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PUBLIC DEBT: A PRIMER FOR DEVELOPMENT PRACTITIONERS

June 2022

This publication was produced for review by the United States Agency for International Development. It was prepared by DevTech Systems, Inc. under the Fiscal Accountability and Sustainable Trade Task Order, 7200AA18D00010/7200AA19F00015.

PUBLIC DEBT: A PRIMER FOR DEVELOPMENT PRACTITIONERS

Program title:	Fiscal Accountability and Sustainable Trade (FAST)
Sponsoring USAID Office:	The Center for Economics and Market Development (EMD)/ Bureau for Development, Democracy, and Innovation (DDI)
Contracting Officer's Representative:	Theresa Stattel
Contract No.	7200AA18D00010
Task No.	7200AA19F00015
Contractor:	DevTech Systems, Inc.
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Date of submission:	June 7, 2022
Date of approval:	June 13, 2022

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ACKNOWLEDGMENTS

The authors would like to extend special gratitude to USAID staff, Anton Kamenov, David Dod, Steve Rozner, Samantha Schasberger, and Theresa Stattel for helpful comments. We would also like to thank Mark Gallagher and Audra Killian of DevTech Systems, Inc., for their guidance and support to this work, and Xavier Debrun for preparing the initial outline for this report.

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Acronyms

CBK	Central Bank of Kenya
CF	Common Framework
CPIA	World Bank's Country Policy and Institutional Assessment
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
DAC	Development Assistance Committee
DeMPA	Debt Management Performance Assessment
DMFAS	Debt Management and Financial Analysis System
DMD	Debt Management Department
DMO	Debt Management Office
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
DSSI	Debt Suspension Initiative
EMBI	Emerging Markets Bond Index
FRL	Fiscal Responsibility Law
FRS	Fiscal Risk Statement
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GNI	Gross National Income
HIPC	Heavily Indebted Poor Country
IDA	International Development Association
IMF	International Monetary Fund
LIC	Low-Income Countries
LIC DSF	World Bank-IMF Debt Sustainability Framework for Low-Income Countries
LMIC	Lower Middle-Income Countries
MAC	Market Access Country
MDRI	Multilateral Debt Relief Initiative
MOF	Ministry of Finance
MTDS	Medium-Term Debt Strategies
MTEF	Medium-Term Expenditure Framework
MTFF	Medium-Term Fiscal Framework
NPV	Net Present Value
OECD	Organization for Economic Cooperation and Development
PBO	Parliamentary Budget Office
PDD	Public Debt Department
PDM	Public Debt Management
PFM	Public Financial Management
PPG	Public and Publicly Guaranteed
PPP	Public-Private Partnership
PRC	People's Republic of China
PRS	Poverty Reduction Strategy
PV	Present Value
SOE	State-Owned Enterprise
UMIC	Upper Middle-Income Countries
UNCTAD	United Nations Conference on Trade and Development
USAID	United States Agency for International Development

I. INTRODUCTION

The steady increase in public sector indebtedness across countries after the Global Financial Crisis and exacerbated by the COVID-19 crisis, has put debt issues at the center of international policy discussions. Debt vulnerabilities—the fragilities created by higher debt burdens—have increased in most countries and are a source of concern in many emerging and developing economies. Some middle-income countries have already defaulted or restructured some of their debts. The World Bank and the International Monetary Fund (IMF) have warned about increasing risks, with half of the low-income countries (LICs) assessed as being in debt distress or at high risk of debt distress—when a country faces difficulties in servicing its debt.¹ Increasing debt burdens are forcing other countries to make difficult trade-offs between the public investments needed to fuel growth and meet development objectives, and the pressure they face to contain debt vulnerabilities. High debt levels also reduce the room for policy maneuvers to deal with adverse shocks.

The costs of excessive debt are significant since debt reduction requires fiscal adjustment—for example, spending cuts or tax increases—that can have negative effects on the level of economic activity. Think of Greece, where austerity measures following its debt crisis caused the economy to shrink by almost 20 percent between 2010 and 2016. Alternatively, where fiscal austerity is not possible or politically feasible, countries may rely on the central bank to finance fiscal deficits, leading to high inflation and a drag on growth; Argentina, whose economy has stagnated and suffered high inflation for 15 years, is a case in point. More recently, debt overhangs have severely affected economic developments in countries as diverse as Mozambique, Zambia, and Lebanon.

Ample historical experience indicates that the cost of debt crises, or debt vulnerabilities, is significant (see **Box 1**).

Box 1 The Cost of Debt Crisis

Sovereign debt defaults are costly. A standard way to assess the cost of default for borrowing countries is to calculate the foregone growth in output (real GDP). Furceri and Zdzienicka (2008) find that debt crises reduce economic growth by about 5 to 10 percentage points, on average. While the effects fade over time, eight years after the occurrence of a debt crisis, output is estimated to be 10 percent lower than it would have been had the

¹ The Evolution of Public Debt Vulnerabilities in Lower Income Economies, IMF, February 2020.

default never happened. Economic research has identified three external channels through which sovereign debt crises affect growth.

The first channel is the loss of access to international debt markets, which on average may last about four years.

The second channel, related to the first, is the temporary increase of external financing costs (interest paid on current international debt), which may climb up to 4 percentage points on average in the year following a default episode, to gradually decline afterward.

The third channel is through international trade, which may decline sharply following default episodes, as the default makes trade-credit less available and more expensive for exporting firms.

In addition to these channels, debt crises can affect output indirectly by leading to banking and currency crises. Normally, domestic banks are large holders of government debt, and restructuring may lead to recapitalizations, credit crunches, and even bank runs—which occur when large groups of depositors withdraw money for fear that the banks would become insolvent. The economic upheaval that follows a default can also reduce consumption and investment and leads to declines in productivity.

The political consequences of a debt crisis are also dire for incumbent governments, which makes them reluctant to declare defaults. Wary of the economic costs, governments may procrastinate or attempt policies that in the end may not avoid default and can also amplify its economic costs.

Yet even governments that submit to default pressures can face grave political costs. Based on a sample of 19 countries, Borenstein and Panizza²⁷ find that ruling coalitions lost votes in 18 countries after default episodes. They also find that, on average, ruling governments in countries that defaulted observed a 16 percentage point decrease in electoral support, and that in 50 percent of the cases there was a change in the head of state either in the year of the default episode or in the following year, more than twice the probability of a change of the head of state in normal times. Debt crisis, the resulting economic turmoil, and austerity may also explain the emergence of populist governments and the weakening of democratic institutions that often follow such episodes.

It is not just the level of public debt in developing countries that is attracting international attention. The composition of developing countries' debt is also evolving, with commercial debt, particularly foreign currency bonds, outpacing other sources of financing for low- and middle-income countries. Increased reliance on commercial debt has raised many countries' exposure to market risks.

The increasing diversity of creditors and debt instruments has not only complicated debt management but also undermined debt transparency, which can obscure debt risks and impede the process of debt restructuring when needed. In response to these dynamics, in 2018 the World Bank and the IMF launched an initiative to help borrowing countries take steps to support better public debt reporting, debt management, and monitoring of fiscal risks.² Furthermore, USAID, in 2022, launched the Debt Transparency Monitor as a means to assess the extent to which governments disclose information on public sector debt to their citizens.³

The many issues surrounding public debt are complex. Debt is an important policy tool that helps countries address several objectives. But managing indebtedness in a prudent manner requires limiting

² The Joint IMF-WB Multipronged Approach for Addressing Emerging Debt Vulnerabilities.

³ Debt Transparency Monitor (2022), USAID/FAST at https://pdf.usaid.gov/pdf_docs/PA00Z727.pdf.

the vulnerabilities that arise with the use of debt; otherwise, countries can end up with insurmountable debt burdens that ultimately impede development progress.⁴

With the stakes so high, debt management is a critical area of policy that any government would want to “get right;” this means achieving a proper balance between the benefits and the costs of debt while managing the risks involved effectively.

This primer covers key concepts and tools that are central to public debt theory and practice. Development stakeholders can use the contents of this primer to put the proper emphasis on public debt developments in their analysis and advice, and to understand appropriate roles that USAID and other partners can play. An improved ability to detect early warnings of debt vulnerabilities can help governments take timely and effective measures to mitigate risks, including productive approaches to debt restructuring. Good international practice derived from past cases will inform the discussion.

