Joint civil society policy brief:

Improving the IMF and World Bank's Debt Sustainability Framework for Low-Income Countries

June 2025

This document represents a contribution by the undersigned debt justice organisations to the ongoing review of the International Monetary Fund (IMF) and World Bank's Debt Sustainability Framework for Low-Income Countries (LIC-DSF).[1]

EXECUTIVE SUMMARY

The debt sustainability analyses produced by the World Bank and IMF under the LIC-DSF[2] are technical in nature but carry enormous political significance. They influence the nature (loans or grants) and volume of funding from the IMF, World Bank and some other aid agencies. They affect private creditors' risk assessments. They can trigger requirements for debt restructuring as a condition for IMF lending. They also guide negotiations about the scale of debt relief for eligible borrowers.

As debt justice organisations, we value the periodic reviews of the technical methodology underpinning these debt sustainability analyses, and we welcome the opportunity to contribute. The key points of our detailed recommendations are as follows:

1. **Adopt a quantitative definition of debt sustainability** that is consistent with the existing qualitative definition – ensuring that debt sustainability analyses reflect both a country's ability to repay debt and the need to preserve fiscal space to achieve development goals (see Recommendation 1).

2. **Adopt a quantitative debt restructuring goal**: Any debt restructuring must bring external public debt down to at most "moderate risk of debt distress with substantial space to absorb shocks" by the time the debt restructuring agreements are signed and until at least the end of the 10-year timeframe of the analysis (see Recommendation 2).

3. **Complement the baseline scenario with an "ambitious scenario"**, including the additional development and climate adaptation and mitigation spending necessary to achieve the Sustainable Development Goals (SDGs) and Paris Agreement (see Recommendations 3 and 6).

4. **End the overoptimism bias** by giving incentives to staff to improve economic forecasting (see Recommendations 24 and 25), by increasing the fiscal multiplier of economic growth, by taking into account the long-term "scarring" effect of negative shocks and positive effect of public investment on productivity, and by including likely shock scenarios in the baseline (see Recommendations 9, 10 and 11).

5. **Add debt sustainability indicators** capturing (i) the flows of total public debt (external plus domestic) and (ii) the stock of total external debt (public plus private) (see Recommendations 12 and 13).

Additional recommendations on the technical framework relate to the debt-carrying capacity, the debt sustainability thresholds, data coverage, country coverage and time horizons.

Because of their political significance, debt sustainability analyses are susceptible to influence by the IMF and World Bank's boards, which are controlled by creditor countries. Creditors' control over debt sustainability analyses represents a conflict of interest that compromises the credibility of these analyses, no matter how much the analytical framework is improved. Therefore, we are also putting forward recommendations to improve the governance of the LIC-DSF.

For the purpose of debt restructurings, debt sustainability analyses must be conducted independently from both the debtor and its creditors, and hence from the IMF and World Bank (Recommendation 23). The staff's analytical work must be insulated from the board's political interference (Recommendations 24 and 25). Transparency of the LIC-DSF must be further increased to make political interference more difficult to hide (Recommendations 26 to 31).

The final section of this document includes recommendations about other IMF and World Bank policies that relate to the LIC-DSF, notably improving the IMF's social spending floor policy (Recommendation 33), and revisiting countries' eligibility to the IMF and World Bank's lending facilities and graduation from one facility to another (Recommendations 35 and 36).

DETAILED RECOMMENDATIONS ON THE LIC-DSF

Debt sustainability definition

<u>Recommendation 1</u>: *The LIC-DSF must adopt a quantitative definition of debt sustainability, which must be published, and must be applied in debt sustainability analyses produced in the context of an IMF programme. This quantitative definition must be consistent with the current qualitative definition, which emphasises both a feasible adjustment in the fiscal balance and acceptable progress on development goals. Two key variables to assess debt sustainability could be: i) the estimated maximum primary fiscal balance, and ii) the change in the primary fiscal balance compatible with economic recovery and growth comparable with peers in the medium term.*

The IMF defines debt sustainability as a *"high likelihood that a country will be able to meet all its current and future financial obligations[, which implies] that the debt level and debt service profile are such that the policies needed for debt stabilization under both the baseline and realistic shock scenarios are politically feasible and socially acceptable, and consistent with preserving growth at a satisfactory level while making adequate progress towards the authorities' development goals."*[3] Although the LIC-DSF includes "mechanical" (ie, quantitative) signals to determine the level of risk (low, moderate, high), whether debt is sustainable or not is a matter of judgement. As the definition suggests, this judgement involves political analysis, which is not the area of expertise of the IMF.

