even be in the form of a safeguard assessment of debt governance.

Like many other Directors, we also note the changing debt landscape and the reduced role of traditional fora to discuss debt issues, which could make potential debt resolution processes more challenging. In turn, we also would support calls for a prompt review of the architecture for sovereign debt resolution.

Ms. Levonian made the following statement:

As a Director who represents both creditor and debtor countries, I have spoken many times with authorities about the tension that lies at the heart of this report; namely, the need to significantly and urgently increase spending on development and climate resilience while, at the same time, ensuring debt sustainability.

There are no easy answers here, but I want to thank Ms. Hakura and staff for the very balanced paper and for the constructive dialogue with my office.

We issued a comprehensive gray statement with Mr. Buissé and Ms. Riach. And I, not surprisingly, want to articulate that I agree with everything Ms. Riach has said this morning as well. So I am going to focus just on a few issues that jumped out of Directors' gray statements.

First, I was struck by the number of Directors who called on Fund staff to help promote the uptake of state-contingent debt instruments. While these innovative financial instruments are not silver bullets, of course, they could help countries meet their borrowing needs and better manage risks to debt sustainability. In particular, I note that there is considerable interest in the Caribbean in expanding the uptake of climate-resilient debt instruments. So the demand is there. But Caribbean authorities need technical assistance to overcome capacity challenges and to help build familiarity among creditors.

I also just want to appreciate the response provided to our technical question on this front, but I wanted to encourage staff to be more ambitious on promoting uptake. For example, staff could reflect on whether there is a role to incentivize the use of resilient debt instruments in the context of the upcoming review of the debt limits policy. I mean, after all, countries with a large stock of resilient debt are less at risk of debt vulnerabilities stemming from exogenous shocks. Given the support expressed by the Board, I encourage staff to reflect on this and on other opportunities to advance and promote the uptake of resilient debt instruments among vulnerable countries.

Second, I would also like to echo Directors' comments on the importance of ensuring that borrowing is financially sustainable. At the risk of stating the obvious, not all debt is bad. Borrowing that finances investment in physical and human capital can support long-term growth and higher income that more than offsets the cost of debt service. However, as the staff report highlights, public borrowing is not always associated with higher public investment, and the impact of investment on growth varies widely. To this end, like Ms. Mahasandana, I am very interested in staff's thoughts on the point raised in Mr. Rosen's gray statement: Article IVs and program reviews should proactively flag where higher borrowing is not leading to increases in high-quality public investment with decent prospects for boosting growth.

While I appreciate that staff may not be in a position to comment on individual projects, guidance on broad policy trends could be very helpful in promoting debt sustainability.

Mr. Buissé made the following statement:

I would like to thank the staff from the Bank and the Fund for the very interesting report and also on the ongoing joint work that is crucial for low-income economies.

The overall public debt dynamics of the LIEs has stabilized recently, however debt has increased in the last decade, so it has to be monitored very closely.

We issued a joint gray statement with Ms. Levonian and Ms. Riach, and I share everything that they said this morning. I would like to briefly make a few comments.

First, we commend staff's broader coverage of public debt, as already shown in some programs setting at the Fund. SOEs, collateralized debt, and contingent liabilities, in particular, are areas where joint work between the Bank and the Fund can be extremely fruitful to improve the coverage and the monitoring of the actual public debt.

Second, on a related note, we would like to emphasize the need to ensure that countries that improve their transparency with respect to the Fund and the Bank have the incentives to do so. They are not overly penalized for the greater openness of their books.

Third, we share the report's message, that LIEs are facing a difficult trade-off, of course, between meeting their development objectives and containing debt vulnerabilities. As has been said by many, there is no one-size-fits-all solution to address this trade-off. Actually, it is not only an LIEs trade-off. I believe all the countries face that dilemma. However, the IMF and the World Bank's role is to ensure that these countries are able to boost domestic revenue mobilization, tap into non-concessional borrowing, and ensure that public investment is efficient and linked with a rigorous cost-benefit analysis. Continued analysis on the efficiency of public investment is needed to ensure that countries are contracting debt for a good reason.

Finally, on the topic of the changing landscape of LIEs' financing, we would like to underline the need for creditors' coordination and, in this regard, the role of the Paris Club as the main forum for bilateral public debt restructuring. Official creditors' participation to the Paris Club, which works as a multilateral forum, enables coordinated debt treatment, including with willing nonmembers, and is efficient in addressing debt resolution, thanks to the club's principle--for example, and in particular, the need for an IMF program and possible Bank financing. In this regard, we echo staff's finding, that un-coordinated debt treatments and debt treatments which are not linked with an IMF program have a higher probability of ending in a nonefficient or partial resolution of debt crisis. We have seen reports underline many examples, a recent example where, for example, the Republic of Congo, Chad, Angola, Mozambique, or Ethiopia show the need to reflect on the ways for the Fund and the Bank to engage with non-traditional actors.

Mr. Beblawi made the following statement:

We thank the staff for this timely report which provides valuable insights and updates on recent debt developments in lower income economies, in line with the Board request. We have issued a gray statement with Mr. Mouminah, so I can be brief and highlight three issues.

First, among the key policy challenges for policymakers is the need to find the right balance between borrowing to scale up investment to meet the significant development needs and ensure debt sustainability. We, therefore, urge countries with a significant debt burden to focus on strengthening domestic revenue mobilization, pursuing fiscal consolidation, and ensuring sustainable financing practices while pursuing sustainable and inclusive growth.

Second, we caution staff against being overly optimistic with respect to future trends in debt levels, even though the pace of debt accumulation in low-income economies has slowed since 2017. The staff's gross projections may prove optimistic, as we can see in Figure 20. We thank Ms. Hakura for the explanation she gave this morning.

Finally, there is a need to address the gaps in debt management and transparency. Here, I would like to reiterate the importance of IMF support and technical assistance to lower income economies, which should remain crucial, including improving debt transparency and coverage, strengthening debt management capacity, and improving the quality of public investment to optimize the gross impact of public borrowing.

Mr. von Kleist made the following statement:

We thank staff and our World Bank colleagues for the candid report. Since we issued a comprehensive gray statement, I can just focus on a very few points.

As everyone has said, debt vulnerabilities in low-income countries are rising, albeit more slowly now, even though we had quite a favorable macroeconomic situation in 2019. Here, I would like to echo Mr. Sigurgeirsson's comments, that, quite simply and directly, debt sustainability depends on sustainable fiscal policy. As Mr. Buissé just mentioned, that is true not only for LIEs but for everyone. In that end, that is a lesson for everyone.

Perhaps I am a bit more pessimistic than many others on the question of the cost-benefit of borrowing. I fear that, currently, risks are skewed toward excessive non-concessional lending to badly managed projects or projects with overly optimistic revenue projections or return projections. So that is something which really needs to be looked at.

We look forward to further discussion on collateralized lending and draw the right conclusions for Fund engagement. That includes, as we have said previously, a discussion on the Fund's preferred creditor status in a world of collateralized official and commercial debt. I trust that these issues will be comprehensively covered in the forthcoming IMF-World Bank paper, as was mentioned by staff in the introductory remarks, and we look forward to the Board discussion on that.

There was one question that we posed in our gray statement. I am not sure whether we got a complete answer. That is the question on avenues, how to overcome information asymmetries regarding collateral agreements in international debt statistics. Data is available and so far is collected from single country reports which, in the end, is quite inefficient if it is not sort of in the overall picture.

My last point, on the research which is going on here--and you mentioned especially the findings of Horn, Reinhart and Trebesch (2019). We welcome staff's assessment of that paper. Notwithstanding the differences in view, we think the paper adds value to the discussion on how to address rising hidden debt from non-traditional lenders. Of course, we are aware that this issue may be uncomfortable for IMF staff, since it could point to shortcomings in the past. However, if we best want to serve our membership, especially the vulnerable members, then we need to look really closely at whether we have had a blind spot in this area and whether the knowledge and treatment of this issue can be improved.

Mr. Villar made the following statement:

We thank the staff for the report and for the comments this morning. We broadly share the staff's analysis. I just want to emphasize three points.

My first point is on the heterogeneity and the importance of periodic updates. In several countries, we observed a reduction in public debt indicators, largely driven by economic growth. We note with concern the vulnerabilities arising from a high number of LIEs, showing unsustainable debt dynamics. This heterogeneity makes the periodic assessment of public debt vulnerabilities particularly relevant, as sudden exogenous shocks or political conditions may affect the debt trajectory of specific countries.

My second point is on transparency. Besides the urgency of revenue mobilization and fiscal consolidation, we agree that LIEs should continue strengthening debt management and transparency. We point out the persistent problems in accounting for debt of state-owned enterprises in some LIEs.

My third point is on capacity development. We want to stress the importance of technical assistance for LIEs on both debt management and debt statistics. It is also relevant to continue encouraging the development of debt markets in local currencies to reduce the exposure of these countries to foreign exchange risks.