The structure of this primer is as follows. Section II discusses the main motives for contracting debt, why countries may overborrow and expose themselves to fiscal and macroeconomic risks, and how overborrowing can be contained. Section III discusses instruments countries can use to limit overborrowing. Section IV reviews key global debt developments, especially among low- and middle-income economies. Section V presents the internationally accepted framework for assessing debt sustainability and concrete tools used by multilateral institutions to perform debt sustainability analysis (DSA). Section VI presents best practices in public debt management. Section VII discusses debt restructuring. Section VIII presents how USAID and other donors can help partner countries achieve sustainable debt and effective and transparent debt management. Section IX offers useful resources on debt statistics, transparency, and sustainability.

Readers may also wish to consult the Annexes to this primer, which provide additional discussion on the scope of public debt, how governments raise funds in capital markets, the debt sustainability framework for LICs, key international debt relief initiatives, and a list of projects and assessments that USAID has funded related to public debt. A glossary is also included for quick reference.

II. WHY GOVERNMENTS BORROW AND WHY MANY OVERBORROW

Public debt is a key instrument of economic policy. Borrowing can help countries invest in their development and spur growth. Indeed, countries deprived of credit access are more likely to be caught in poverty traps and aid dependency. Through debt accumulation, governments can mobilize domestic and foreign savings to fund public investment and other growth-enhancing programs such as education, health, or sanitation.

⁴ Excessive debt in LICs by the end of the 1980s led to global interventions to provide debt relief through the Heavily Indebted Poor Country (HIPC) and Multilateral Debt Relief (MDRI) initiatives. See Annex IV.

Public debt can also help countries deal with negative economic shocks and better manage business cycles with appropriate countercyclical policies (e.g., fiscal stimulus). As is well known, these policies were critical for dealing with the consequences of the GFC in 2008 and the COVID-19 crisis in 2020.

Nevertheless, experience shows that countries that do not manage their debt prudently may accumulate excessive debt. Doing so can affect the future ability of governments to repay existing debts, let alone assume new debt to invest in new public assets or stimulate a flagging economy. Rapid growth in public debt and debt service can lay increasing claims on the government budget and crowd out critical development spending. More generally, increasing public debt may result in lower future growth, as it reduces the room for the private sector to borrow, increases uncertainty regarding levels of taxation needed to service public debt, and raises the risk of defaults.

A. DEFINING PUBLIC DEBT

When we talk about debt, we will refer generally to any public sector liability, issued either externally, where non-resident foreigners are the creditors or holders of the liability, or domestically, where local banks or local investors are the creditors. It could be a loan from a commercial or multilateral bank, or a government-issued debt security such as a treasury bill or bond. Debt can even come in the form of accounts payable, such as payments owed by the government to vendors, which represent public sector liabilities until they are settled. In most countries, borrowing takes place in various parts of the public sector: Debt could be created by a central or subnational government, a State-Owned Enterprise (SOE), the central bank, or virtually any other public corporation.

To arrive at a comprehensive definition of debt, the best practice is to consider also *contingent liabilities*, or financial obligations that only arise if a particular event occurs in the future. Contingent liabilities can be *explicit*, e.g., where the government issues a (legally-binding) guarantee for a loan taken by an SOE or a private entity. They can also be implicit, for instance, where there is a public expectation that the national government will bail out local governments or financial institutions should they find themselves in financial straits.⁵

Because of the risks that these contingent liabilities pose, a more comprehensive definition of public debt will focus on both *public and publicly-guaranteed* (PPG) debt, which is the standard used in most international debt statistics. PPG debt includes all the interest and principal owed on the obligations of public sector debtors as well as the obligations of private debtors that are guaranteed for repayment by a public entity. Annex I provides a more detailed discussion of the wide range of debt instruments, the degrees to which the various components of the “public sector” are included in debt reporting and analysis, and selected issues in recording and accounting for public debt.

B. GOOD REASONS FOR GOVERNMENTS TO BORROW

INVESTING

Borrowing is one of the most important means of funding public investment in low- and middle-income countries. Public debt finances investments in infrastructure, agriculture, and social sectors. It can fund

⁵ Implicit guarantees are considered when assessments of fiscal risks are conducted. See Section VIII for more on conducting fiscal risk analysis.

critical research. And it can finance the construction and maintenance of key facilities such as schools, hospitals, clinics, and universities. These capital projects are a key source of economic growth and fundamental for provision of public services to citizens. Yet they typically require large upfront investments that cannot be financed by raising taxes, since sharply higher levels of taxation reduce efficiency, discourage private investment in the economy, and may be politically unfeasible. Alternatively, a government could opt to curtail expenditures for years to build the savings necessary to finance future public investment, but that would delay the benefits of investment and growth unnecessarily. Thus, by not borrowing, governments would lose considerable opportunities to invest in their growth and their people. The opportunity costs are particularly high in countries where domestic savings are low, the private sector is too fragile to borrow enough or at affordable cost, and where the financial sector is not well developed. In these environments, the public sector is often unique in its access to debt financing.

But still, the benefits of debt financing are not automatic. Governments must pay close attention to how they invest or the purposes for which they borrow. The selection of investment projects should prioritize those that provide real contributions to economic growth (e.g., infrastructure that improves communication, electricity access, or transport) and welfare to the broad population (e.g., schools and hospitals in the right places). This highlights the importance of effective public investment management systems.⁶

Given that investment for development yields returns over the long term, the terms of borrowing also matter. The maturity, or length of time until the debt must be fully repaid, should be consistent with the nature of the investment it is financing. It would be unwise, for instance, to issue one-year bonds to finance the upgrade of a port. Like the maturity, the currency denomination and interest rate paid on the debt need to be consistent with the investment portfolio that is being financed.⁷ In the poorest and most vulnerable countries, concessional loans, extended at low-interest rates and with long maturities, are often the most appropriate instrument for such investments. The issue of maturity is closely interrelated with the intergenerational equity discussion (see **Box 2**).

Box 2 Future Benefit or Future Burden? Public Debt and Intergenerational Equity

Public debt may facilitate the intergenerational sharing of the burden and benefits of government investment. While debt-financed public investment places the burden of repayment on the shoulders of future generations, they will also benefit the most from the investments made today. This argument that public investments promote intergenerational equity is disputed, however. Advocates of the theory of public choice point out that while future generations may indeed benefit from investments today, they had no voice in deciding to make such investments nor how to fund them. Moreover, when governments borrow irresponsibly or for ill-advised investments, this may

⁶ Analysis by the IMF suggests that the average country loses about 30 percent of the returns on its investment to inefficiencies in its public investment management processes, and that there is substantial scope for improvement across countries. See “Making Public Investment More Efficient,” IMF Board Paper, 2015.

⁷ Care should be exercised when financing projects with foreign-currency denominated debt and the revenue from such projects is in domestic currency. Variable-interest-rate obligations (as opposed to fixed-rate obligations) also add uncertainty regarding the final financing cost for long-term projects.

generate intergenerational inequity, as future generations will shoulder the consequences of the poor decisions of generations past.

MANAGING INTRA-YEAR FLUCTUATIONS

Typically, governments around the world experience short-term fluctuations in their fiscal balances. These can arise from seasonal fluctuations in spending, for instance from the payment of wage bonuses at year's end. They can also arise from the normal ups and downs of revenue—due to the tax calendar, to the seasonality of certain business activity, or to household spending patterns, for instance increased spending during holidays or summer vacations. These affect consumption taxes like the sales tax, value added tax, or excise taxes, which are important sources of revenue. Similarly, while estimated or anticipated corporate income tax payments are made throughout the year, the annual payment, which is often the largest lump of this tax, tends to be paid during the first or second quarter of the calendar year.

These fluctuations in revenue and spending during the year require governments to manage the resulting imbalances either through fluctuations in a liquid asset (typically bank deposits) or access to short-term debt financing. In this case, the use of public debt helps to cover temporary cash flow deficits that a government might face throughout the year.

MANAGING ECONOMIC CYCLES AND COUNTERCYCLICAL FISCAL POLICY

In any country, given the tax system, tax collections will increase in good times (booms), when consumption and private earnings surge, and decline in bad times (recessions). What should government do in response? One option would be to increase spending in good times and cut it in bad times, keeping the books balanced every year. There are good reasons, however, not to follow this path. More public spending during booms, when aggregate demand is high and supply is stretched, may increase inflation. And if governments increase current expenditures (wages, employment, transfers) in booms, they may be forced to cut them in bad times, adding to the malaise that arises in recessions. If they choose to make new investments in a boom, recessions may create funding shortfalls that result in wasteful interruptions to those projects.