Whether the IMF calls a debt unsustainable is therefore ultimately a political decision under the current LIC-DSF. As such, it is susceptible to political pressures from its shareholders, who are mainly made up of creditors. That matters because the IMF has a policy of not lending into unsustainable debt situations unless a debt restructuring takes place (or additional grants or concessional loans are provided) during the IMF programme in such a way as to make the debt sustainable. It is an important policy that is designed to prevent IMF resources from bailing out existing creditors, prolonging debt crises and pushing the eventual costs of debt restructurings onto multilateral lenders, which is what happened in the debt crises of the 1980s and 1990s. Allowing too much political discretion when it comes to defining unsustainability heightens the risk of debt restructuring being undertaken "too little, too late".[4]

The alternative framework that the IMF uses for "market access countries" (the Sovereign Risk and Debt Sustainability Framework or SRDSF) does incorporate a quantitative definition of debt sustainability, which is complemented by judgement. However, it focuses on the first part of the IMF's definition: ability to pay back the debt. In the past, some governments have managed to pay back their debt only at the cost of deep and prolonged austerity measures that have depressed their economic growth and development over a decade or more. These situations do not fit the sustainability definition. The IMF and World Bank should estimate the maximum primary fiscal balance – and change in the primary fiscal balance – that is compatible with an economic recovery that is strong enough to restore medium-term economic growth in line with peer countries (ie, countries at similar development levels within the same region) in the medium term. Primary fiscal balances or changes in primary fiscal balances that exceed those thresholds should be treated as indicators of debt distress within the model estimating the likelihood of debt distress, even in the absence of arrears.

Debt restructuring goal

<u>Recommendation 2</u>: The LIC-DSF must state that any debt restructuring must reduce external public debt down to, at most, a "moderate risk of debt distress with substantial space to absorb shocks" by the time the debt restructuring agreements are signed. Furthermore, debt levels must remain below this threshold for each year of the remaining 10-year period covered by the analysis.

The IMF acknowledges that debt relief has been granted "too little, too late".[5] The current LIC-DSF and even the 2024 supplemental guidance are not categorical enough in setting an objective and quantitative goal for debt restructuring agreements. Most of the recent debt restructurings have lowered debt only just below the threshold for "high-risk of debt distress". This means that countries could relapse into "high risk" after a single natural disaster or other shock. For example, Zambia's 2023 restructuring reduced debt from 120 per cent to 54 per cent of GDP, but climate shocks in 2024 pushed it back to 62 per cent.[6]

Too little debt relief fails *"to re-establish debt sustainability and market access in a durable way".*[7] It leaves countries at risk of repeated restructurings and with a high cost of capital that blunts economic recovery. This discourages more low-income countries from applying for debt relief under the Common Framework despite the fact that over half of them are rated at "high risk of debt distress". Debt restructurings have historically been politically and socially painful experiences; they must be made worth it. The LIC-DSF must not permit staff judgement to set external or public debt targets above the threshold of "moderate risk of debt distress with substantial space to absorb shocks" at the point when debt restructuring agreements are signed, nor at any point throughout the subsequent 10-year timeframe.

Human rights[8]

<u>Recommendation 3</u>: In addition to the baseline projection and stress tests, the LIC-DSF must include an "ambitious scenario" for all countries, where government spending is increased in order to achieve the Sustainable Development Goals (SDGs) or other UN benchmarks for the progressive attainment of universal economic and social rights. Governments and donors must invest more resources into applying existing standardised methodologies to estimate the cost of each SDG in each country in consultation with the government and civil society (and can meanwhile use per capita estimates of countries of similar income level and region). The ambitious scenario must indicate how much additional concessional borrowing (until the debtor reaches the threshold for high-risk of debt distress) or additional grants or debt relief are needed to ensure debt sustainability. The LIC-DSF must let users customise both the spending and financing of the ambitious scenario.