Mr. Di Tata made the following statement:

We thank the staff from the Fund and the Bank for the comprehensive report and for their responses to our questions. We issued a gray statement, but we have a few additional issues we would like to raise.

The report indicates that a stability-oriented realistic macroeconomic framework, geared toward reducing imbalances and building buffers, is a key starting point to address the trade-off between Financing for Development and debt sustainability.

Alongside policies to improve domestic revenue mobilization, spending efficiency and debt management and transparency are important. In this regard, we have three questions for the staff.

First, regarding domestic revenue mobilization, the Fund has provided extensive technical assistance in varying degrees to many lower income economies. Could the staff comment on whether technical assistance has made a big difference by comparing the outcome for those countries that have benefited from it relative to other countries that have not relied so much on TA?

Second, the report underscores the need to further improve the efficiency of debt-financed public spending. Based on experience, could we develop reasonable estimates of the speed with which investment efficiency could be improved over time that could be used with some confidence in the medium- to long-term projections?

Finally, in the view of staff, what are the main reasons why the uptake of debt instruments with state-contingent risk sharing features remains limited?

Mr. Mojarrad made the following statement:

We thank the IMF and World Bank staff for an informative report and commend their close cooperation in addressing debt vulnerabilities in LIEs. We have issued a joint gray statement with Mr. Raghani and would like to add a few brief points for emphasis.

First, the report points to the declining availability of official development assistance (ODA), while recognizing the challenging situation of LIEs achieving the 2030 SDGs amid the still significant infrastructure deficits. Cognizant of the risk of the shift in debt dynamics, we believe a further analysis is needed to appreciate the underpinnings of emerging trends in borrowing in a growth-oriented context, while also emphasizing the importance of debt sustainability. At the same time, we agree with other Directors, that creditors can play an important role in helping debtors safeguard debt sustainability through the adoption of sustainable financing practices.

Second, on collateralization, we support other Directors and encourage the staff to take a case-by-case approach in analyzing the investment returns, while taking a broader view of the benefits generated by the projects they finance.

Finally, we would like to reiterate the need to continue to strengthen the capacity to enhance domestic revenue mobilization, public investment efficiency, and debt management, which will help limit the interest rate risk in the context of limited fiscal space.

Mr. Saraiva made the following statement:

We thank Ms. Hakura for the opening remarks this morning and thank Bank and Fund staff for the very useful and balanced paper on such a critical issue. This is clearly an issue where Bank-Fund collaboration is of the essence, and this should be at the top of the agendas of both institutions going forward.

I believe the report, even though it is a balanced report and provides information on several fronts, also turns a flashing yellow light on. I understand that Mr. Inderbinen thinks that the previous Bank report released on the issue is even more intense in this warning signal. But I think we can clearly infer from the report that we need to tackle a major issue moving forward. And the issue needs to be framed, as many Directors have done here, within the trade-off that the low-income economies face in order to meet the SDGs in a sustainable way. It is clear that the potential for domestic resource mobilization is limited. Nevertheless, it needs to be boosted. I believe the Fund has an important role to play in this respect. But the prospects for increasing domestic resource mobilization with the expected level of official development finance is clearly not enough for the countries to meet the SDGs. So, there is a strong demand for non-traditional sources of finance. Those sources--commercial or non-Paris Club official development loans--they have, let’s say, somewhat filled this gap but with higher interest costs for the countries and raising the risks of debt sustainability.

We see important push factors acting as well in this environment of lower-for-longer interest rates and abundant liquidity. There are a lot of forces acting, pushing resources to come toward those countries where there are more opportunities for investment.

In an ideal world, that would be a good development, but we know that--and we have seen this before--that, unfortunately, this does not necessarily happen in a way that ensures sustainability over time. Unfortunately, again, the incentives and political economy dynamics are not necessarily in our favor in this regard. So I believe that what has been stressed here, the need to use the guidelines or the principles for sustainable lending is paramount, but we know that those are, like, voluntary and unenforceable, so we have to think in ways in which the Fund can use its leverage. Of course, in programs, as Mr. Rosen has said, restoring debt sustainability is a major issue, and the Fund needs to pay a lot of attention to that. But I would like to highlight the role of the Fund in surveillance and technical assistance in order to try to align as much as possible the incentives and to bring an awareness about the risks of unsustainable borrowing.

I believe that we may be seeing a disaster coming, but we could act preemptively to avoid it. And understanding that a disaster could come, by a debt crisis--and this is something that we need to avoid--but it also could come in the form of a protracted endemic and, at some point, acute social crisis as well that could undermine political and economic sustainability in those countries. So this is something that we definitely need to give a lot of attention to in a holistic way in order to achieve our goals.

Mr. Ray made the following statement:

Like others, I would like to join everyone else in thanking the staff from both sides of the street for what I thought was a very good paper on a critically important topic.

At this stage of the discussion, I just want to add a couple of relatively micro comments from the point of view of low-income borrowers in this chair and also a slightly more possibly gratuitous comment from me.

Many of my authorities would actually welcome assistance in understanding the nature of the contract that they might be faced with, if they have actually got a contract or if it is just a series of promises. The reality is that it is quite difficult for them to develop this in house, and it is very hard to work out where they might go. And it is something that I think that Fund and Bank staff could assist the authorities. It has to do with debt management, but it is actually working out what the debt is before you start to manage it. That is the way I would think about it. That is something which has been raised directly with me by ministers, and there is not an easy solution to that.

Second is just to amplify a point that we did put in the gray statement. Authorities in this chair find it very difficult to navigate the web of concessional finance, particularly the concessional finance that sits around climate change adaptation and resilience building. There is a risk that, if they give up, they will go to non-concessional sources of finance, and that seems an undesirable outcome. And there is a clear role for Fund and Bank staff here to assist, particularly smaller members.

On non-concessional debt, in particular commercial lending, there have been examples in this constituency of, quite frankly, outrageous behavior. In one case that I am aware of--because it is public--the home authorities of the bank in question have investigated and, to some degree, dealt with the behaviors. I do wonder whether more could be done on that front by our regulators, because they tend not to regulate behaviors outside the home jurisdiction. And I would just wonder whether we have thought about that at all.

Ms. Zhao made the following statement:

We join others in thanking the staff of the World Bank and the IMF for the informative report that documents the evolution of public debt vulnerabilities in lower income economies. We issued a gray statement and would like to offer the following comments for emphasis.

First, we join Mr. Psalidopoulos and others, that the analysis on debt issues should focus not only on the absolute debt level but also on how the debt is used. In this regard, we encourage staff to adopt a growth-oriented approach and to differentiate debt issued for productive investment and for nonproductive expenses.

We support the staff's view in their written responses to technical questions, that debt that finances productive investment can lead to higher income that can offset the cost of debt service. We encourage lower income economies to enhance their debt management so that the positive externality of the productive investment could be reflected in the government revenue and the project's profitability in a timely manner. In this vein, we encourage staff to grant more flexibility for lower income countries in choosing the type of financing that best satisfies their needs. If the debt could generate net positive returns, whether the loan is concessional, semi-concessional, or even non-concessional should not be the most important factor. We encourage the staff to do more research in this regard.

On debt data, we join Ms. Mannathoko, Mr. Sitima-wina, and other Executive Directors in thanking staff for their helpful clarification in the analysis in Box 2 on the hidden debt, as implied by Horn, Reinhart and Trebesch (2019). The inaccurate messaging in this academic paper can unfairly exacerbate risk perceptions in markets and can lead to higher borrowing costs facing lower income economies. We encourage the Fund's communications to play a bigger role here to ensure the fairness and accuracy of this message.

On debt restructuring, we join other Executive Directors in encouraging the Fund to play a more constructive role by providing technical assistance and trainings on best restructuring practices, not only to debtors but also to creditors. The best restructuring practices should take both the debtors' and the creditors' interests into consideration and ensure that future creditors still have enough incentives to provide the financing that the lower income countries urgently need to achieve their SDGs.

Finally, we welcome the improvements made so far on most dimensions of debt management by lower income economies. Given the capacity challenges still facing some lower income countries, we join other Directors in encouraging the Fund to strengthen its support and provide more technical assistance to enhance the debt management capacity of lower income countries.

The staff representative from the Strategy, Policy, and Review Department (Mr. Flanagan), in response to questions and comments from Executive Directors, made the following statement:

This turns out to be a useful opportunity to talk for a moment about our work program. Many Directors raised it. So let me say a few words about that.

As Directors know, we are starting to see the fruits of the multi-pronged agenda now coming forward. In the very near term, Directors should see our note for the G-20 on collateralized debt. They should see our G-20 note on debt definitions and reporting. Both of those notes are joint with our World Bank colleagues. Very soon thereafter, Directors should see our MAC DSA proposals, and our debt limit policy proposals.

Moving forward into May, we will have a paper on the multi-pronged agenda. Again, that will be joint with our World Bank colleagues. And the paper for the G-20 and the Board, of course--I think our primary audience for that now is the Board--on the sovereign debt restructuring architecture.

A few remarks about this. First of all, we always thought that this paper we are doing here would help inform this other work. And we have certainly listened to Directors today about their thoughts on how this might inform the forthcoming work, and we will reflect on it.