For these reasons, it is widely agreed that governments should run surpluses in good times and deficits in bad times. Thus, in a recession, the government should increase expenditure or cut taxes to bring the economy back to life, while during booms it should lower expenditure or increase taxes. When pursuing *countercyclical fiscal policies* in this way, governments can accumulate liquid assets or reduce debt with their surpluses in good times, so that in recessions they have room to ramp up borrowing or convert liquid assets to cash to finance their deficits. If governments follow this behavior, it is expected that debt burdens will be broadly stable over time, and fiscal policy will contribute to more stable economic activity.

PUBLIC DEBT AS A LOW-RISK SAVINGS INSTRUMENT

It has been argued that public debt instruments can offer a “risk-free” alternative to households and businesses to save. It is not that investing in public debt instruments does not carry risk. It is well known that governments may and sometimes do default on their obligations. But in general, public debt is the

least risky of all the domestic investment alternatives. This is because the government has the legal capacity to tax private incomes and consumption and as such is more diversified, or less exposed to economic risks, than private businesses that issue their own debt. Accordingly, investors will generally demand a lower interest rate to buy government bonds than to buy corporate bonds. Central bank bonds, when they exist, may carry even lower risk and interest rates than government bonds, since the central bank can print currency quickly to service its own debt.

Certainly, some government debt instruments are riskier than others. For instance, short-term bonds, maturing in less than a year, return investors' principal more quickly than long-term bonds do, and therefore tend to offer lower yields than longer-term alternatives, which carry greater repayment risk. Similarly, foreign-currency denominated bonds are riskier than local-currency bonds since exchange rate fluctuations affect governments' ability to repay the debt.

The important point in this discussion is that if the government offers the safest domestic savings option, the interest rate paid on its debt instruments serves as a key benchmark for the rest of the financial market. This is why a deep and efficient market for government bonds is an important first step in developing domestic capital markets, especially in low- and middle-income countries.

C. WHY GOVERNMENTS MAY OVERBORROW

Are there limits to the positive effects that debt issuance may bring? Could the costs associated with higher debt levels outweigh the benefits? The answer is a resounding yes.

There can be a number of reasons why governments find themselves in debt distress, or in situations where debt burdens end up harming the broader economy.

Institutional weaknesses may complicate monitoring of public sector debt transactions and, in turn, lead to unsafe debt accumulation. For instance, a lack of transparency due to incomplete disclosure of fiscal and debt information may cause the sudden emergence of debts that were previously hidden. This is common when there is weak oversight of SOEs, whose debt may be backed by either explicit or implicit government guarantees.

Borrowed resources can also be misused. Weak public investment management systems, not to mention outright fraud, can lead to the financing of proverbial white elephants—projects with no net social value—or low productivity assets, leaving a government with no meaningful revenue stream with which to repay debt. Even assuming these problems can be overcome, overborrowing can arise if policymakers assume unrealistic growth prospects.

Political cycles and governance issues can also explain overborrowing. In an election year, politicians may commit to increasing spending or cutting taxes in order to garner votes. Voters, in turn, may not be sufficiently informed to grasp the implications of such actions, enabling politically motivated borrowing to proceed unchecked. For fear of losing elections, politicians in power may also be reluctant to make fiscal adjustments—for instance, to raise taxes or cut spending—when necessary. Therefore, little by little, countries may end up with high or unsustainable debt levels.

Problems can be compounded by the presence of concentrated interest groups—those that stand to benefit from a particular government policy or program. The beneficiaries will have strong incentives to lobby in support of that policy or spending target, while the taxpayers who ultimately bear the cost may not have the capacity or information needed to oppose it. This can lead to higher spending and gradually higher debt.

Of course, borrowing is a two-way street, and creditors or lenders sometimes share the responsibility for situations where governments find themselves in unsafe debt territory. Creditors may not internalize the risk of debt repayment and lend in excess.⁸ This can occur especially if they lend against collateral and therefore are protected in case of debt distress. In the banking sector, financial rewards (bonuses) are tied to closing a debt deal, independently of the debt being repaid, which can incentivize lenders to understate risks. Geopolitical considerations may motivate official bilateral lending decisions with similar consequences.

III. LIMITING OVERBORROWING

Economists have studied ways for countries to avoid excessive debt. Two broad tools that can help to limit overborrowing—fiscal rules and budgetary institutions and processes—are discussed below.

FISCAL RULES

A fiscal rule imposes a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates. Fiscal rules come in a variety of forms, some limiting a spending aggregate (e.g., total budgetary expenditure, current budgetary expenditure), others limiting a debt aggregate or the deficit. In some cases, rules limit both the deficit and the debt, a strategy that could be useful when debt surprises are common. In other cases, rules limit the contracting of debt only to the financing of investment, prohibiting debt-financed current spending.

Fiscal rules, which are present in about 100 countries,⁹ can have important signaling effects, clarifying the course of fiscal policy over time. Rules can also have a political function by ensuring broad agreement on pursuing a sustainable fiscal policy. An example of a fiscal rule can be found in **Box 3**.

⁸ For instance, some multilateral and bilateral creditors may not be constrained by policies that limit them from financing risky projects or borrowers.

⁹ See Fiscal Rules Dataset, IMF at <https://www.imf.org/external/datamapper/fiscalrules/map/map.htm> and Lledo at al: Fiscal Rules at a Glance, IMF, March 2017.

Box 3 Fiscal Rules in Paraguay

Enacted in 2013, Paraguay's Fiscal Responsibility Law (FRL) features several fiscal rules. In particular:

Rule on the budget balance: The FRL imposes a deficit ceiling of 1.5 percent of GDP for the central government, starting with the 2015 budget. Congress can approve a deficit of up to 3 percent of GDP in cases of national emergency, international crisis affecting the domestic economy, or negative growth.

Rule on Spending: The 2013 FRL caps the real growth of primary (non-interest) spending at 4 percent per year, starting with the 2015 budget.

The Comptroller General is responsible for monitoring FRL compliance. Any breach is deemed a dereliction of duty by the civil servants responsible and subject to sanctions.

Despite the widespread use of fiscal rules, governments' history of compliance with them has been mixed, raising questions about their effectiveness. Successful rules generally have broad institutional coverage—for instance, applying not only to the central government but also to subnational governments and SOEs—and are easy to understand and monitor. Integrating fiscal rules into budget discussions can contribute to their ongoing use and provide a built-in enforcement mechanism. Furthermore, any “escape clauses” need to be precisely defined to cover events that are truly outside the government's control (e.g., a natural disaster or other exogenous shocks).

Some countries have established independent agencies, known as fiscal councils, to support the monitoring and enforcement of fiscal rules, and more generally to promote sound fiscal policies.¹⁰ Fiscal councils date back several decades, but the economic and fiscal fallout from the GFC of 2008-09 led to the rapid proliferation of fiscal councils, including in a number of developing countries. Where they exist, independent fiscal councils are tasked with monitoring compliance and ensuring that rules are not circumvented thanks to over-optimistic assumptions (like high growth, or unrealistic expectations about tax administration improvements). If they are well-resourced and truly independent, fiscal councils help by raising the reputational cost to the government of breaching the rules. According to a recent survey by the IMF, Grenada, Kenya, and Vietnam are examples of countries that have set up fiscal councils with operational independence.¹¹

BUDGETARY INSTITUTIONS AND PROCESSES

During budget preparation, laws and regulations should ensure the integrity of the budget, seeking to avoid the emergence of extrabudgetary funds or unreported activities, including borrowing by public sector entities. Budgetary spending authorizations approved in the budget law need to be accurate to avoid large differences with actual execution. Revenue estimates need to be consistent with the

¹⁰ As of 2021, the IMF had identified fiscal councils in 49 countries. See Davoodi, Hamid, Paul Elger, Alexandra Fotiou, Daniel Garcia-Macia, Andresa Lagerborg, Raphael Lam, and Sharanya Pillai. 2022. "Fiscal Councils Dataset: The 2021 Update", International Monetary Fund, Washington, D.C.

¹¹ Ibid.

expected macroeconomic scenario, avoiding the practice of “closing” ex-ante gaps with unrealistic revenue projections. If these practices are effective, public debt can be projected with more precision.