Under the current LIC-DSF, the baseline scenario is based on current policies, including both the current government spending plan and the inflows of external resources that are expected based on donors' plans. The IMF and World Bank consider that it is the borrowing government's responsibility to integrate the SDGs into their current spending plan. In practice, however, governments do not do this because they know that they cannot finance more ambitious plans.

The ambitious scenario could be used as a fundraising tool, to encourage borrowing governments to develop national development plans showing donors what could be achieved with debt relief or additional grants and concessional loans. While governments could, in theory, do that unilaterally outside of the LIC-DSF, it requires expertise that they often lack. They also face pressure from donors not to ask for too much. As members of the UN system bound by international human rights law, the IMF and World Bank should produce the ambitious scenario to give a strong signal to borrowing and donor governments alike that financing plans ought to be aligned with the SDGs. This ambitious scenario will help civil society to advocate for the borrowing government to include the SDGs in their spending plans. Borrowing governments could and should be more assertive and present ambitious spending plans to be integrated into the IMF's baseline projections, because it is their legal obligation under human rights treaties.

The IMF and World Bank can draw upon national and international sources to estimate the cost of SDGs, such as UN Conference on Trade and Development (UNCTAD)'s Sustainable Development Finance Assessment (SDFA) Framework,[9] in consultation with civil society. Donors must invest more resources into these analyses.

The positive impact of social spending on economic growth and exports (including long-term positive impacts on productivity) must also be included (see Recommendation 9).

Climate change[10]

<u>Recommendation 4</u>: The stress test for natural hazards must: i) be applied to all countries, ii) assume recurrent shocks, and iii) be recalibrated with updated and, where available, country-specific studies.

The current LIC-DSF already includes a stress test for natural hazards, although this is only required for very vulnerable countries (ie, a list of small states that are vulnerable to climate change plus countries that experience at least two disasters every three years leading to a loss of Gross Domestic Product (GDP) of 5 per cent per year). Stress tests are meant to capture the impact of contingencies, ie, events that might or might not occur during the projection period. Low-income countries are particularly vulnerable to natural hazards, which can and do take place periodically in any of them. The stress test must therefore be applied to all countries. For the very vulnerable countries, natural hazards are a "known unknown" and should be reflected in the baseline projection (see Recommendation 5). A natural hazard stress test can still be applied to these countries to capture possible extreme weather events above and beyond expected disasters captured in the baseline.

The current stress test assumes a single natural hazard occurring in the second year of the projection, which currently runs for 10 years. That is an unrealistically low frequency for many countries, and even less realistic if the time horizon is extended (see Recommendation 22). The stress test must assume recurrent disasters, based on the country's history but considering a likely increase in frequency due to climate change.

The stress test assumes: an increase in the debt-to-GDP ratio of 10 percentage points; a decrease in the GDP growth rate of 1.5 percentage points; and a decrease in exports of 3.5 percentage points in the second year of the projection. These assumptions must ideally be tailored to the country's experience considering a likely increase in the severity of disasters because of climate change; in the absence of country-specific studies, updated averages of countries of similar income levels and regions should be used.

<u>Recommendation 5</u>: Baseline projections must take into account the impact of natural hazards for countries experiencing frequent hazards. They must also incorporate the long-term, slow-moving impact of climate change on economic growth and exports of all countries, using the best available in-depth models of the economy and climate.

GDP growth, current and fiscal balance must be lowered every year throughout the baseline projection for countries experiencing frequent natural hazards (ie, at least those for which the natural hazards stress test is required in the current LIC-DSF).

Building on the 2024 supplemental guidance note on the LIC-DSF, the baseline macroeconomic projections must take into account the long-term, slow-moving impacts of climate change.

<u>Recommendation 6</u>: The "ambitious" scenario (see Recommendation 3) must also include cost estimates for the country's climate adaptation and mitigation needs.

The LIC-DSF must incorporate the climate module of the SRDSF, including both its adaptation and mitigation sub-modules, into the ambitious scenario (see Recommendation 3). However, the additional spending on adaptation and mitigation must be included from the first year of the projection, not the sixth, as it is imperative to invest in climate adaptation and mitigation now. It must draw on Nationally Determined Contributions and National Adaptation Plans. We cannot assume that the private sector alone will meet the investment needs for climate adaptation and mitigation; therefore, increased public financing must be factored in. The positive impact of adaptation and mitigation spending on economic growth and exports (including long-term positive impacts on productivity) must also be included (see Recommendation 9).