Secondly, I just want to, again, mention the collaboration with the World Bank in these areas. I know several of you mentioned the usefulness of this. I went back, and I counted this morning. We have had seven products joint with the World Bank over the last three, four years, which is a lot, considering, for most of them, we are not required to do it. A lot of the collaboration between the Bank and the Fund is required. This is not required, and it is probably one of the better examples of collaboration between the Bank and Fund in any policy topic. We fully intend to continue that, and I would like to thank our Bank colleagues for all this collaboration.

Now, just to touch on a couple of specific elements of this work program that came up.

First, on the note on collateralization. Maybe just a few points of clarity about this note. This was designed as a note for the G-20. It is designed for outreach to creditors and borrowers, specifically, low-income borrowers. It is not designed for an internal discussion here at the Fund about preferred creditor status, negative pledge clauses, and all of this. In fact, that would get in the way of outreach to these intended audiences because, if we give them a note about something internal to the Fund, they will see it as self-serving. So let's bear that in mind. That does not mean we are not going to talk about some of the issues people have brought up on preferred creditor status and negative pledge clauses, but we will do that in a separate presentation so that we can use this note as part of our efforts at outreach to creditors and borrowers, which many of you highlighted is critical going forward. We hope to be able to provide the presentation soon. And we hope to be able to, in the context of Board discussion, address all the important issues that Directors have raised today on that topic.

The second thing I want to bring up is the paper on the sovereign debt restructuring architecture. Let me differentiate two things here. One is, the Fund has some role in the architecture through our lending into arrears policies. A review of both policies is now officially overdue. We do intend to get to that as soon as possible; looking at lending into arrears, looking at lending into official arrears and, more generally, our policy on debtor and creditor engagement. Our paper in May focuses more the architecture that sits outside of the Fund.

We have had some interesting reflections here by Directors. We had one Director raise the question of: Should there be a general approach to debt relief? Should it be case-by-case? Just to quickly comment on that, our view is case by case for the moment. We are not in a generalized debt crisis. That is one of the points of the paper here.

And another Director raised a question of making the registration of debt a requirement and, if not, should the debt contract be enforceable? This speaks to the issue that there is a lot of interest in the architecture and how it can be adapted to better serve the purposes of efficient and effective debt resolution.

We have detected for some time now some concern in the international community that the resolution framework will not be effective for the challenges coming and that there are gaps. As I said, this sits outside the Fund.

So what has been happening? Of course, the world does not stand still. We may stand still and be delayed with our lending into arrears policies, but the practitioners out there, the sovereign debt lawyers and advisors, try to find ways around the problems in the architecture.

One of the purposes of this upcoming note is to try to communicate, what practitioners are actually doing, and is there anything the international community wants to think about in terms of supporting, in much the same manner that the international community thought about aggregated collective action clauses and enhanced pari passu clauses five years ago. Of course, we will go beyond those narrow issues, but that will be the starting point: What is actually happening? Where are the gaps? What is actually happening to fill the gaps? And is there anything of interest to the international community? So I think it will be useful. One Director raised the possibility of reflecting afterwards. I think that would be useful, for sure.

The other issue I want to touch on is the question of debt and investment. A number of Directors raised this. Just on stylized facts, of course--here, I am partly drawing on my long experience in the Fiscal Affairs Department many of the things people raised are fundamentally fiscal issues: Is debt used productively? Is it used to fight inequality? Is it used to address poverty reduction? All of these are important issues. I could perhaps better frame them as fiscal issues when you consider how to set the public deficit, how to set the spending plan for a government. They are critical, of course.

It is difficult, I would say as well, for us to comment on precise issues of when borrowing is helpful, when it is not helpful, partly because so often, what we put in our programs is not what actually comes out. Many of you know the stylized facts, that adjustment tends to be designed to preserve investment and cut current spending and raise revenues. Ex post, it leans more toward cutting investment. And there are shortfalls on revenue and current spending cuts.

Some of these outcomes on investment are not intended. Our commentary at the time of a program might be entirely appropriate, but the outcome might be entirely different. And that is an enduring problem of program implementation.

What we do want to avoid--and I will defer a lot of this kind of discussion to the debt limits policy review--is trying to get into evaluating individual projects where the staff does not have a particular comparative advantage. We are macroeconomists, of course, so a specific project evaluation would give us some difficulties.

More generally, on the whole question of debt and investment in assets; is it creating useful assets; should we be paying more attention to balance sheets? I think the answer is yes, but perhaps not in the way that people sometimes think about it.

If you have done your macroeconomic forecasts correctly, you should account for the income that assets produce in GDP. You should account for the income that assets produce that gets transferred to the government and becomes part of government revenues. You should account for the value of any of these assets that may be privatized.

So, strictly speaking, if you have done everything perfectly, the balance sheet does not add anything to the debt analysis; it is already there. However, we all know that people do not do these things perfectly, so the balance sheet provides an additional window to try to get staff to look more carefully at some of these assumptions. What are we assuming about the use of public assets? Does it make sense? What we are assuming on privatization? Does it make sense? What we are assuming on revenues? Is it a useful complement? And I do want to point out that the mere existence of assets does not make a government necessarily better off from a debt sustainability perspective. You have to look carefully at what income the assets can produce and whether those assets can actually be liquidated in some way. Because the debt is there; it is rigid; it has to be paid. So there is the difficulty in that respect.

I will stop there. And I know Ms. Hakura will handle a few other more detailed questions.

The staff representative from the Strategy, Policy, and Review Department (Ms. Hakura), in response to further questions and comments from Executive Directors, made the following additional statement:

With regard to the question on consolidating the World Bank and IMF debt databases and the questions on the quality of debt data, as Mr. Flanagan mentioned, we are in the process of finalizing a note on debt data definitions and reporting by low-income countries. This is part of the deliverables under the debt transparency pillar of the IMF-World Bank multi-pronged approach. This note will discuss in more detail the different databases that are available and the identified gaps in reporting. The aim is for the note to make some recommendations on how to improve debt data coverage and streamline the reporting, as well as to bridge gaps in international debt databases. However, I would like to highlight that the different international debt databases do serve different purposes, so there is an advantage to maintaining these databases. This will be discussed in more detail in the note.

With regard to the question on the country groupings. Why the group of LIEs? These are the countries that are eligible for concessional financing from the World Bank through the IDA 18 period. The approach that we took is the same approach that was taken in the 2015 joint IMF-World Bank paper analyzing debt vulnerabilities in low-income countries. However, we do recognize that there are differences across different groups, even within the LIEs. Throughout the paper, we have split the country sample to various country groups to highlight certain analytical findings. Also, we have shown the findings for the low-income developing country (LIDC) sample, which is consistent with our LIDC report.

Third, on the question of, what are the differences with the World Bank Global Waves of Debt paper? The objective of the World Bank paper was slightly different. It is looking at debt accumulation waves over the last 50 years. It was intended to identify broad macroeconomic trends and drivers. The focus of that paper is slightly different from this paper, which is also with the World Bank. We apply different methodologies. More specifically, this paper goes into more depth into analyzing or looking at the recent efforts in strengthening debt management and debt transparency. We review the lessons learned from recent debt restructurings. So, overall, the focus is different from the World Bank paper.

Finally, on the question regarding the impact of technical assistance on domestic revenue mobilization and what assumptions can we make about improvements in investment efficiency? We take note of these questions. These are fiscal issues, and they would be better addressed in that context. This is outside the scope of this report, but we take note of this.

Ms. Mannathoko made the following statement:

Thank you. This is just a small observation. Part of the reason we tend to raise issues about productivity of investment is that whether borrowing goes to productive purposes has implications for debt servicing in the future. We raise it in this context mainly because it is a joint World Bank-IMF framework. So it is just our opportunity at the Fund to reference that in the context of the Bank-Fund framework.

Mr. von Kleist made the following statement:

Now that the G-20 will predominantly be an outreach paper, I can see that, but the question is this other paper on preferred creditor status, negative pledge clause, and so forth. What is the timing of that? I think much of the discussion, when Directors requested a discussion of the G-20 paper in the

Board actually circled around those issues. So what is the timing? I hope we are not pushing that way into the future but that it will be close to the other paper.

Mr. Raghani made the following statement:

I have just two comments and one question. The first comment is on the intervention of Mr. Flanagan on the use of our comments this morning and our gray statements on this paper. It seems that some points will not be taken into consideration. Maybe I am mistaken. I want perhaps some clarification on this. I understand that many comments and points and recommendations in the paper will not be taken into consideration in the work. Is this correct?

My second question, I believe everybody agree that sound macroeconomic policies, transparency, governance, and debt management are important, but t maybe we need to do more, particularly when it comes to taking into consideration the impact of the process of the selection of projects, even if it is a microeconomic issue, but I think its impact at the macroeconomic level is key, particularly in the way we analyze that issue. I believe there is a need to do more in order to take this into consideration in the assessment of the debt vulnerability of countries. I believe this point has been highlighted by many, many speakers.