The countries that have advanced the most in achieving effective budget preparation frame the annual budget discussion into a Medium-Term Fiscal Framework (MTFF). The MTFF gives a broader perspective on the expected macroeconomic scenario, typically five years into the future, and projects the main fiscal aggregates: revenue, spending, deficits, and debt. These projections are made considering the policies that the government is expected to implement and its fiscal objectives during the period. MTFFs include an analysis of debt sustainability and, importantly, a Statement of Fiscal Risks, which reviews the range of actual and contingent liabilities that may affect debt levels. The Fiscal Risk Statement (FRS) should identify and evaluate possible events that can generate sudden debt increases (see **Box 4**).

Box 4 Causes of Sudden Debt Increases

Public debt may increase very rapidly and without advanced warning. These ‘debt surprises’ can be triggered by a variety of factors. Among them are the following:

Off-budget and contingent liabilities: A review of financial arrangements between the IMF and LICs concluded that large projection errors in debt levels occur, among other reasons, due to the materialization of contingent liabilities and off-budget guarantees.¹² Most of these liabilities are related to the operation of public corporations that at some point require government assistance, for instance to maintain subsidies to energy consumption.

Banking crises: Governments might bail-out banks in case of a crisis. Laeven and Valencia¹³ identify 157 banking crises between 1970 and 2017. They calculate that the median cost for these crises in high-income countries is 6.7 percent of GDP, and reaches 10 percent of GDP for low- and middle-income countries.

Armed conflict: Besides human suffering, conflicts impose large economic and social costs. Fiscal deficits and public debt rise as a result of conflict, while resources shift away from social and developmental spending. The IMF has estimated that following intense conflict, public debt can rise by 9 percentage points of GDP.¹⁴

Currency depreciation: For countries that are heavily dependent on foreign-currency denominated debt, a sharp or rapid currency depreciation could render a government unable to service its external debts, triggering a default.

Illegal indebtedness/fraud: Institutional fragilities can lead to debt surprises. In Mozambique, the exposure in 2016 of \$2 billion of undisclosed and unlawful borrowing by some public companies triggered a chain of events that rocked the economy.

Natural disasters: In 2017, Category 5 hurricane Maria devastated Dominica, causing death and losses estimated at more than 200 percent of GDP. Dominica’s debt increased from 80% of GDP in 2017 to 108% of GDP in 2020.

¹² IMF Policy Paper, 2018 Review of Program Design and Conditionality, May 2019.

¹³ “Systemic Banking Crises Revisited,” by Luc Laeven and Fabian Valencia, IMF Working Paper WP/18/206, September 2018.

¹⁴ Regional Economic Outlook, Sub-Saharan Africa, Chapter 2: The Economic Consequences of Conflict, International Monetary Fund, April 2019.

IV. DEBT STRUCTURE: RECENT TRENDS

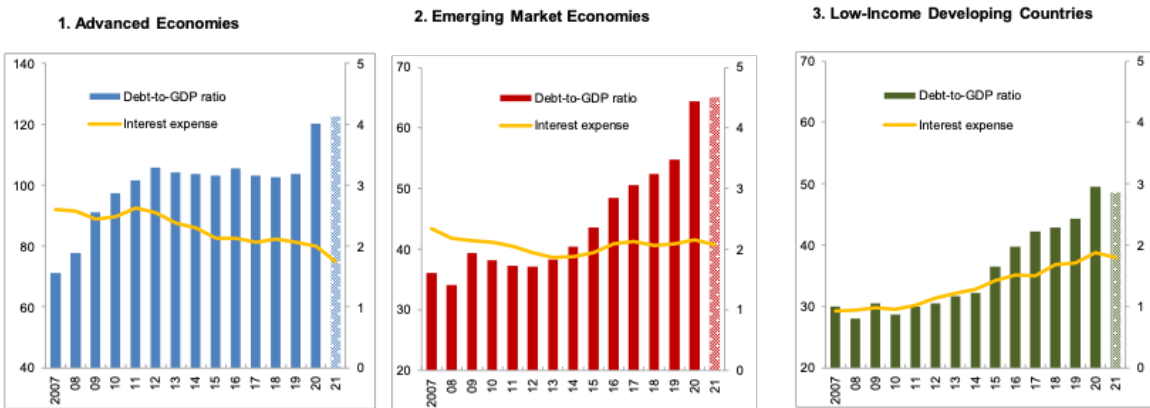
A. DEBT AND DEBT SERVICE LEVELS

Average public debt worldwide reached an unprecedented 97 percent of GDP in 2020. In advanced economies, public debt climbed to about 120 percent of GDP, much higher than in emerging market economies (65 percent of GDP) and LICs (50 percent of GDP). While the impact of COVID-19 has been a contributing factor in explaining debt increases in 2020, the charts in Figure 1 indicate a clear upward trend in debt-to-GDP ratios years earlier, following the GFC.

Despite higher debt, average interest payments to GDP have declined in advanced economies and many emerging markets, given the trend decline in market interest rates globally. In contrast, interest payments on public debt made by LICs have almost doubled, from 1 percent of GDP before the GFC to 2 percent of GDP in 2020, a worrisome development that is explained in part by the increasing contribution of non-concessional sources of financing, including commercial debt borrowed at higher interest rates, to LICs' overall debt mix.

Figure 1 Interest Expense and Government Debt, 2007-21

(percent of GDP; Debt-to-GDP, left scale; Interest expense, right scale)



Sources: IMF, World Economic Outlook database and IMF staff calculations

At the same time, while in advanced and emerging market countries debt issuance has been facilitated by supportive global financial conditions (and purchases by their own central banks), LICs have seen limited market access and limited room for central banks to intervene without jeopardizing macroeconomic stability.

B. DEBT COMPOSITION

The composition of public sector debt also varies by income level. According to the World Bank, while growth in local debt markets has enabled upper middle-income countries (UMICs) to rely on domestic debt for close to 80 percent of their financing needs, lower middle-income countries (LMICs) secure

only half of their financing, and LICs only 30 percent of their financing, from domestic sources.¹⁵ Unfortunately, data on the breakdown of these domestic debts is limited. However, far more is known about the changing composition of their external debts.

Table I shows how external debts owed by low- and middle-income countries evolved between 2010 and 2020.¹⁶ Note, first, that long-term external debt more than doubled over this period. Note also the changing composition in the sources of financing—in particular, how the share of total external debt owed to “official creditors” declined over this period, while the share owed to “private creditors” increased.

Table 1 PPG External Debt, 2015-20, by Creditor Type

All low- and middle-income countries						
	2010	2016	2017	2018	2019	2020
Face value, US\$ billions						
Long term external debt	1,582	2,461	2,784	2,960	3,163	3,445
Official creditors	828	989	1,075	1,111	1,150	1,267
Multilateral	482	596	649	670	703	792
Bilateral	346	393	426	441	447	475
Private creditors	754	1,472	1,709	1,849	2,013	2,178
Bondholders	473	1,038	1,260	1,394	1,563	1,736
Commercial banks and others	281	434	449	455	450	442
Composition, in percent						
Long term external debt	100	100	100	100	100	100
Official creditors	52	40	39	38	36	37
Multilateral	30	24	23	23	22	23
Bilateral	22	16	15	15	14	14
Private creditors	48	60	61	62	64	63
Bondholders	30	42	45	47	49	50
Commercial banks and others	18	18	16	15	14	13

Source: International Debt Statistics, 2022 report.

More granularly, the share of bonds (external debt held by “Bondholders” in Table I) increased over the decade, from 30 percent of total external debt in 2010 to 50 percent in 2020. This shift has important implications for the debt landscapes in low- and middle-income countries. In particular, with roughly half

¹⁵ See <https://www.worldbank.org/en/programs/debt-statistics/domestic-debt>.

¹⁶ The World Bank classifies economies into four income groups (low, lower-middle, upper-middle, and high-income countries). The classifications are updated each year based on Gross National Income (GNI) per capita in current U.S. dollars. For 2021, low- and lower middle-income countries have a GNI per capita under \$4,095.

of their foreign debts now owed to investors in international capital markets, developing countries are not only more exposed to more costly, commercial lending terms. They may also find it more difficult to secure cooperation from a diffuse group of investors should they encounter debt stress and need to negotiate relief.

A closer look at the external debt structure in 2020 shows starkly how debt composition also varies with countries' income level (See Table 2). External bond issuance, for instance, represents only 1.4 percent of external debt in LICs, a ratio that rises to 34.3 percent in lower-middle-income and 63.5 percent in upper-middle-income countries. Conversely, the share of concessional lending to total lending in LICs is about 40 percent, while declining to 30 percent in lower-middle-income and to 4.3 percent in upper-middle-income countries. This has two clear implications. First, as countries develop and reach higher levels of income, their access to concessional financing declines, leaving them increasingly reliant on debt obtained on commercial terms and at a higher average cost. Second, because they rely more on private investors and lenders, as opposed to multilateral or bilateral creditors, they face higher risks associated with refinancing their debts. Access to these private funding sources also tends to be more vulnerable to changing global liquidity conditions than is the case for multilateral or bilateral lending.