<u>Recommendation 8</u>: Beyond climate change, the IMF and World Bank must invest in data and analytical capacity to integrate other environmental threats in the LIC-DSF and develop a stress test for a nature-collapse scenario.

To comprehensively address the development challenges facing low-income countries, the IMF and World Bank should prioritise investments in data collection and analytical capacity. This will enable the LIC-DSF to integrate assessments of various environmental threats, such as biodiversity loss, deforestation and water scarcity, in addition to climate change. By doing this effectively, the LIC-DSF can provide a more nuanced and accurate evaluation of low-income countries' long-term debt sustainability, ultimately supporting more informed decision-making and sustainable development outcomes.

Nature-collapse-related risks are increasingly being taken very seriously by others who are assessing risks to economic sustainability. The World Bank and credit rating agencies have developed tools for assessing the scale of these risks and their macroeconomic impact, and for integrating the LIC-DSF.[11]

Economic forecasting[12]

<u>Recommendation 9</u>: The LIC-DSF must increase the fiscal multiplier of economic growth. It must also take into account the long-term "scarring" effect of negative shocks and long-term positive effect of public investment (including current spending on human development) on productivity.

IMF staff themselves have long recognised that they tend to be over-optimistic in their economic forecasts.[13] This is a major reason why debt restructuring tends to occur too little, too late. Recent studies confirm that this over-optimism is persisting despite the revision of the LIC-DSF adopted in 2018.[14] The contractionary effect of fiscal adjustment and the expansionary effect of public investments tend to be underestimated. That is particularly true for countries with poor governance, over-dependence on commodities exports, or access to international financial markets. The long-term scarring effects of large shocks and the long-term positive effect of public investments (including current spending on human capital) on productivity are also neglected. Finally, more granular multipliers (varying by type of fiscal policy, stage in the business cycle and country context) should be used to the extent of data availability.

The LIC-DSF must also increase the transparency of its economic projections (see Recommendation 27) and give incentives to staff to counter the optimism bias (see Recommendations 24 and 25).

<u>Recommendation 10</u>: The IMF and World Bank must review and reflect on their past projections of fiscal balance in debt sustainability analyses and produce more detailed

guidance to staff to assess political feasibility, including more extensive consultation of national civil society.

The IMF tends to overestimate the political feasibility of its adjustment programmes: projections of fiscal balances, and particularly of rising revenue, are too optimistic.[15] That is another major reason behind the “too little, too late” phenomenon. Enabling a public debate about the fiscal measures assumed in the projections is therefore very important (see Recommendation 26).

<u>Recommendation 11</u>*: Stress tests’ assumptions that are probable must be included in the baseline projections, based on historical experience that the debt sustainability analysis must document.*

Over-optimism is also reflected in the exercise of judgement: “downside risks” dominate “upside risks” in 90 per cent of the debt sustainability analyses carried out between 2020 and 2022, with “exceptionally high” downside risks in 30 per cent of them.[16] Analyses show that downside risks often come to pass.[17] The baseline scenario is intrinsically optimistic when it fails to take into account events that are likely to occur. It would be reasonable to build a safety buffer into the economic forecast by integrating probable stress test scenarios into the baseline itself (as in Recommendation 5, but for all stress tests). That is relevant to all low-income countries because of their limited fiscal space, but particularly to those rated at “moderate risk of debt distress with limited space to absorb shocks”. Debt sustainability analyses must indicate whether the scenario of each stress test has actually occurred or has almost occurred in the past 10 years.

Debt sustainability indicators

<u>Recommendation 12</u>*: A flow indicator (either interest payments, or debt service, or net debt flows – all relative to revenue) for total public debt must be added to assess the risk of public debt distress.*

Total (external and domestic) public and publicly guaranteed debt flow indicators are critical to assess public debt sustainability because it is the government’s total debt service (regardless of the nature of the creditor) that drives the austerity that undermines progress on development and climate goals. Debt stock indicators are merely indicative of future debt flows.