The question is about the conference that took place in Dakar recently, I think in December. It was organized jointly by the Senegalese authorities and with the IMF. I do not know if there are some findings or some points that should be incorporated into in the paper or the discussion.

Mr. Mouminah made the following statement:

This is a peak time where all of the papers are coming together for addressing debt issues. Is there a plan to put this together as a coherent perspective. I know each paper will have its own objectives and will address certain issues, but then we need to look back and ask how to aggregate. I have not heard any comments on that from your side.

The Acting Chair (Mr. Zhang) made the following statement:

Before I give the floor to staff, let me address the two points that were just raised by Mr. Mouminah and Mr. Raghani.

The first point, to whatever the remarks made here and in the gray statements I think will be accurately, to the extent possible, reflected in the Summing Up.

Mr. Mouminah mentioned the messages conveyed by different papers. We will have to think about the best way to communicate to the outside world. Given these papers cover different aspects and carry different objectives, but there has to be a coherence in putting them into sort of the same framework.

Mr. Mouminah made the following statement:

Again, it is not about messaging and communication, rather than putting it together in terms of policy recommendations, data share. All of the work that is being done has to be coherent and integrated at some point because we do not want to look at each one as a separate piece. The staff has to think about this. They have not answered it. I do not know if there is a plan; but if there are any comments, it would be appreciated.

The Acting Chair (Mr. Zhang) made the following statement:

Thank you for your comments. It is important for all of our messages, recommendations to be consistent. Then we will have to think about, what is the best way to convey it, to put it into the same platform. Then we will think about how to move forward in terms of that.

On the other questions, I will give it back to staff.

The staff representative from the Strategy, Policy, and Review Department (Mr. Flanagan), in response to further questions and comments from Executive Directors, made the following additional statement:

On the collateralization note, we plan to do a presentation on the Fund's existing policy on collateralization. Hopefully I can give you more of a description about that in a couple of days. But there is not a paper planned at this stage. It would be a presentation from the involved departments--the Strategy, Policy, and Review Department, the Legal Department, and the Finance Department.

Our G-20 paper started off as an effort to try to help creditors and borrowers who are thinking about these issues. We certainly do not want to lose sight of serving our membership. We fully understand that we also have to have a discussion internally about this, but we do not want to lose sight of that effort to better serve our membership.

On pulling together papers, we have been thinking about that. If I go back to our multi-pronged agenda, and even further back to our Notes on how to improve transparency for the G-20, we have been talking about our creditor outreach efforts and our efforts on borrower outreach and on enhancing our lending to LICs mailboxes, providing a newsletter to creditors and borrowers, and enhancing our website and access to information for both creditors and borrowers. We do want to do this. As we think about the policy agenda going forward, we are trying to consolidate some of our guidance in one place. Some of you may know from discussions that we are trying to consolidate our policies on collateral into our debt limits policy because it makes sense to have all of our debt limits policies together in one place. Otherwise, people may come along and read the debt limits policy and not realize that theyhave to read something else. So we are trying to consolidate these things.

We will do--at least the plan right now is to do--the lending into arrears reviews together and have that guidance in one place. So we are trying to pull together some of our diverse work in the debt area. Again, we take the point that we need to improve the way these are presented, but our first goal is definitely to get the things done. Then we will worry about how we combine them.

To Mr. Raghani, we baked into our LIC DSF framework a tool on the realism of investment and growth so that these discussions could be had by Directors. That tool is based on a simple growth decomposition into capital, labor, and total factor productivity (TFP). It splits capital into public capital and private capital. For public capital, it assumes the average cross-country investment efficiency and average cross-country returns on investment. That tool exposes what assumptions staff are making about public investment on a year-over-year basis because, if you subtract last year from the current year, you can see what staff is assuming about public investment. Then we can filter it through the simple growth model and come up with what staff is assuming about the impact on growth. That tool is now there in every low-income country report, and it gives the opportunity to challenge assumptions made about investment and growth. We do not treat it as prescriptive, as with any realism tool. We treat it as an invitation to discuss if the numbers are out-of-line with the international averages, why staff thinks investment efficiency will be higher in this case or worse. Because sometimes, in some of our testing of this tool, we discovered that, actually, staff was essentially assuming full crowding out of public investment onto private investment. So we do have these tools. We do invite these discussions. We do want to have these discussions. It is just that there are limits to what the staff can do on a project-by-project basis. And given that money is fungible and can finance different parts of a budget, there are also limits to how much we can attribute borrowing to investment versus other things once you get beyond project finance--and many countries, of course, are getting beyond project finance, using commercial borrowing to support a general budget deficit. So once you are in that circumstance, it is not so easy to attribute the borrowing to one thing or the other.

I just want to be clear that we do have tools to help with this. We expect these discussions, but there are limitations on how far we can take them because of staff's comparative advantage but also because just outside of project finance, we just cannot pin these things down properly.

Mr. Sigurgeirsson made the following statement:

I wanted to commend staff for their helpful answers and the clarity of their proposals going forward. Most importantly, I would like to thank the Secretary's Department for the improvement acoustics here. It has very much made a difference. Thank you very much for that.

Mr. von Kleist made the following statement:

I am sorry to have to come back to this, but I must say that I was disappointed by staff's answer to my question.

With collateralized debt, we have two issues. One is collateralized debt from official and private creditors, and then we have the World Bank-IMF issue. And I think why we had a number of Directors who wrote to management with concerns was this World Bank-IMF issue. So I strongly hope that the presentation--and really, the presentation is a lot less than what was promised to us last year in the Board.

When we had the Angola discussion, the Chair basically said, let's not discuss this now, the World Bank having invoked its negative pledge clause. And it was said, we will discuss that in depth in the Board. So I am looking forward to an in-depth discussion in the Board on the issue of IMF-World Bank relations regarding the negative pledge clause of the Bank and the preferred creditor status of both the Bank and the Fund and what the policies are going forward.

A presentation just on what the IMF is doing will not be enough. I am really sorry, but that was not what was agreed to by management at the end of last year. And it should not be pushed off. Oh, yes, we will have the discussion on the G-20 note. It should be timely, this discussion on the IMF-World Bank issues.

The Acting Chair (Mr. Zhang) made the following statement:

Maybe we could come back on the timing. Mr. von Kleist, your remark is fair. We will consider that and deliver what management promised.

In response to a question from the Acting Chair on the timing for the presentation, the staff representative from the Strategy, Policy, and Review Department (Mr. Flanagan) indicated as soon as possible.

Mr. Palei made the following statement:

I think I may get the same answer, but my question is related to this notion that the reviews of lending into arrears policy have been delayed. Is there a timing issue here? Recently, we have seen that many reviews have been delayed. The Comprehensive Surveillance Review, the FSAP Review, the Transparency Policy Review, Communications Policy Review, now the Lending Into Arrears Review. Maybe two different parts of it. So could you maybe give us a hint on the timing of when we are going to have these reviews?

The staff representative from the Strategy, Policy, and Review Department (Mr. Flanagan), in response to further questions and comments from Executive Directors, made the following additional statement:

Well, no. It is not "as soon as possible" here because we barely have the capacity to deliver the six items that I listed to you over the next five months. We cannot even start this until we get through that big bulge of work. We are close to getting through it. But, yes, we have to get through that bulge first. Then we can take up these issues, but I think we would also want to hear from Directors after the discussion of the paper on developments with sovereign debt resolution practices in May. That may provide some additional guidance or thoughts to help us calibrate what we want to do.

The staff representative from the Strategy, Policy, and Review Department (Ms. Hakura), in response to a question by Mr. Raghani on Senegal, noted that the focus of the Senegal conference was on the trade-offs between striking a balance between spending for development and financing and containing debt sustainability. This paper takes a different angle, and reports on the debt vulnerabilities and the evolution of the debt trends, but does not touch as much on the tension between the spending for development and ensuring debt sustainability.

The following summing up was issued:

Executive Directors welcomed the opportunity to discuss the evolution of public debt vulnerabilities in Lower Income Economies (LIEs). They noted that accommodative global financial conditions and expanded funding from non-Paris Club creditors have allowed LIEs to mobilize larger volumes of external financing. This has provided the opportunity to help finance important development spending. At the same time, Directors highlighted the challenge for countries to strike a balance between boosting development spending and containing debt vulnerabilities.

Directors welcomed the recent stabilization in debt levels. However, they expressed concern at the continued high levels of public debt in many LIEs, which could reduce fiscal space and ultimately feed through to lower investment and growth. They noted that continued stability of debt levels hinges, in many countries, on a continued benign global environment and relative stability of commodity prices. They expressed concern that materialization of global risks (such as from weaker global growth and rising protectionism) could expose debt vulnerabilities particularly for countries that are already assessed to be at high risk. In this context, Directors urged greater caution in forecasting growth outcomes, and welcomed the realism tools used by staff in this regard. Directors also stressed the importance of assessing the impact of new borrowing, including whether or not it is aimed at productive public investment that could raise economic growth and reduce poverty, and highlighted the Fund's role in providing appropriate advice.