Table 2 External Debt Structure, 2020, by Creditor Type and Income Group

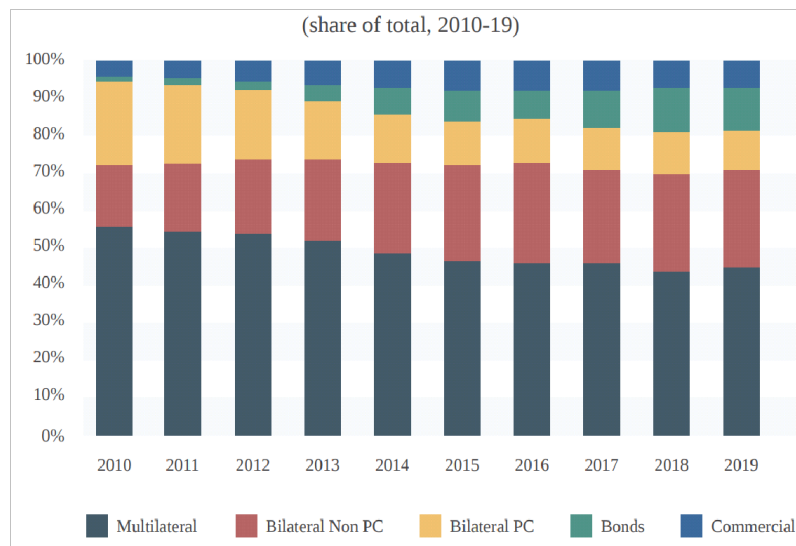
percent	IDA only	Low Income	Lower Mid Income	Upper Mid Income
Total Public and publicly guaranteed debt	100.0	100.0	100.0	100.0
Official creditors	81.9	87.1	57.7	20.5
Multilateral	46.2	51.1	32.8	15.1
IBRD	0.1	0.0	6.6	5.9
IDA	25.2	30.3	10.3	0.3
Other multilateral	21.0	20.8	15.9	8.9
Bilateral	35.7	36.0	25.0	5.4
Concessional	11.4	8.1	9.4	1.2
Private creditors	18.1	12.9	42.3	79.5
Bondholders	9.0	1.4	34.3	63.5
Commercial banks	6.4	6.9	7.5	12.2
Others	2.7	4.6	0.5	3.8
Total loans	91.0	98.6	65.7	36.5
concessional	36.6	38.5	19.7	1.6
Bonds	9.0	1.4	34.3	63.5
Concessional / total loans	40.2	39.0	29.9	4.3

Source: International Debt Statistics

Figure 2 highlights the changing composition of PPG external debt across LICs. Until the late 1990s, LICs borrowed primarily from Paris Club creditors and multilateral institutions. The relative share these

creditors hold in external debt has decreased over time, while the shares of bilateral non-Paris-Club creditors—most prominently the People’s Republic of China (PRC)—as well as bonds and commercial lending have increased.

Figure 2 Composition of PPG External Debt in LICs



Source: Debt transparency in Developing Economies, World Bank 2021

The range of borrowers within the public sector has also expanded. In particular, many developing countries have seen increases in borrowing by SOEs and other extra-budgetary entities. While precise figures are difficult to ascertain, many SOEs, thanks to their size and political importance, can often contract large loans from the market, often backed by explicit or implicit government guarantees. SOEs also commonly struggle to cover these commitments, and with weak controls, the government may need to step in to assume the debt—putting strain on its own balance sheet. This happened in Mozambique in 2016, after two undisclosed state guarantees to SOEs on loans worth \$2 billion led to a sovereign default.

Aside from the growing array of public sector borrowers, the types of lending instruments and terms have also multiplied. New instruments include collateralized loans and contingent obligations in the context of Public-Private Partnerships (PPPs). In the latter case, a debt assumed by the PPP’s private operator is guaranteed by the government; and oftentimes the assessment of risk in these operations (the fact that the government may have to assume the private debt in the event of a default) is not robust. These kinds of practices carry transparency risks with which reporting and management practices in many countries have failed to keep pace.¹⁷

C. RECENT DEBT RELIEF INITIATIVES

In light of increasing debt in LICs, especially after the COVID-19 crisis, the international community, through agreements in the G20, has launched new initiatives to alleviate their debt burden. The Debt Service Suspension Initiative (DSSI), which expired in December 2021, allowed for the suspension of

¹⁷ See Debt Transparency in Developing Economies, World Bank, 2021.

debt service payments on bilateral lending at the request of qualifying countries. The IMF and the World Bank provided technical support and helped monitor the use of resources released by the DSSI, which benefited about 45 countries.

For countries that would need additional debt relief, the G20 also agreed on a Common Framework for Debt Treatments (CF). Debt treatments under the CF, which can include rescheduling (debt relief by postponement) or outright reduction of debt service obligations, are initiated at the request of a debtor country on a case-by-case basis. The framework is designed to ensure broad participation of creditors with fair burden-sharing and includes not only members of the Paris Club but also G20 official bilateral creditors (PRC, India, Turkey, and Saudi Arabia) that are not members of the Paris Club (more on this in Section VII).

V. DEBT SUSTAINABILITY

A. DEFINING SUSTAINABILITY

Elevated debt in developing countries in recent years has raised concerns about countries' capacity to sustain these levels of debt. But what does it mean for public debt to be *sustainable*?

A country's public debt is considered sustainable if the government is able to meet all its current and future payment obligations without exceptional financial assistance or going into default.¹⁸ This is the *solvency* dimension of debt sustainability. Insolvency, by contrast, occurs when the debtor is incapable of raising enough revenues in the long run to meet its financial obligations. A good indicator that a country meets the solvency condition is that its overall debt burden, measured by the debt-to-GDP ratio, is stable or declining over time. Naturally, reducing the debt burden is harder to do when the debt-to-GDP ratio is already high, because the interest payments on the debt will also be high, limiting room in the government budget to reduce spending and thereby contain fiscal deficits and debt.¹⁹

Debt sustainability also has a *liquidity* dimension. Regardless of whether the solvency condition is met, a government can encounter a liquidity problem if it is unable to meet its maturing liabilities at a particular point in time. In other words, illiquidity occurs when the debtor is unable to meet its obligations when they come due, or it is unable to *roll-over* or convert those liabilities into new debt. A liquidity problem, on its own, may not render a government's debt unsustainable. However, sudden reductions in market access at home or abroad can diminish the government's ability to roll-over its existing debts, potentially creating a solvency problem. Thus, large roll-over needs may make the debt unsustainable.

B. DEBT-CARRYING CAPACITY AND FACTORS INFLUENCING IT

There are established frameworks that the IMF and other international institutions use to determine how much debt a country can carry before the burden becomes too much, i.e., before solvency becomes a concern. Past observations of debt-stress episodes highlight that the ability of any given

¹⁸ See <https://www.imf.org/external/pubs/ft/fandd/2020/09/what-is-debt-sustainability-basics.htm>.

¹⁹ Since the ability of a government to continually raise revenue to service debt is obviously limited.

country to shoulder debt, what is called the *debt-carrying capacity*, varies due to each country's own structural, institutional, or historical features.

Among the structural factors, a country that relies heavily on natural resource revenues (e.g., oil or mining) may be subject to terms-of-trade shocks that would affect economic activity and debt service capacity (think of the effects of a decline in oil prices on the fiscal revenues of countries like Angola or Ecuador). Thus, compared with countries that have a diversified revenue base, we would expect sustainable debt levels in resource-rich countries to be lower. This explains why oil producers applying best practices in fiscal management channel a portion of their annual oil revenue into extrabudgetary savings funds (e.g., sovereign wealth funds), to be better prepared to manage terms-of-trade shocks and be able to sustain higher levels of debt.

Countries with high projected growth rates are notably capable of carrying higher levels of debt-to-GDP than countries that will struggle to grow over time. For some rapidly growing economies, those prospects may be anchored in clear demographic advantages, such as, a strong education system or a vibrant tourism sector.