The absence of a public debt flow indicator in the current LIC-DSF is a major source of disconnect between the global debt justice movement and decision-makers in the current debt debate. The former argue that we are facing the worst debt crisis ever on the basis of this indicator.[18] The latter retort that the situation is not as bad as before the Heavily Indebted Poor Countries (HIPC) initiative in the 1990s.[19] However, the latter fail to consider domestic debt service altogether, which was low in low-income countries in the 1990s and high today. While they do acknowledge that external debt service is at an all-time high, driven by more expensive private creditors, decision-makers misinterpret this as a temporary liquidity crisis.[20]

Including indicators of total public debt in debt sustainability analysis does not imply that all public debt must be included within the perimeter of debt subject to restructuring. That is consistent with the current practice of including multilateral debt in debt sustainability analyses, but not in the restructuring perimeter (although we believe that one should be!). Existing IMF guidance advises strong caution when considering the inclusion of domestic debt in the restructuring perimeter, due to the high risk of domestic spillovers (eg, banking crisis and recession). Risks of external debt and public debt must continue to be assessed separately.

<u>Recommendation 13</u>: A stock indicator for total external debt (public plus private) must be added as a debt sustainability indicator. The risk of external public debt distress could continue to be assessed separately from the risk of total external debt distress.

While public and publicly-guaranteed debt represents the bulk of external debt for many low-income countries, external debt contracted by the private sector and not guaranteed by the government is substantial for some of them. Excessive external borrowing by the private sector can put pressure on the balance of payments and exchange rate, thereby affecting the economy and government finances.

Total external debt does not feature in the LIC-DSF, except as one element to consider by staff when exercising judgement over the mechanical signals of the macroeconomic framework. However, it is hard for staff to judge the risk posed by private external debt without quantitative benchmarks.

Paying attention to private external debt is likely to become more important in future. While the 1990s debt crisis was enabled by overlending by Paris Club official creditors, and today's debt crisis was caused by overlending by non-Paris Club official creditors and external and domestic private creditors, the next debt crisis might be enabled by a switch of lending to private instead of public borrowers. Low-income countries face huge investment needs to adapt to climate change and meet the SDGs. There is a push from creditor governments to leverage billions of dollars of public funds into trillions of dollars of private funds to meet those needs. This drive clashes with the limited debt-absorbing capacity of low-income countries, the measure of which is the purpose of the LIC-DSF. It must be expected that there will be an increase in lending to the private sector in low-income countries by both official external and private external creditors (some of which may be guaranteed by official creditors, philanthropic organisations or specialised private sector actors but not by the government and hence not included in public and publicly-guaranteed debt). We have warned against relying so heavily on the private sector to finance development.[21] The LIC-DSF must be adapted to monitor this worrying trend.

Data on external private sector debt already features in the reference tables of debt sustainability analyses. It is weak in many low-income countries, meaning that this indicator might not be reliable. For this LIC-DSF review, this indicator could be added on a non-binding basis. However, the data availability must be remedied in the medium term.

<u>Recommendation 14</u>: The indicator "Present value of public and publicly-guaranteed debt-to-revenue ratio" should be added.

While exports are the more relevant denominator to assess the sustainability of external debt, government revenue is the more relevant denominator to assess public debt sustainability.

<u>Recommendation 15</u>: The presence of substantial domestic arrears – such as unpaid obligations to vendors and civil servants – should automatically trigger an "in distress" rating, and therefore a determination that the debt is "unsustainable".

Arrears to creditors above a de minimis amount already trigger an automatic "in debt distress" rating. This is not the case, however, for arrears to providers of goods and services to the government. Leaving civil servants unpaid for months in order to reimburse banks and hedge funds should not be encouraged.

Debt-carrying capacity

<u>Recommendation 16</u>: IMF and World Bank staff must explore the explanatory power of additional variables in the composite indicator of debt-carrying capacity to reflect the greater

heterogeneity of low-income countries, and include the variables that do have explanatory power. Variables to be explored include: ratio of domestic public debt to public debt or other measures of domestic financial market depth; ratio of external public debt to private creditors to external public debt or other measures of external market access; average interest rate on outstanding public debt; average maturity of outstanding public debt; vulnerability to climate change or Small Island Developing State (SIDS) status; and measures of political fragility or conflict.

The countries subject to the LIC-DSF have grown more diverse. A one-size-fits-all approach to debt-carrying capacity is unlikely to be fit for purpose. The proportion of domestic debt and external debt to private creditors, or alternatively the average maturity and interest rates of outstanding debt, are relevant because domestic debt and debt to external private creditors tend to carry higher interest rates and shorter maturities, hence probably lower the debt-carrying capacity. Vulnerability to climate change or conflicts may affect debt-carrying capacity as well.