Directors emphasized the importance for LIEs to adhere to their medium-term fiscal frameworks, closely monitor the evolution of debt levels, and undertake structural reforms to support inclusive and sustainable medium-term growth and build resilience to shocks and natural disasters. Countries should also be ready to make adjustments to safeguard debt sustainability in case growth disappoints and/or the economy is hit by shocks.

Directors noted that the increased reliance on debt provided on commercial or near-commercial terms is raising debt service burdens and making LIEs more vulnerable to domestic and external shocks, including interest rate, exchange rate, and rollover risks. They encouraged countries to continue to take advantage of opportunities in the current financing environment to use debt buybacks to ease near-term refinancing risks and voluntarily reprofile external debt service payments. They also encouraged countries to develop local currency debt markets to help reduce exchange rate risk.

Directors welcomed the ongoing efforts of LIEs to strengthen institutional capacity to manage and monitor debt, including with the support of the IMF and the World Bank, as well as operational measures that countries are undertaking to better manage debt risks. They stressed the importance of continued efforts to enhance debt management strategies (including through climate-resilient borrowing) and strengthening debt transparency, including with the support of the international community and in the context of the joint IMF/World Bank multi-pronged approach. They noted that the increasing complexity of debt instruments and volatility of capital flows, particularly for the frontier economies that have tapped international debt markets, should be matched by a strengthening of debt management practices.

Directors underscored the importance of enhancing coverage of all public and publicly-guaranteed debt in public debt statistics to allow full assessment of debt vulnerabilities and contingent liabilities. They expressed concern at the limited amount of publicly available data on external debt of state-owned enterprises in LIEs, which can be an important source of fiscal risks. They also called for greater efforts to address the information gap on collateralized debt.

Directors noted with concern that the process of completing debt resolutions has been drawn out in several recent cases. A number of Directors also noted that ad hoc bilateral restructuring arrangements outside a comprehensive macroeconomic program framework, while valuable, raise questions about their effectiveness in maintaining debt sustainability. They noted that effective coordination among official creditors is critical for timely and effective debt resolution and called for further efforts to facilitate such coordination. Directors broadly concurred that a review of developments concerning sovereign debt resolution practices is needed.

More broadly, noting the substantial financing needs to achieve the SDGs, Directors called for enhanced efforts by both debtors and creditors to engage in sustainable financing practices. Borrowing countries need to adhere to sustainable fiscal policies, raise domestic revenue, increase spending efficiency, improve public investment management, strengthen debt management and transparency, and tap concessional financing where available. Official creditors should pay appropriate attention to maintaining debt sustainability in borrower countries. The sustainable financing practices identified in the IMF and World Bank G20 note on *Operational Guidelines for Sustainable Financing—Diagnostic Tool* can help guide improvements in lending practices. Directors urged stepped-up efforts by the international community in support of the SDGs and called for creative ways to mobilize long-term concessional financing.

APPROVAL: September 21, 2022

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Debt Structure

1. Could staff provide information about the status of the IIF private creditor database and its potential usefulness for LIEs debt monitoring?

2. Could staff comment on opportunities for official creditors to improve disclosure of the terms and conditions of borrowing? /// Can staff provide an update on their work with the Institute of International Finance (IIF) on operationalizing the "Voluntary Principles for Debt Transparency", particularly efforts to publish private sector lending data?

- The International Institute of Finance has articulated Voluntary Principles covering debt data disclosures by private creditors. Given the potential for agency problems in borrowers—where borrowing may not always be duly authorized—disclosure by lenders is an important avenue to achieve accountability. The initiative is expected to come to fruition during 2020, upon identification of a host for the data.

- A Working Group comprising IIF, IMF, World Bank and BIS staff has been constituted to help operationalize the initiative. The Group will soon put forward potential options to this end.

3. While we see merit in encouraging creditors to adopt sustainable financing practices, further guidance on how these would be operationalized would be useful. This would shed light on the Fund's role in supporting the effectiveness of these policy recommendations. To this end, how does the Fund intend to proceed in ensuring these policy recommendations are followed through?

- The IMF and World Bank staff provided a note to the G-20 IFA Working Group in November 2019 entitled *G-20 Operational Guidelines for Sustainable Financing: Diagnostic Tool*. This took the G-20's Guidelines and converted them into 17 practices, identifying 3 levels of performance for each (strong, sound and needs improvement). The tool thus allows a creditor to self-diagnose areas for improvement and identifies ways to achieve this.

- To date 20 creditors have performed a self-diagnosis (based on the first version of the tool) and 11 have followed up with Fund and Bank staff to discuss further their results. We do not have any information at this stage about whether this has produced any changes.

- We will continue to support this initiative going forward.

4. In this regard, we wonder whether guidelines are being developed to provide staff with a clear institutional view on collateralized debt?

- Staff is in the process of finalizing a note for the G-20 IFA Working Group that provides a framework for public lenders and borrowers to assess collateralized financing practices from a development perspective. We expect to issue this soon.

5. Could the staff comment on whether non-PC creditors have employed the sustainable financing practices identified in the G20 operational guidelines for sustainable financing in recent debt restructuring cases?

- There are two relevant practices: (2.3) promoting disclosure of information on past restructurings; and (3.2) committing to the long-term debt sustainability of borrowing countries – by facilitating smooth debt restructurings when needed.

- We have not made an assessment of these practices for such creditors. (Note that some would have made a self-diagnosis as part of the G-20 exercise.)

6. Can staff comment whether there is a causality relation from buildup in non-concessional debt to lower growth? Can staff further elaborate on the reasons behind the expected decrease of the share of concessional debt?

- The report does not examine the causal relationship between the buildup of non-concessional debt and growth. There is a significant literature that points at the detrimental effects of rising public debt on growth, for instance https://www.imf.org/~/media/Websites/IMF/imported-full-text-pdf/external/pubs/ft/wp/2002/_wp0269.ashx.

- If ODA is stable in percent of donors GDP, and LIEs grow faster than donors, and LIEs maintain a stable overall debt to GDP ratio then the share of concessional debt will fall by implication.

7. Could staff elaborate further on how the exposure to China—hidden or not—affects sovereign debt risk and to what extent it distorts the risk assessment?

- The increase in borrowing from China, like any other country, is reflected in the debt build up and would impact debt ratios and ratings as would any other external borrowing, along with exchange rate and other relevant risks. If such debt is not fully captured in the statistics, the contingent liability stress tests can be used as an approximation, which could itself inform the DSA rating.

8. Regarding the creditor composition, we note staff's statement that the scale of China's lending has increased but the precise magnitude remains uncertain. This, together with staff's rather vague assessment of the findings in HRT (Box 2), makes us wonder how more transparency can be achieved, both on the borrower and creditor side. More specifically: What is staff's estimation of the difference between official debt data and actual debt levels? How does staff plan to address the acknowledged differences in the statistics? How does staff handle the uncertainty regarding debt data in the context of program conditionality/Debt Limits Policy/LIC-DSF/MAC-DSA? Would a continuous PC on debt transparency be warranted/feasible?

- As regards staff's estimate, the figure adjacent to paragraph 30 in the report illustrates the wide range of estimates for contingent liabilities. Also, in the cases where public debt coverage has expanded, the resulting increase in public debt has also varied widely (e.g. by 10.8 percent of GDP in Senegal and 18.9 percent of GDP in Sao Tome and Principe, both in 2017).

- While a debt data gap is country-specific and difficult to generalize, a Fund program would require upfront or increased debt data disclosure when an existing data gap is assessed as macro-critical (as, for example, has been done recently in Angola and Ecuador programs). Program conditionality prohibiting the contracting of specific-types of debt (e.g., collateralized debt) could be also introduced if it is deemed to be macro-critical. In this case a TMU would specify (continuing) reporting requirements.

9. Given the record high level of Global debt at US$ 188 trillion, with a third of this being public debt both for advanced and developing economies, we would like more details to better appreciate the debt landscape for LIEs. In this context, could staff offer an assessment on a) LIEs private debt levels scenario vis a vis the public debt levels b) To what extent could the high debt levels of the lender country themselves amplify the vulnerabilities amidst slowing growth, especially where governments step in to extend bailouts for private debt?

- LIEs typically lack good data on private external debt. Nevertheless, private external borrowing in LIEs is thought to remain limited, including because of constrained creditworthiness. That said, excessive external borrowing by the private sector or a substantial currency mismatch in its balance sheet could lead to a systemic problem and a need for direct government intervention and recapitalization for the banking sector, in turn harming public debt sustainability. The LIC DSF, therefore, encourages country teams to monitor developments of private sector debt and take account of these vulnerabilities in assessing risk ratings.

- High debts and a decrease in fiscal space in creditor countries could be one of the factors holding back ODA levels notwithstanding creditors commitments in international fora to support LIEs efforts to achieve the SDGs.