Another structural factor that allows countries to carry higher levels of debt is the presence of developed domestic financial markets. Financial systems that are better able to mobilize savings from businesses and households create a larger pool of domestic savings from which both the private and public sectors can borrow at lower risk and lower cost. When local markets are small, costly, and volatile, governments need to tap external sources of funds. Borrowing from these sources is made primarily in foreign currency, which introduces additional risks from unfavorable fluctuations in exchange rates.

Governance also matters. For instance, the strength of the rule of law, especially in terms of protection of creditors' rights, is an institutional factor whose absence may also reduce debt-carrying capacity. Likewise, if at the first sign of a problem investors believe they are going to "pay the bill" through *haircuts* (reductions in principal amounts) or inflation-driven erosion of their claims, it will be hard to convince them to purchase public debt in the first place. The presence of institutional and governance shortcomings has been found to create *debt intolerance*, defined as a syndrome that prevents some countries from sustaining levels of debt that would be manageable for better-governed economies.

C. INDICATORS OF DEBT SUSTAINABILITY

The practice of assessing risks to debt sustainability relies on the use of debt metrics and market indicators. Debt metrics are used to measure the current and future debt burden.

The most common debt indicators scale the debt stock by GDP, government revenue, or when analyzing external debt only, the level of exports. The *debt-to-GDP ratio* provides an indication of the overall debt burden in relation to the size of the economy. In 2020, the country with the highest debt-to-GDP was Venezuela, estimated to be above 300% (IMF 2021a). The second-highest was Sudan, estimated to be around 270% (IMF 2021a).

The *debt to government revenue ratio* measures the debt in relation to the direct sources of funds a government has to repay it, namely taxes and other public revenue. Meanwhile, the *external debt to exports ratio* measures a country's capacity specifically to service its external debt, in that exports yield

the foreign currency needed to repay those debts. Countries with the highest debt-to-revenue ratios in 2020 were Sudan (25.5), Venezuela (20.5), and Yemen (10.5).²⁰

A number of other indicators are often used to assess a country's sovereign debt. They include:

Interest expense to public revenue (or to budget expenditure) ratio: This indicator gauges the degree of flexibility of fiscal policy, where higher ratios of interest expense to revenue (or total expenditure) may limit the room for productive spending on things like social services and infrastructure. According to the World Bank World Development Indicators for 2019, the country with the highest interest expense to revenue ratio was Lebanon at 50.8%, and the country with the highest interest expense over total expense was Zambia at 42%.

External debt interest to exports ratio: This indicator measures the extent to which a country's foreign currency revenue is sufficient to service its external debt. When countries also receive other significant sources of foreign revenue (remittances, tourism), these can be added to exports in the denominator of the ratio, for a better measure of the burden. Based on data from the World Bank International Debt Statistics for 2019, the country with the highest ratio was Lebanon with 22.7, followed by Argentina with 14.5.

Gross financing needs of the public sector to GDP ratio: Gross financing needs (also called gross borrowing requirements) refers to the volume of debt that the government needs to issue in any given period to fully pay back maturing debt as well as finance that period's fiscal deficit.

Composition ratios: Various indicators are constructed to understand the structure of debt. Besides the usual breakdowns of debt by creditor groups (multilateral, bilateral, commercial loans, bonds), important metrics include the ratio of foreign-currency denominated debt to total debt, share of concessional debt in total debt, and the average debt maturity. For countries issuing bonds, domestically and externally, it is useful to understand who the holders of such bonds are; a useful metric is the share of non-resident holdings of bonds since these holdings can be more unstable under changes in global liquidity conditions. For example, the IMF publishes the foreign share of local currency debt holdings for emerging markets. In this publication, the country with the highest share is Peru with 49%, while the lowest share is Kenya with 1% (IMF 2022).

Market indicators also provide information about debt sustainability risk. A key metric is the *sovereign risk premium* implicit in international bond prices. Risk premiums are obtained by comparing the yield (the return to the investor) of a country's bond with the yield of a bond issued by the safest advanced economy. If bonds are denominated in dollars, yields are compared with bonds issued by the United States (Germany, if bonds are euro-denominated, and Japan if denominated in yen). The computation of the risk premium needs to be made between bonds of similar maturity, to isolate the risk component, as yields tend to increase with bonds' maturity. Normally, high premia will reflect a higher risk assessment by market participants. In fact, risk premia are generally correlated with the issuer's credit quality, as assessed by international credit rating agencies (discussed in more detail in Annex II).

²⁰ Own calculations based on data from the IMF World Economic Outlook October 2021.

D. DEBT SUSTAINABILITY ANALYSIS IN PRACTICE

The World Bank and the IMF have a long tradition of preparing debt sustainability analyses (DSAs) for their member countries, with methodologies that have evolved over time.²¹ Their documents are used by a large number of practitioners and investors, and their methodologies, which are summarized in this section, are readily available.

Separate frameworks are used to assess LICs and market-access countries (MACs), the latter involving countries with more significant exposures to private creditors. The Debt Sustainability Framework for Low-Income Countries (LIC DSF) is used for countries that qualify for IMF concessional financing that also have access to lending from the World Bank’s International Development Association (IDA) or are eligible for IDA grants.²² For such countries, external financing remains largely concessional and computing the *present value* (PV) of debt plays a key role in understanding debt-related vulnerabilities.²³ Annex I provides more detail on calculating the PV of debt and deriving the concessionality or *grant element* of a loan.

LOW-INCOME COUNTRIES DEBT SUSTAINABILITY FRAMEWORK – LIC DSF

The LIC DSF is the main tool that multilateral institutions and other creditors use to assess risks to debt sustainability in LICs. The framework classifies countries based on their assessed debt-carrying capacity (weak, medium, or strong—see Annex III for details) and then compares countries’ debt burden indicators against pre-defined thresholds or benchmarks. Table 3 shows the LIC DSF benchmarks for each of the five debt burden indicators; these are expressed in present value (PV) terms given the importance of concessionality in LICs’ financing mix.

Table 3 LIC DSF Benchmarks

Country Debt Carrying Capacity	PPG External Debt Ratios				PV of Total Public Debt in percent of GDP
	PV of PPG External Debt in percent of		PPG External Debt Service in percent of		
	GDP	Exports	Exports	Revenue	
Weak	30	140	10	14	35
Medium	40	180	15	18	55
Strong	55	240	21	23	70

²¹ Credit Rating Agencies also assess debt sustainability and their conclusions are summarized in credit quality indicators (AAA, BBB, etc.). Bilateral creditors and institutional investor also assess credit quality of debt issuers. See Annex II for more detailed discussion of credit ratings.

²² Eligibility for IDA support depends first and foremost on a country’s relative poverty, defined as GNI per capita below an established threshold and updated annually (\$1,205 as of 2022). An updated list of IDA eligible countries can be found here: <https://ida.worldbank.org/en/about/borrowing-countries>.

²³ Concessional debt is easier to service (interest rates are low) and repay (maturities are long). Thus, the larger the share of concessional debt in total debt, the easier it is to manage such debt. The PV of debt aims at measuring the degree of concessionality embedded in the debt structure, and allows for a more accurate comparison of debt service capacity across LICs. Details on how the PV of debt is calculated are provided in Annex I.

Source: LIC DSF, 2020, IMF and WB.

A country's debt burden indicators are projected under both a baseline scenario and a series of stress-test scenarios, to gauge the sensitivity of the indicators to various shocks. The results are then evaluated against the benchmarks to provide signals about the risk of debt distress, taking into account the frequency and the number of scenarios in which thresholds are broken.

Based on this analysis in combination with expert judgment, DSAs culminate in a top-line assessment of the risk of external and overall debt distress, in one of four categories: *low risk* (when there are no breaches of thresholds); *moderate risk* (when thresholds are breached in stress-test scenarios); *high risk* (when thresholds are breached in the baseline scenario); and *in debt distress* (when a distress event, like a default or a restructuring, has occurred or is considered imminent). Table 4 presents some examples of the application of the LIC DSF.²⁴ Annex III provides a more comprehensive list of risk ratings for LICs, based on their last completed DSA.

Table 4 DSA Outcomes in Selected Countries

Country	Debt Carrying Capacity	Applicable Benchmarks					Risks of Debt Distress in last DSA report		Date of DSA Report
		PPG External Debt Ratios				PV of Total Public Debt	External	Overall	
		PV of PPG External Debt in percent of		PPG External Debt Service in percent of		in percent of GDP			
		GDP	Exports	Exports	Revenue				
Honduras	Strong	55	240	21	23	70	Low	Low	Jul-19
Kenya	Medium	40	180	15	18	55	High	High	Apr-21
Sierra Leone	Weak	30	140	10	14	35	High	High	Sep-21
Congo	Weak	30	140	10	14	35	In Distress	In Distress	Jan-20

Source: Country DSA reports, IMF and WB.