<u>Recommendation 17</u>: *Abandon the three brackets of debt-carrying capacity.*

The current LIC-DSF puts borrowing countries in three buckets – weak, medium and strong debt-carrying capacity – which greatly affects the debt that they are supposed to be able to carry, as well as the amount of debt relief they receive when they restructure their debt. That creates threshold or cliff-edge effects, whereby a government may suddenly be expected to carry significantly more debt even though it has not done anything (as many variables driving debt-carrying capacity are out of the government's control). The recent debt restructuring in Zambia highlights this problem: creditors demanded the insertion of a contingency clause requiring Zambia to repay significantly more debt if its composite indicator of debt-carrying capacity increases only marginally. The debt thresholds should be country specific, not based on which debt-carrying capacity bucket the country falls into.

Debt sustainability thresholds

<u>Recommendation 18</u>: *The debt sustainability thresholds for each of the existing debt sustainability indicators must be recalibrated with recent data, and those of new debt sustainability indicators must be calculated. The weights of the objective to simultaneously minimise the occurrence of missed crises (2/3) and false alarms (1/3) must not be changed.*

The debt sustainability thresholds must, of course, be recalibrated to remain current. Given the absence of missed crisis – ie, all countries that experienced debt distress since the last revision of the LIC-DSF in 2018 were rated at high risk of debt distress before the distress event – and the high proportion of low-income countries that have been rated at high risk of, but without moving into, debt distress for the past few years (ie, a lot of "false alarms"), there may be a temptation to raise the level of false alarms. That must absolutely be avoided by virtue of the precautionary principle: the goal of the LIC-DSF is to warn about risk. Besides, because many countries have been carrying high debts without default, the recalibration is likely to produce higher thresholds, which means that fewer countries will be rated at high risk after recalibration.

<u>Recommendation 19</u>: *The debt sustainability thresholds must be recalibrated again in 2027.*

As already mentioned, there has been widespread acknowledgement that debt relief has been provided too little, too late.[22] Past experience is therefore not a good guide for future policy. Given that many countries have crossed the current high-risk threshold for several years, the frequency of debt distress events could increase in the near future. If that turns out to be the case, the IMF and World Bank should not wait for the next review of the LIC-DSF in five years to recalibrate the thresholds again. The timing of the 2025 recalibration (at a time of high indebtedness with few defaults) would give a false sense of security. More frequent recalibration of the thresholds, without changing the rest of the model, is easy to do and could become routine.

Debt coverage

<u>Recommendation 20</u>: The IMF and World Bank must redouble efforts to ensure that the data for debt sustainability analyses covers all the country's external and domestic public and publicly guaranteed debt, including the debt of state-owned enterprises.

Omitting some debt or including poor data in debt sustainability analysis obviously undermines confidence in the results.

Country coverage

<u>Recommendation 21</u>: For countries that are losing eligibility to the IMF and World Bank's concessional lending facilities and that are therefore graduating from the LIC-DSF to the SRDSF, the IMF must continue to produce debt sustainability analyses according to the LIC-DSF, in addition to an alternative analysis based on the SRDSF, for a period of five years and use the more conservative one (ie, the one that is most pessimistic about debt sustainability) in its lending and debt relief decisions.

Graduating out of concessional funding raises a serious risk of debt unsustainability, as it often leads countries to take on too much debt from expensive private creditors. Likewise, the shift from one debt sustainability framework to the other involves a threshold effect that is potentially harmful. The recent debt restructurings of Ghana and Sri Lanka are a case in point. The LIC-DSF was used for the former and SRDSF for the latter, even though the former relied more on private creditors than the latter.[23] The case of Sri Lanka has also highlighted serious shortcomings with the new SRDSF.[24]

Time horizon

<u>Recommendation 22</u>: The timeframe of the LIC-DSF must remain 10 years, but indicative 30-year projections must be added.

Economic forecasting is hard; it is harder for low-income countries; and it is much harder to make forecasts for the very long term. The 10-year timeframe for the risk-rating of the LIC-DSF is appropriate. However, an indicative 30-year projection would be useful to inform debate, particularly on the interactions between debt and climate change.