10. We would further welcome additional staff comments on the findings in HRT (2019). We note staff's skepticism about HRT estimates with regards to the magnitude of "hidden debt". However, staff does not elaborate further on HRT's assertion of a sharp increase in the incidence of sovereign debt restructurings since 2011 outside of the public domain. As this finding could well suggest an underestimation of debt overhangs, we would welcome additional staff comments on the issue of "missing defaults" or "hidden restructurings". Especially if hidden restructurings coincide with an IMF-supported program, the lack of transparency over terms and conditions of any such restructuring would raise important policy questions for the Fund.

- We agree that hidden restructurings would create a host of potential issues for the Fund. Of course, by definition, we are not aware of any such events.

- It is worth bearing in mind that to the extent such events may be happening, they could well be happening outside of Fund fiscal and debt coverage, e.g. in SOEs. The broader coverage of the LIC DSF should help reassure or not on this point.

11. We would have highly welcomed a more comprehensive assessment of collateralization practices in the staff report. Staff points out that comprehensive data on collateralization of official bilateral loans and commercial lending is not readily available and international debt statistics do not collect information on collateral features of loans. This topic and its treatment in the document raise the same questions as with creditor composition and, additionally, the issue of potential implications for the Fund's preferred creditor status (PCS). Could staff outline avenues to overcome these information asymmetries in international debt statistics commenting on the main limitations such as confidentiality clauses? How does staff deal with collateralization in the program context, in particular in GRA cases, with a view to protect its PCS? Would a continuous PC on collateral (ceiling) or a disclosure requirement be warranted/feasible?

- Both the IIF's Voluntary Principles and the practices underlying the G-20's Operational Guidelines for Sustainable Financing call for transparency by lenders about collateralization clauses. Indeed, it is in lenders joint interest to be transparent.

- In Fund programs, program conditionality to address the contracting/accumulation of specific types of debt (e.g., collateralized debt) can be introduced if the associated vulnerability is considered macro-critical (as, for example, has been done recently in Angola program).

12. Those projects that generate more revenue than needed to cover the debt services should be encouraged and better managed, so that the positive externality of the project could be reflected by the government revenue and the project's profitability in a timely manner. Staff's comments are welcome.

- Countries should take a comprehensive approach and compare the return from contracting debt with the cost of accumulating debt. Debt that finances productive investment and social spending can lead to higher income that can offset the cost of debt service and can help balance the risks to debt sustainability. The DSF picks this up to the extent the macroframework correctly models this.

- A prudent debt management strategy should involve:

    - A careful selection and evaluation of projects to ensure that the return on investment is high and that the investments are carried out in a cost-effective manner. Also, the pricing of outputs (such as energy) should ensure full cost recovery, enabling governments to finance debts incurred.
    - The decision on how much debt to take on should take into account the country's debt-carrying capacity and current levels of debt. Typically, countries with stronger debt-carrying capacity have bigger buffers such as higher international reserves, higher income and stronger macroeconomic management and institutional capacity.
    - Safeguards can be put in place to balance the uncertain longer-term gains with the short-term costs of borrowing. This can be done by matching debt service profiles with expected investment returns and by including contingency features to manage volatility and deal with shocks such as weather-related shocks and natural disasters. Countries could explore developing local-currency debt markets that would help to reduce reliance on foreign currency borrowing that would enhance resilience to sudden reversals of capital flows.

13. Regarding the structure of the debt portfolio, we note that the shifts in the composition of debt have further affected interest rate, exchange rate, and rollover risks. The latter mainly because of the continued decline in the average maturity on new external commitments, and despite lengthening in maturity in several economies' local currency debt. What is the capacity of LICs to build foreign exchange reserves?

- Macroeconomic frameworks and domestic demand policies can be calibrated in such a way that a reserve buildup results. This is what is typically done in a financial program for an IMF-supported program where reserves need to be restored. The same approach can be followed by a country which wants to increase its reserve buffer.

Outlook/Risks

14. The projections that envisage a slight decline in the public debt of LIEs hinge on assumptions of sustained fiscal consolidation and strong growth, which may turn out to be overly optimistic. The realism of the underlying assumptions should be carefully considered. It should be stressed that the risks to the favorable debt trajectories are internal as well as external, large, and firmly skewed downwards. A debt-at-risk look at the projections could give more insight on the distribution of possible developments. The assessment should also include analysis of climate-related risks to LIEs' debt burdens and fiscal positions. Could staff provide a range of alternative projections, assuming e.g. no fiscal consolidation, lower economic growth, or tighter financial conditions?

- Figure 18 (p. 27) shows the wedge between projected and actual debt trajectories during 2013-18 was close to 20 percent of GDP for a median LIE, which could be attributed to both policy surprises and external shocks. DSAs of individual countries offer a comprehensive analysis of alternative debt trajectories through stress-testing which factors in country-specific characteristics such as its susceptibility to commodity price shocks, market financing conditions, and climate risks. In this regard, Table 2 (p. 31) succinctly summarizes how important global risks could lead to adverse debt outcomes among LIEs per DSA findings, including potential debt distress rating downgrades in several cases.

15. Drawing lessons from past crises where appropriate, can staff comment further on what more can the Fund do to help LIEs in dealing with longer-term policy trade-offs (such as achieving development goals without building up debt excessively) vis-à-vis building resilience in the near term against the ensuing market corrections that may arise from a sudden tightening of global financial conditions?

16. In light of the World Bank's warning on the biggest buildup in borrowing in the past 50 years and the risk of a fresh global debt crisis, we are wondering how the Fund could better assist countries, both through surveillance, program work, and technical assistance, in tackling debt accumulation and strengthening buffers.

- As highlighted in the report, a stability-oriented realistic macroeconomic framework geared toward reducing imbalances and building buffers is a key starting point to address the overarching tradeoff between financing for development (including SDGs) and debt sustainability. Alongside, policies to improve domestic revenue mobilization, spending efficiency, and debt management and transparency are also important.

- In this context, the Fund continues to look for ways to enhance surveillance and has committed considerable capacity development resources to assist LIEs' efforts to make tangible progress in raising revenue, strengthening PFM and strengthening debt management. The IMF has been expanding its toolkit to support LIEs' efforts in these areas. The toolkit now includes, among others: public investment management assessments; medium-term debt management strategies; the debt sustainability frameworks; and medium-term revenue strategy to support domestic resource mobilization

17. Can Staff indicate how the review of the DLP could help countries balance the tradeoff between scaling up public investments to meet development objectives while containing debt vulnerabilities?

- As noted during the May 2019 informal Board meeting, the DLP review will propose reforms that would strengthen the link between conditionality and the nature of vulnerabilities. We will elaborate more in the forthcoming informal board meeting to be scheduled in February.

18. We were particularly struck by the finding that widening fiscal deficits were not always associated with higher public investment. We would welcome more research on the underlying reasons for such adverse outcomes, and on how Fund surveillance could play a role in averting such situations in the future.

- Public borrowing may be used to smooth consumption during economic downturns, and even to promote consumption during upturns. The political economy underlying this result varies country-to-country. Increased reliance on commercial borrowing (including eurobond issuances) may also have played a role since, unlike traditional ODA lending, is not always earmarked to investment.

- The DSF framework a key tool to help Fund surveillance identify over-borrowing for unproductive spending, which is often associated with future payment difficulties and potentially unsustainable debt situation.

19. Could staff comment on the reasons for the worsening debt dynamics experienced by frontier economies?

- Frontier economies access to domestic and international financial markets has increased in recent years. Both of these developments entail higher interest costs and higher debt servicing costs. Compared to emerging market economies, Frontier LIEs also face wider spreads due to perceived risks and search for yield. As highlighted in Figure 5, for frontier economies, the contribution of the interest rate to the worsening debt dynamics is comparatively large due to access to more diversified financing sources and to the steady increase in debt.

20. Staff mentions that 20 percent of HIPC/MDRI recipients have public debt-to-GDP ratios larger than those observed one year before the HIPC completion/MDRI point.

Considering this observation, does staff envisage further debt relief requirements in the medium term?

- Given the large number of countries currently at high risk of debt distress, further restructurings/reprofilings cannot be ruled out, especially if LIEs are hit by shocks or if downside risks materialize. However, given that not all high risk countries would go into distress, and that most countries remain at moderate or low risk of debt distress, a comprehensive debt relief scheme for the group of LIEs would not appear to be needed.

21. In view of staff's assessment that risks to baseline projections disproportionately affect countries already at high risk of debt distress, we would welcome a more balanced assessment over the short-, medium and long-term perspective on the downside risks resulting from prolonged globally low interest-rate environments inducing search-for-yield on (hidden) debt accumulation and debt-servicing capacity. To what extent would baseline projections change in response to a prolonged period of accommodative global financing conditions?

- The baseline projections have incorporated WEO assumptions for global interest rates, which are expected to remain low throughout the medium-term. Most LIEs are expected to benefit from this benign environment through, ceteris paribus, a higher growth-interest differential and an easier access to financing. At the same time, a prolonged period of low interest rates also signals weak global demand which is expected to affect the debt sustainability of many LIEs through the trade channel (Table 2, p. 31). If the search for yield during a prolonged period of accommodative financing conditions would lead to unproductive overborrowing by LIEs, this would risk payment difficulties when financing conditions eventually start to tighten.