MARKET ACCESS COUNTRIES DEBT SUSTAINABILITY FRAMEWORK – MAC DSF

While the assessment for MACs follows the same logic as in the LIC DSF, there are differences. Risk ratings are not issued. Rather, the assessment aims to flag debt profile vulnerabilities that can impair access to debt markets. The vulnerabilities are gauged by comparing a set of indicators to early-warning benchmarks derived from past debt-stress situations. Vulnerabilities exist when the indicators are higher than the benchmarks (see Table 5).

²⁴ Honduras and Kenya are lower middle-income countries eligible for IMF's concessional financing and therefore debt sustainability is assessed with the LIC DSF.

Table 5 Debt Profile Benchmarks for MACs

shares in percent	Advanced Economies	Emerging Markets
Risk premium, basis points	800	800
External financing requirements, percent of GDP	35	20
Share of public debt held by non-residents	60	60
Share of public debt in foreign currency	NA	80
Change in share of short term debt	2	1

Source: MAC DSA, 2013, IMF

Baseline and stress-test scenarios are prepared, including the impact of contingent liabilities when needed. Depending on the frequency and the scenarios in which a country's debt burden indicators exceed established thresholds (see Table 6), risk signals are triggered.

Table 6 Debt Burden Benchmarks

percent	Debt to GDP ratio	Gross Financing to GDP ratio
Emerging markets	70	15
Advanced economies	85	20

Source: MAC DSA, 2013, IMF

The quantitative analysis is summarized in a heat map, with lower indicators relative to benchmarks resulting in *low risk* and higher indicators resulting in *high risk*. Debt can be assessed to be sustainable with high probability or sustainable but not with high probability. The MAC DSF does not rate countries' debt as unsustainable, to avoid triggering adverse market reactions when assessments are published.

VI. DEBT MANAGEMENT

Given the potential harm wrought by unsustainable debt, governments are well served to adopt and implement sound debt management policies and practices.

A. OBJECTIVES AND PRINCIPLES OF DEBT MANAGEMENT

The main objective of public debt management (PDM) is to maintain the creditworthiness of the government while avoiding debt sustainability concerns. To this end, it is critical to ensure that financing needs and payment obligations are fulfilled at the lowest possible cost over time, consistent with a prudent degree of risk. Sound macroeconomic policies that contribute to keeping debt at sustainable

levels are a precondition for successful debt management. In addition to this, several principles contribute to effective PDM.²⁵

Transparency and Accountability. The objectives for debt management should be clearly defined and publicly disclosed, and the measures of cost and risk that are adopted should be explained. Ideally, these objectives are presented in a Medium-Term Debt Strategy (MTDS) document, normally issued by a Debt-Management Office (DMO). If a country does not prepare or publish such a strategy, this should be considered a signal of potential weaknesses in debt management. Objectives of a sound MTDS will depend on country circumstances, but it is common to see that governments aim to reduce the share of foreign-currency debt, to minimize the risk that their debt burden will balloon in the event of a depreciation of the domestic currency. They also seek to extend the average maturity of debt, to reduce the amount of debt that falls due in the near term, which will reduce the risk of refinancing.

Ready examples of MTDSs include (click to follow the links):

- [Jamaica's Medium-Term Debt Management Strategy](#)
- [Nigeria's Medium-Term Debt Management Strategy](#)

There must be clarity also in the allocation of responsibilities among various agencies for PDM functions: for instance, who is in charge of issuing new debt; who regulates the operation of domestic debt markets; and who prepares debt reports. Regular reporting on the outstanding stock of debt and its composition, including by creditor, currency denomination, maturity, and interest rate, facilitates scrutiny and oversight of public debt and provides various stakeholders, including lenders and investors, with critical information to evaluate the government's creditworthiness.

Good Governance. Good governance is central to debt management and sustainability. In this regard, the role of the legislature or parliament cannot be overstated. Among other responsibilities, the legislature will approve the budget, which will include authorizations to contract new debt, to refinance maturing debt (i.e., debt falling due in the near term) and to finance eventual fiscal deficits.

The legal framework, also approved by the legislature, should clarify the operational authority to borrow, i.e., which public sector entities can borrow and for what purposes, and to hold cash assets for repayment purposes. Operational risks should be managed according to sound business practices, including clear responsibilities for staff, monitoring and control policies, and reporting arrangements. In addition, debt managers should ensure that they have received appropriate legal advice and that the transactions they undertake incorporate sound legal features.

Sound Strategy and Risk Management. To help guide borrowing decisions, debt managers should consider the financial and other risk characteristics of the government's cash flows, including contingent liabilities. A risk-management framework should exist to identify and manage the trade-offs between expected

²⁵ For a detailed discussion on implementing sound debt management, see Developing a Medium-Term Debt Management Strategy Framework (MTDS)-Updated Guidance Note for Country Authorities, World Bank and International Monetary Fund, February 2019.

costs and risks in the public sector debt portfolio. Debt managers should advise on cash management policies to ensure that the government's financial and budgetary obligations, including contingent liabilities, are met as they come due. The risk management framework should include stress tests of the debt portfolio and financing needs under shocks to which the government and the country are potentially exposed. For instance, debt-sustainability analyses conducted by debt managers would project debt levels and financing needs in scenarios assuming lower growth, higher interest rates, currency depreciation, or lower fiscal balances.

Deep Debt Markets. The development of domestic markets for government securities contributes to successful debt management. Government should strive to achieve a broad investor base for its domestic debt instruments (see **Box 5**). This involves both *primary markets* and *secondary markets* for government debt. Operations in the *primary market* (where bonds or other debt securities are issued) should be transparent and predictable. A calendar of debt issuance over the year, with amounts to be placed on each occasion, is a best practice.²⁶ To the extent possible, debt should be issued through market-based mechanisms—for instance, through competitive auctions as opposed to direct allocation to specific investors. Governments and central banks should also promote the development of liquid *secondary markets* (where debt securities that have already been issued trade on a daily basis) that can function effectively under a wide range of market conditions. This will require that the systems used for settlement of financial transactions involving government securities work effectively.

Box 5 Developing Local Debt Markets in Kenya.

Kenya's is a success story of developing local debt markets. In the middle of the 2000s, the Central Bank of Kenya (CBK) embarked on a path aimed at developing the country's debt markets. Following the re-launch of the Treasury Bonds Programme and in partnership with the National Treasury and market participants, the CBK initiated the creation of a Market Leaders Forum. The Market Leaders Forum set out as its objectives: first, to market government securities through direct linkage with potential investors; second, to advise the CBK and Treasury on various developments in the debt and money markets that would have direct bearing on the performance of the new issues; and third, to propose the floating of suitable debt instruments to diversify the product range and as a result ensure stability in the financial markets. As a result of the CBK's reform program and the efforts of the Market Leaders Forum, the Kenyan bond market has become one of the fastest growing bond markets in sub-Saharan Africa.

Source: Bank of International Settlements. 2014

B. INSTITUTIONAL ARRANGEMENTS FOR DEBT MANAGEMENT

Following the principles described above, the legal framework for debt should also assign clear roles and responsibilities to various entities. The Ministry of Finance is generally vested with authority to borrow and to issue new debt, invest, and undertake transactions on behalf of the government, to produce a debt management strategy and debt management regulations, to select the instruments necessary for borrowing, and to monitor the debt situation to ensure that it remains sustainable. This includes regular preparation of its own debt sustainability analysis, similar to the DSAs conducted by the multilateral institutions such as the IMF and World Bank. The legal framework will also usually assign the power to

²⁶ A good example of a calendar of debt issuance is Mexico. Mexico published its calendar which includes maturity, amounts, and instrument. For the second trimester of 2022 the calendar can be found here: <https://www.gob.mx/shcp/prensa/comunicado-no-22-programa-de-subasta-de-valores-gubernamentales-para-el-segundo-trimestre-de-2022>

grant government guarantees to the Ministry of Finance. The organization responsible for debt management, the Debt Management Office (DMO), will typically be set up within the Ministry of Finance (see **Box 6**).

