Review of the IMF's Debt Limits Policy for Low-Income Countries

We would like to thank the IMF for the opportunity to provide suggestions on IMF policies regarding debt limits for low-income countries (LICs). The IMF-World Bank Debt Sustainability Framework (DSF) was set up in the wake of the Gleneagles debt deal in 2005, in order to ensure that another debt relief initiative would not be necessary. This was meant to be done by determining whether countries should receive grants or loans according to indebtedness and institutional performance indicators ("capacity"). In 2009 the IMF launched a new policy on external debt limits in IMF-supported programs in order to prevent the build-up of unsustainable debt burdens, while allowing for adequate external financing.

We welcome the IMF's intention to prevent the build-up of unsustainable debts. However, the Debt Sustainability Framework has not been able to prevent this. According to the IMF's own estimates, one third of LICs and one fourth of countries that received debt relief through the Heavily Indebted Poor Country (HIPC)-Initiative, are now at high risk of debt distress[1].

We therefore welcome some of the changes made to the DSF earlier this year, which involves lowering the threshold for debt distress[2]. However, it is concerning that the DSF solely looks at ability to pay when making judgments on a country's indebtedness, rather than a broader criteria of the impact debt repayments are having on a country's ability to cut poverty and promote human rights. What's more, contrary to what the review says, the data in the review illustrates that the DSF analyses tend to consistently under-predict future debt burdens.

Additionally, the recent review recognizes that external private debt, contingent liabilities and domestic debt are important when assessing debt vulnerability. This is of great significance, as external private debt is a large – and growing - part of LICs' total debt burden.

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[1] The IMF-report "Preserving Debt Sustainability in Low-Income Countries in the Wake of the Global Crisis" (2010). Download here: http://www.imf.org/external/np/pp/eng/2010/040110.pdf. These calculations were confirmed in the report "Initiative for Heavily Indebted Poor Countries and Multilateral Debt Relief Initiative- Status of Implementation and Proposals for the Future of the HIPC-Initiative" (2011). Download here: http://www.imf.org/external/np/pp/eng/2011/110811.pdf

[2] "Revisiting the Debt Sustainability Framework for Low-Income Countries" (2012). Download here: http://siteresources.worldbank.org/INTDEBTDEPT/PolicyPapers/23125643/RevisitingDSFLIC201201.pdf

Unfortunately, the review does not provide detail on how an additional risk rating for such debt will be formulated. Strangely, the review also suggests cutting down on debt analyses, and only conducting them every three years.

Finally, the largest problem with the IMF debt limit policy is that the Fund does not adhere to its own framework, as a report by the Center for Global Development reveals[3]. The report illustrates that half of HIPC-lending in 2008 and 2009 went to countries that were either already in debt distress, or at a high risk of experiencing debt distress.

As the Principles on Promoting Responsible Sovereign Lending and Borrowing, launched by the United Nations Conference on Trade and Development (Unctad) in April 2012, suggest, lenders are responsible for making a realistic assessment of the sovereign borrower's capacity to service a loan[4]. Unfortunately, the World Bank-IMF Debt Sustainability Framework has not made realistic assessments, as many LICs now face mounting, unsustainable debt burdens[5]. There is clearly a need for a debt work-out mechanism as well as a better framework to prevent unsustainable debt burdens from building up again. We therefore urge the IMF to ensure:

- More cautiousness in the DSF in order to ensure more accurate predictions.
- That IMF-lending adheres to the Debt Sustainability Framework, in order to prevent lending to countries in risk of high debt distress.
- That the DSF should not solely look at a country's ability to pay when judging a country's indebtedness. The analysis should also consider the impact debt repayments are having on a country's ability to cut poverty and protect basic human rights, such as the right to education and health care.
- Quantified indicators to monitor the risk of external private debt, contingent liabilities and domestic debt.
- The Fund and the Bank should conduct full annual debt sustainability analyses.
- IMF-lending to LICs should be in line with the Principles on Promoting Responsible Sovereign Lending and Borrowing.

We hope that our suggestions will be carefully considered. Regards,

The Norwegian Coalition for Debt Cancellation,
The Norwegian Forum for Environment and Development,
Jubilee USA Network,
Norwegian Church Aid,
The Development Fund (Norway),
11.11.11, The Coalition of the Flemish North-South movement (Belgium),
FOKUS – Forum for Women and Development (Norway)

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[3] Red Flags and Red Lights for IMF Lending to HIPCs, Center for Global Development, 2010. Download here: http://www.cgdev.org/content/publications/detail/1423285

[4] Download the Principles here: www.unctad.info/en/Debt-Portal/Project-Promoting-Responsible-Sovereign-Lending-and-Borrowing/About-the-Project

[5] The IMF-report "Initiative for Heavily Indebted Poor Countries and Multilateral Debt Relief Initiative- Status of Implementation and Proposals for the Future of the HIPC-Initiative" (2011).