22. We wonder what the experience has been with the tailored contingent liability stress tests in DSAs (which is typically where SOE and PPP uncertainties are captured), and the extent to which they have helped flag forward-looking risks for the authorities. We also wonder why the contingent liability stress test is stand-alone, and not included in the combined risks scenario. Staff comments would be welcome.

- While we have not yet seen the materialization of significant contingent liabilities (given the new LIC DSF has been implemented only for 18 months), the new framework has increased staff's engagement with the authorities on debt coverage and potential sources of contingent liabilities to a fuller extent, and encouraged country authorities to strengthen the monitoring of such vulnerabilities along with fuller collection of public sector debt. The shock was designed as a stand-alone—to highlight country coverage risks—but the DSF does allow for the preparation of a customized scenario capturing these shocks jointly if such a scenario is seen to be relevant for the country case in question.

23. The paper cites thirteen countries that achieved significant debt reduction thanks to growth-friendly fiscal consolidation. Can staff comment on some of the lessons that can be learned from these positive stories, and whether broader adoption of such lessons is feasible and could meaningfully bend the curve of debt risks?

- This is an area that requires more work. The literature points to public investment as having a large fiscal multiplier effect, i.e. fiscal consolidation based on cuts in public investment have larger contractionary effects on output. It also finds that lower multipliers are associated with cuts in current expenditure or on revenue mobilization (see e.g. 2017 SSA REO). The literature also points to the importance of the broader macro framework, namely monetary and exchange rate policies as contributing to outcomes. Clearly external circumstances also play a role.

24. We are surprised to read that, according to staff's projections, a gradual decline in debt levels is envisaged over the next five years, while in the paper on macroeconomic developments and prospects in LICs, staff pointed to the fact that debt levels will continue to rise and will remain at high levels, especially given the risks that loom at the horizon. Could staff elaborate on the projections which we think are too optimistic, especially in light of paragraph 21 of the Staff Paper, stating: "Risks to the baseline debt projections also arise from global risks, and these appear to disproportionally affect countries already at high risk of debt distress".

- Our analysis points to potential optimism bias in LIEs where a growth pickup is projected during a period of large fiscal adjustment. At the same time, most LIEs are also subject to important global risks which, if materialized, could cause the debt trajectories to deviate from their projected paths under the baseline. In a large proportion of LIEs already at high risk of debt distress, global risks (particularly those transmitting through the trade channel) are associated with the most extreme stress scenario and could significantly affect their debt sustainability.

25. We also find that the countries that are currently in debt distress in our constituency are all characterized by fragility;[1] furthermore, half of these are commodity dependent and vulnerable to commodity price shocks, and half have to contend with repeated climate shocks. Thus, work being done by the Fund focused on debt sustainability in FCS remains especially important. Could staff elaborate on progress in this regard?

- The new LIC DSF recognizes that some countries are susceptible to commodity shocks and climate shock. Before finalizing the low-income countries debt sustainability framework, there is a carefully check that the various factors relevant for risk assessments in fragile states are properly accounted for. For instance, the debt sustainability framework allows country teams to use a longer time horizon to inform the risk rating beyond the standard ten years to take account of long-term concerns including climate change. The LIC

DSF also includes tailored stress tests for countries that are exposed to natural disasters, volatile commodity prices, and market financing pressures. These tools have been applied in a number of fragile country cases (e.g., Afghanistan and Maldives).

26. We appreciate the country specificity in DSAs and in staff's bilateral discussions with authorities and encourage more emphasis on enhancing this and allowing adequate modeling flexibility to accommodate differences. Staff views are welcome.

- The DSF training program is designed to enhance country capacity to do DSAs, which would support even stronger bilateral dialogue. So far only one country (Uganda) formally publishes the DSA that they have produced themselves, but from bilateral discussions many LICs prepare an internal DSA. Still, an important shift is occurring in our training, which will see our workshops built around participants using their own country-specific macro and debt data rather than a given case study. The first joint LIC DSF-MTDS workshop was delivered in August 2019 in partnership with MCM, in which country-specific data was used by all participants.

27. The possibility of a widening interest rate-growth differential and resultant fiscal sustainability challenges is worrisome. Staff views are welcome.

- The interest-rate growth differential has become more adverse of late, due to borrowing on commercial terms, which has apparently not been delivering enough of a return to offset the higher costs.

- Our projections suggest that non-concessional borrowing will rise from 60 to 70 percent of the stock of total debt in these countries in the next decade (in the baseline, without an attempt to scale up to meet SDGs).

- Thus unless there is a marked improvement in economic returns, or some threshold effects that kick in, one can expect the trend deterioration of the real interest-growth differential to continue.

28. As the report notes, the implied increase in commercial borrowing that would be needed to finance the SDGs is very large. Given this challenge, we see merit in the IMF exploring ways to motivate long-term concessional financing supported by grants with repayment profiles closely aligned to the timing of related infrastructure investment returns. The absence of such a long-term financing mechanism has resulted in expensive non-concessional debt being used to finance infrastructure development. Staff comments are welcome.

- There appears to be an inherent limit on the amount of concessional finance presently available. ODA has been fairly stable at around 0.3 percent of donors' GNI (and falling as a share of borrowers debt and income). Our policies (e.g. the DLP) can incentivize movements

29. We also ask RES to conduct analysis that will inform a meaningful global solution to the problem of frequent, recurring spillovers and related shocks faced by developing countries. These shocks curtail growth and exacerbate debt. Staff thoughts on exploring new ideas and solutions are welcome.

- Noted. We will convey this to RES.

30. Could staff elaborate on the progress made so far in adopting the balance sheet approach in conducting DSAs?

- As highlighted in the 2017 LIC DSF guidance note, the DSA is conducted on the basis of gross debt. For assessing debt sustainability, gross debt is the appropriate concept as it measures the burden of financing of debt service obligations for which the government is responsible. The availability of liquid financial assets mitigates, but may not eliminate, risks to debt sustainability (for instance, due to currency or maturity mismatches, and since some minimum level of assets is required for normal government operations or there are legal restrictions on the use of these funds that does not allow them to be used for repaying debt).

- However, where the assets are considered important to the DSA conclusions (e.g. in cases where a government has significant financial assets that could be liquidated to service debt), these assets can be accounted for in the final DSA risk rating via judgment. In such cases, their scale should be reported in the DSA write-up (see Section VIIID in the 2017 LIC DSF guidance note).

- For instance, since the new LIC DSF was put in place, Timor-Leste has had a change in risk rating (from moderate to low risk of debt distress). In Timor Leste's case, the sizable petroleum fund reserves help to mitigate risks to debt distress.

31. In a previous staff paper, countries under Fund-supported programs were reported to have better performance on debt vulnerabilities than the overall group. Comments on the role of program conditionality are welcome.

- In the context of the ongoing review of the debt limits policy, staff's analysis finds that debt accumulation has been markedly lower for countries under IMF programs in recent years, both among market access and low-income countries. PRGT programs have generally helped prevent a deterioration in countries' risk of debt distress, and debt vulnerabilities appear to have reduced in most GRA programs. In general, there has been a strong record of adherence to program debt limit conditionality, with relatively tight implementation. Where debt and fiscal conditionality have been met, vulnerabilities have remained contained. Strong adherence to debt and fiscal conditionality appears to have contributed to this positive track record. However, there is also some evidence that debt vulnerabilities may have arisen in areas not covered by program debt limits (e.g. PPPs, trade credits and SOEs/SPVs).

Managing Debt Vulnerabilities

32. More efforts are needed to better capture information on SOEs and contingent liabilities in order to help the countries better assess and manage debt risks in a forward-looking manner. Does staff see merit in consolidating both IMF and WB databases on public debt to have a more complete information on public debt liabilities?

- We agree that more streamlined debt data reporting with increased debt coverage would be key to increase debt transparency. Staff is finalizing a note as part of the deliverables under the debt transparency pillar of the joint IMF-World Bank multipronged approach. The note will include some recommendations on how to improve debt data coverage, streamline database reporting, and bridge data gaps in the international debt data reporting. However, there will remain room for different databases at the Bank and Fund serving different purposes.

33. With the global architecture for debt still operating in silos and we would like to hear staff assessment on whether there are any proposals to converge the multiple debt data sources from academic institutions, think tanks and other international institutions? If so, do we have any timelines for this?

- International organizations like the IMF and the World Bank are mandated to rely on data compiled by individual member countries. That said, staff can use other debt databases as needed to inform our dialogue with country authorities, and we will look into ways of making such other research/data more accessible to staff.

34. Debt sustainability risks need to be managed carefully to avoid another large-scale sovereign debt crisis in LIEs. Could staff elaborate on the experience with the joint IMF-WB multi-pronged approach (MPA) so far?

- There will be an informal Board meeting in May to brief Executive Directors on the MPA.