RECOMMENDATIONS ON THE GOVERNANCE OF DEBT SUSTAINABILITY ANALYSES

Ownership

Recommendation 23: The IMF and World Bank must support the effort to create a UN Framework Convention on Sovereign Debt,[25] which, among other provisions, would create a debt restructuring process based on debt sustainability analyses that are developed independently from both the debtor and its creditors. The immediate opportunity to do so is the UN Financing for Development Conference IV in July 2025.

As technical documents, debt sustainability analyses are written by IMF and World Bank staff. Because of their political significance, they are susceptible to influence by the IMF and World Bank's boards, which are controlled by creditor countries, as well as by the IMF and World Bank's senior management, given that these institutions are themselves creditors. There are documented cases where the IMF and World Bank have probably massaged their analyses in order to lend more to over-indebted countries instead of recommending the debt relief they needed (eg, Argentina,[26] Egypt,[27] Ethiopia[28] and Pakistan,[29] with more cases expected in the near future as the IMF and World Bank now want to see upcoming crises as temporary liquidity crises,[30] which call for more loans, instead of solvency crises,[31] which call for debt restructuring).

Creditors' control over debt sustainability analyses constitutes a conflict of interest that compromises the credibility of these analyses, no matter how well the analytical framework is improved. Recommendations 26 to 31 are meant to increase transparency in the LIC-DSF. Implementing them will hopefully make political interference more difficult to hide. Nevertheless, no degree of transparency will be enough to overcome the conflict of interest due to the framework's complexity and to the uncertainty inherent in any economic forecast. The only solution is to move decision-making over debt sustainability analyses to a forum that is independent from both debtors and creditors. The World Bank itself floated the idea of basing debt sustainability analyses on economic forecasts assessed independently.[32]

While independent debt sustainability analyses would govern debt relief decisions, any lender or borrower could of course carry out their own analysis for their own lending or borrowing decisions. Even if debt restructuring processes were moved to the United Nations, the IMF would continue to play a major role as lender of last resort. While creditors would lose their influence to short-change debt relief initiatives, they could not be forced to lend fresh money. They would presumably continue to demand IMF programmes as a guarantee of forward-looking creditworthiness. That implies that the IMF would continue to have a LIC-DSF and that the United Nations and the IMF would have to coordinate closely and in real-time when a country requests a debt restructuring, as the decision of each institution would be impacted by the other: the size of the IMF loan (if any) would impact the scale of debt relief and vice versa. Such interdependence would be no different from the current practice of the IMF seeking "financial assurances" from official donors and lenders before it lends to a country seeking debt restructuring to ensure that no financing gap remains.

Accountability

Recommendation 24: The IMF and World Bank must expand their whistleblower protection policies to encourage staff to expose pressures from their board or senior management to alter the debt sustainability analyses they draft. (This policy could be extended to other economic analyses informing board decisions.)

Since the LIC-DSF will continue to inform the IMF and World Bank's lending decisions, which are themselves hugely important with or without debt relief, it is important to address the conflict of interest mentioned in Recommendation 23 within the IMF and World Bank themselves.

Recommendation 25: *The IMF and World Bank must create a prize to reward staff producing the best economic forecasts.*

Economic forecasting will always remain very difficult and subject to significant errors. However, forecasting errors should be random, not systematically biased in one way or the other despite repeated reviews of the methodology. The optimism bias (see Recommendations 9 to 11) is a major way in which the IMF and World Bank's bias toward creditors manifests itself. Staff must be incentivised to counter that bias. Such prizes already exist for forecasters in the private sector.[33]

Transparency and participation[34]

Recommendation 26: *The IMF must consult civil society ahead of debt sustainability analyses and at the design stage of programmes, and publish IMF programme documents (including the debt sustainability analysis) at the time of the staff-level agreement with the borrowing government.*

IMF loan agreements are politically very important and the analyses behind them ought to be publicly released before approval by the IMF board and translation into the national budget by the borrowing country's parliament. National parliaments should also approve IMF agreements themselves. That will enable a real national debate about the country's financial future, involving the media, academics and civil society organisations.

This recommendation is consistent with Recommendation 23, as it would clearly separate the technical analysis (by the IMF staff) from the political decision (by both the IMF board and national parliament). It is also consistent with the good current practice in IMF documents of summarising the board discussion ahead of the staff analysis.