35. Can staff comment on whether the current surveillance activities identify the specific gaps in debt management capacity and debt transparency that need to be addressed for all LIEs using the DeMPA or similar methodology and how is the progress towards addressing these gaps being monitored? From the experience to date, can staff comment on the effectiveness of the MPA in reducing countries' debt vulnerabilities?

- At present our surveillance relies on the LIC DSF to identify gaps in debt data transparency (through its coverage and disclosure requirements). DeMPA is a World Bank tool that is not always available to Fund staff. That said we anticipate some synergies in the new Debt Limits Policy and Bank Sustainable Development Financing Policy that should help in the identification and addressing of gaps

- There will be an informal Board meeting in May to brief Executive Directors on the MPA.

- However, it is important to note that it takes time for capacity development efforts to bear fruit. As shown in the report, under the debt management facility (DMF), considerable progress has been made in supporting LIEs to prepare and publish debt management reports. By 2018, 35 LIEs were preparing and publishing debt management strategies on a regular basis, typically three years, compared with less than 5 countries in 2010.

36. Having said that, we wonder whether there are lessons learned from recent developments and trends in debt vulnerabilities that suggest the need for readjusting the multi-pronged approach (MPA) or changing specific aspects of the debt limit policy in gestation. Conversely, we wonder if any measures taken within the framework of the MPA would have contributed to recent developments?

- We will provide an update to the Board on the joint Fund-Bank Multi-Pronged Agenda for reducing debt vulnerabilities in May 2020. It is still too soon to assess the effectiveness of the MPA which began in earnest in Fall 2018.

37. On state-contingent debt, staff finds that "uptake remains limited" and "costs of issuance are high". How reliable is the empirical evidence for this statement? Could staff elaborate further on the extent to which described state contingent instruments and counter-cyclical loans for project financing came into effect at what costs and benefits?

- State-contingent debt has been issued in the context of recent debt restructuring episodes, for example in Grenada in 2015, and in Barbados in 2018 (domestic debt) and 2019 (external debt). Natural disaster clauses included in the debt of these Caribbean islands would have the clear benefit of providing relief in the aftermath of a natural disaster. They do not appear to have come at any meaningful cost (although with little data this is difficult to judge).

- However, in "normal", non-crisis times, the use of state contingent elements in government debt has been limited, as has been documented in the IMFs 2017 policy paper on the topic (*State Contingent Debt Instruments for Sovereigns,* SM/17/61). Feedback from surveyed issuers suggests a first-mover problem. Complications include novelty and liquidity premia demanded by investors, moral hazard (automatic debt relief may reduce incentives to keep vulnerabilities at bay), and undesirable political economy incentives (e.g. incentives for data manipulation).

- In staff's view, the cost-benefit calculus in respect of state-contingent debt instruments can be improved (i) by educating investors about the benefits of such instruments; (ii) if a group of sovereigns were to issue these instruments together; or (iii) if a group of bilateral creditors and MDBs included state-contingent clauses in their lending. There is some progress on these fronts. In 2018, ICMA and Clifford Chance, with support from IMF and World Bank, prepared indicative term sheets for different possible extendible hurricane bond structures, to facilitate use by interested sovereigns. Paris Club creditors have also discussed these term sheets and agreed to incorporate these on a voluntary basis in their new debt contracts. Staff is continuing its engagement with interested sovereigns to support market development.

38. Going forward, how can the Fund improve familiarity and promote uptake of climate-resilient debt instruments among vulnerable countries?

- The IMF has been making efforts to promote more resilient debt contracts including state contingent debt instruments. In 2018, a high-level IMF-World Bank conference on Building Resilience to Disasters and Climate Change in the Caribbean discussed design options for climate-resilient debt instruments, which were concretized into term sheets by the International Capital Market Association. There is some discussion of a workshop in the Caribbean in the spring to further educate about the use and potential benefits of these instruments. Staff will continue to support this as well as any other requests from potential users.

39. We welcome the increased focus of the Bretton Woods institutions on the challenge of climate change and, more specifically, the ongoing analysis of climate-resilient debt instruments. We encourage the IMF and the World Bank to continue with their efforts to accommodate these challenges with tools to fortify the countries' resilience to natural disasters and mitigate climate-related shocks, particularly in small states with minimal fiscal space. To this end, we would appreciate exploring the degree to which weather-related shocks have contributed to debt distress in these countries.

- Reconstruction needs following natural disasters have in some cases played a role in increasing public debt. For instance, Vanuatu was struck by a cyclone in 2015, Dominica was hit by a hurricane in 2017 and Tonga experienced a cyclone in 2018. The latest available DSA for these countries indicates that Vanuatu is now assessed to be at moderate risk of debt distress and Dominica and Tonga are assessed to be at high risk of debt distress. More generally, the newly introduced natural disaster tailored stress test in the LIC-DSF has been used in 21 cases and has been useful in illuminating risks. However, it has not affected the final debt distress risk rating (while it can be very important other shocks have played a larger role).

40. We recognize the need for ongoing measures to expand the coverage of public sector debt data for all countries. This is critical for policy analysis, comparability and ultimately, effective management of debt vulnerabilities. In this context, we would appreciate a clarification on the differences in the definitions of public debt in the LIC DSF and the WEO as noted in footnote 1 on page 5 of the report.

- To enable data comparison across countries and to standardize data submissions, WEO recommends general government for the coverage of public debt as well as fiscal data. On the other hand, the LIC DSF whose main objective is to assess debt vulnerabilities and risks encourages country teams to use as broad a definition of public sector debt as possible, including SOEs' debt. DSA debt coverage, therefore, might well be broader than WEO depending on debt vulnerabilities outside the general government and data availability.

Sovereign Debt Resolution

41. Could staff provide additional information about the potential review of the architecture for sovereign debt resolution? What would be the primary scope, expected timeline, and who would conduct the review?

- The G20 requested a paper on 'Sovereign Debt Resolution: Recent Developments, Implications for the Architecture, and Interactions with Fund Policies.' First, this is not a review of Fund policies. Rather, the paper will take stock of recent developments on Sovereign Debt Restructuring. Second, the paper is being prepared jointly by LEG and SPR and planned to be discussed at the Board in May 2020.

- The last review of the sovereign debt architecture was kicked off in 2013 and covered a multi-pronged work program including strengthening the contractual approach (with enhanced CACs and modified pari passu clauses), a more flexible Exceptional Access Policy (with a removal of the systemic exception), and the adoption of the official lending into arrears policy (LIOA).

- The forthcoming G20 paper aims at taking stock of the initiative to implement enhanced CACs in bonds, describing potential limitations of the enhanced CACs in facilitating orderly debt restructuring, and reporting on legal innovations that could facilitate orderly debt restructuring.

42. We also note the update on LIEs' experience with debt restructuring, including the increasing number of restructurings outside of the IMF program frameworks and that some of these have been protracted, incomplete and non-transparent. In this context, is

there scope for the Fund to play a bigger role in helping LIEs on debt restructuring including economic adjustment to address the underlying root causes of the debt problem?

- The IMF regularly reviews its policies to facilitate efficient and orderly debt restructuring when debt distress occurs. For instance, together with the World Bank, in July 2018, the Fund began implementing a new debt sustainability framework for low-income countries which emphasizes broader coverage of debt, including contingent liabilities. The Fund is also undertaking a review of the debt sustainability framework for market access countries. These are important for timely recognition of a debt sustainability problem.

- At the request of the G20, staff will also report on recent developments in sovereign debt restructuring. This is planned to be discussed at the Board in May (see answer to question 37).

- In addition, the IMF has been making efforts to promote more innovative debt contracts, including state contingent debt instruments, which may help prevent the need for debt resolution in the first place.

43. We think that the benefits in case of an adverse event should also be adequately acknowledged, while it goes without saying that insurance costs are usually greater than zero. Higher costs have had also been feared in the case of CACs, which did not materialize. Could staff elaborate further on the identified gaps in the existing architecture for debt resolution" and what they have in mind regarding a "review of the architecture for sovereign debt resolution"?

- Please see response to Q[37] above.

- Staff have identified a few challenges to orderly and timely debt resolution. The creditor base has become more diverse (including non-Paris Club creditors, plurilaterals, commodity traders), there is an increased use of certain features in loans/bonds (such as collateral) and new instruments have emerged (e.g., repos), and there is sometimes a lack of transparency for instruments contracted, creditors or certain features in the instruments.

44. We wonder if, in the absence of a program, the IMF engagement in LIEs' debt restructuring could be strengthened by enhancing TA or a more targeted surveillance work?

- One way the IMF supports a restructuring is by providing a macroeconomic assessment of the sustainable repayment envelope (embodied in the "program" scenario). Outside of a program this is much more difficult to achieve; creditors have used our surveillance products to calibrate relief (e.g. Belize), but results have been disappointing (i.e. repeated restructurings).

- The Fund does not provide any legal advice to a country on how to restructure its sovereign debt due to our duty of neutrality. TA could only cover efforts in designing and implementing effective debt management strategies and risk management frameworks (i.e. post-restructuring considerations).