While such transparency may create volatility in financial markets, any IMF programme is a market surprise. The disadvantage of having two surprises (one at the time of the staff-level agreement, and possibly a second at the time of board approval, if the final programme differs from the staff proposal) is outweighed by the imperative of having a democratic debate.

Recommendation 27: *The LIC-DSF write-up must provide narrative explanations supporting the economic forecasts for GDP, exports, revenue, interest rate, exchange rate, primary balance and fiscal multiplier.*

Economic forecasts are a critical input into the LIC-DSF. They are controversial (see Recommendations 9 to 11) and ought to be better argued.

As initiated in the SRDSF, the graphs of the realism tools must be accompanied by narrative explanations and conclusions.

Recommendation 28: *The debt sustainability analysis must include an assessment of data quality and of compliance with the Debt Reporting System (with rating).*

The LIC-DSF should be more transparent about the quality of the data it relies on. A rating of data quality similar to that of Debt Management Performance Assessments would incentivise the government to increase that quality. See also Recommendation 32.

<u>Recommendation 29</u>: Debt sustainability analyses must include an executive summary explaining in plain language their conclusions in more detail than the current abstract. In addition, they must be translated into the country's national language(s).

Non-technical language and translation would increase the accessibility of this document, which carries huge political significance.

When the debt sustainability analysis is accompanying a loan, the loan agreement must also include a translated executive summary in non-technical language. When the debt sustainability analysis accompanies a debt restructuring process, the executive summary must clearly indicate the key restructuring parameters: the financing gap; each donor's contribution to filling the gap; residual needed cash flow requiring debt relief; implied amount of required debt relief as a percentage of the debt's face value and in Net Present Value terms, and for the first debt sustainability analysis following the implementation of debt restructuring agreements with creditors, the metrics showing how comparability of treatment among creditors was achieved.

<u>Recommendation 30</u>: The spreadsheet version of each debt sustainability analysis must be published alongside the narrative version.

The IMF has helpfully published the spreadsheet template that its staff uses to produce debt sustainability analyses, as well as the spreadsheet versions of some historical debt sustainability analyses.[35] Systematically publishing the spreadsheet version alongside the narrative version of each debt sustainability analysis would allow parliamentarians, academics and civil society to make deeper sensitivity analyses, which would in turn inform the public debate.

<u>Recommendation 31</u>: Historical debt sustainability analysis must be compiled into a single, easily searchable database.

Such a database would be very helpful for researchers.

OTHER RECOMMENDATIONS

What follows are recommendations for other IMF and World Bank processes relevant to the LIC-DSF.

Recommendation 32: The World Bank must publish its Debt Management Performance Assessments.

This would further improve debt transparency.

Recommendation 33: The IMF must strengthen its social spending floor policy, and extend its scope to climate spending.

The IMF's social spending floor policy plays a critical role in mitigating the harshest impacts of austerity required by its programmes. However, the policy remains inadequate and inconsistently implemented. The IMF should base social spending floors on each country's national development strategy and transform them into outcome-based binding conditions, developed and mutually agreed with country authorities and their citizens. Additionally, the IMF should establish clearer and more transparent mechanisms for monitoring both changes in the composition and levels of social expenditure over time.[36]

Recommendation 34: The IMF must make distributional and human rights impact assessments to inform its loan agreements.

The IMF must comply with human rights law and ensure that, at a minimum, its programmes do not lead to an increase in inequality or a regression in economic, social and cultural rights. As the UN Guiding Principles on Human Rights Impact Assessments of Economic Reforms state, "the purpose of these [human rights impact assessments should be to assess the short, medium and long term human rights impacts of proposed policies"[37] that accompany IMF programmes in the form of conditionalities and recommendations. Human Rights Impact Assessments should comply with the principles of participation, access to information and accountability.

Recommendation 35: The IMF and World Bank must review the eligibility criteria for their concessional lending facilities to ensure a smoother and more gradual transition over time for countries graduating from concessional support.

Graduating from concessional lending constitutes a big financial challenge and must become an even slower, more gradual process.

Recommendation 36: The IMF and World Bank must open eligibility to their concessional lending facilities to countries that are vulnerable to climate change.

Most, if not all, loss and damage and adaptation funding should take the form of grants or very concessional loans, even for middle-income countries.

ENDNOTES

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