While the Ministry of Finance generally plays the lead role in PDM, no single institution can effectively manage public debt on its own. Several institutions have distinct roles and responsibilities in the PDM space. For instance, the central bank plays an active role in sovereign debt or bond markets. With its primary focus on monetary policy, the central bank may intervene in the economy to control inflation induced by an increase in public debt. Yet in many countries, the central bank is also legally authorized to act as the government's auction agent for issuing new debt. Where this is the case, the legislation should clearly distinguish the central bank's role as a fiscal agent of the government from its role in monetary policy operations.

Outside the executive branch, the legislature or parliament has both a legislative and an oversight role to play with respect to public debt. Its legislative role includes setting a legal framework for PDM that provides strategic direction to borrowing decisions and clearly specifies the roles and responsibilities of the institutions involved in PDM. It should also retain the authority to ratify loan agreements, both domestic and international, and to approve or at a minimum be informed of any guarantees or other contingent liabilities taken on by the government.

In addition to its legislative role, the legislature also has a critical budgetary oversight role to play throughout the budget cycle. As discussed already, it is the responsibility of the legislature to approve the budget, including government plans to contract new loans, to roll-over maturing debts, and to issue new debt to finance fiscal deficits. Once the budget is approved and enacted into law, the legislature can exercise oversight of the implementation of the budget by scrutinizing the government's in-year and mid-year budget reports, and holding committee hearings to raise questions about government debt. Legislatures can also use this authority to probe into the debt situation of SOEs and other public corporations, to assess their budgetary implications and any fiscal risks they might pose (e.g., from government guarantees). At the end of the year, the legislature should review and scrutinize the audited financial statements and any debt reports that the government produces, as well as the compliance and performance audit reports provided by the Supreme Audit Institution (SAI).

Ideally, debt management activities will be audited annually by the SAI or an external independent auditor, including for compliance with rules and regulations, and to evaluate whether the government's debt operations are delivering "value for money." Debt manager performance, systems, and control procedures should also be audited regularly to assess risks of fraud and corruption, and to identify areas for improvement through changes in the legal framework or systems for debt management.

Box 6 Organization of the Debt Management Office

Laws and regulations in each country will assign specific functions to the DMO, which will shape its organizational structure. Ideally, the DMO will consist of three distinct functions: recording, analysis, and execution.

The recording function, also known as the "back office," is responsible for registering and recording debt transactions, settling debt service payments, and forecasting cash requirements, in addition to maintaining debt data

and generating and publishing debt data and reports. The back office, thus, plays a central role in promoting debt transparency, by ensuring that the government is making available accurate and up-to-date debt information.

The analytical function, or “middle office,” provides elements for analysis and decision-making, including shaping the debt management strategy, conducting debt sustainability analysis, and evaluating the risk of alternative financing options in coordination with the “front office” (see below). The middle office plays an important role in assessing the fiscal impact and risks of the debt portfolio and determining the appropriate terms for new borrowing.²⁷

The key objective of the execution function, or “front office,” is to mobilize financing for the government in a manner that minimizes the cost of borrowing while respecting established risk parameters. Its core activities generally include: managing relationships with creditors and investors; implementing the government’s borrowing plan; negotiating and contracting loans; and issuing guarantees and government securities (e.g., bonds). In addition to negotiating new borrowing, the front office is also the locus of refinancing and rescheduling operations.

While best practice is for a single entity (the DMO) to undertake all borrowings and debt-related transactions for the government, in some countries, the authority to negotiate new borrowing may vary based on the type of financing or the purpose for which the debt is being raised. For instance, multilateral or bilateral loans are more likely to be used to finance specific projects that may be negotiated by line ministries (say, infrastructure, health, or education), while a bond, which is more likely to be used to finance deficits, is typically negotiated and executed by the DMO itself. When the authority to negotiate and contract debt lies outside the DMO, the DMO still has an important advisory and coordination role to play to ensure that government borrowing is consistent with the overall debt management strategy.

VII. DEBT RESTRUCTURING

Debt crises occur when governments run out of liquid resources (cash in deposits) and are unable to borrow to pay their obligations. Well-prepared debt sustainability assessments can identify serious vulnerabilities, although these analyses can at times generate “false alarms.” Lebanon maintained public debt levels between 130-180 percent of GDP for over two decades, yet the country was still able to secure financing and get the liquidity it needed; it was only in 2020 that the country defaulted when access to debt markets stopped (see **Box 7**). Other times, debt appears sustainable and a crisis still occurs, for instance when hidden debts are exposed and the country loses access to borrowing (as in Mozambique in 2016). In other cases, perhaps less frequent, governments face reduced access to debt markets in the face of unforeseen shocks or financial contagion.²⁸ Examples of the latter include the 1998 Russian debt crisis that spilled over to countries as far-flung as Mexico, Brazil, and Hong Kong; although these countries did not default, they faced turbulent market conditions for some time.

Box 7 Lebanon Defaults

Lebanon had long suffered from large fiscal and external current account deficits. By 2018, public debt was at around 150 percent of GDP, as sluggish growth and public sector salary increases pushed the fiscal deficit to 11 percent of GDP. To meet the country’s external obligations, the Banque du Liban (the central bank) implemented unconventional measures to attract foreign deposits, paying increasingly high interest rates, while lending to the

²⁷ See, for instance Uganda, Ministry of Finance, Planning, and Economic Development: “Report of Public Debt, Guarantees, Other Financial Liabilities, and Grants for Financial Year 2019/20” and “The Medium Term Debt Management Strategy, 2020/21 – 2023/24.”

²⁸ The term financial contagion means that adverse financial conditions in one country can spread to other countries. In an integrated global financial system, such events can often be triggered by the behavior of asset managers or financial institutions, which in the face of losses in one country may cut financial investments (including holdings of public debt) in other countries to reduce their risk exposure.

government. These policies helped maintain stability but aggravated the underlying situation as the balance sheet of the central bank deteriorated. Reducing vulnerabilities required fiscal adjustment and structural reforms that did not come to pass. The inflow of foreign deposits declined, reducing international reserves and ultimately triggering a debt default in March 2020.

When countries are unable to meet both their debt service requirements and budgetary commitments, they go into *debt distress*. Typically, the distress is triggered by creditors, as they become reluctant to continue financing government operations if concerns about debt sustainability are high.

Under debt distress, governments may first try to reduce spending or increase taxes to remain current on debt payments and avoid the costly consequences of default (see **Box I**). In some cases, the central bank will step in to finance the government, which may help avert a default temporarily, but will also result in higher and potential destabilizing inflation. However, oftentimes, political pressure (e.g., to protect priority spending or stem inflation) will eventually force the government to default on its debt obligations.

Because debt distress seldom just works itself out, its resolution will likely require some sort of debt restructuring. The restructuring can take various forms. For example, it can involve a simple extension of debt maturities, to reduce immediate financing needs arising from debts falling due in the near term. This is called debt reprofiling and can improve sustainability by addressing short-term liquidity problems. But restructuring can also seek to reduce the size of the overall debt and/or its interest rate when long-term solvency is the concern.

While nothing precludes a country from seeking debt restructuring on its own, when severe crises occur, IMF involvement is common. This will typically take the form of an official financing arrangement, accompanied by agreed fiscal adjustment policies that the debtor must undertake. These conditionalities lend credibility to the country's strategy and confidence to investors to continue lending. They may also make other creditors more willing to work with the government to refinance existing obligations.²⁹ Recent examples of restructurings include Ecuador in 2020, in the context of an IMF adjustment program, and Argentina, after a failed program with the IMF in 2018.³⁰

²⁹ For a comprehensive analysis of the debt restructuring process, see Buchheit et al. *The Restructuring Process*, Chapter 8 in *Sovereign Debt, A Guide for Economists and Practitioners*, Oxford, 2019.

³⁰ The IMF agreement with Argentina helped to gradually reduce the fiscal deficit, but was unable to reverse capital outflows that accelerated in the run up to a presidential election in 2019. Inflation remained high and economic activity declined. When fiscal adjustment and other measures did not help the country regain market access, Argentina entered into debt restructurings in 2019 and again in 2020.

³¹ How Costly Are Debt Crises? Davide Furceri and Aleksandra Zdzienicka, IMF Working Paper WP/11/280, 2008.

³² One Reason Countries Pay Their Debts: Renegotiation and International Trade, Rose, A., 2005, *Journal of Development Economics*, Vol. 77(1), pp. 189–206.

³³ The Costs of Sovereign Default, Eduardo Borensztein and Ugo Panizza, IMF Working Paper WP/08/238, 2008.

A. RESTRUCTURING SUPPORT FROM THE IMF AND MULTILATERAL INSTITUTIONS

While the IMF and other multilateral institutions have participated in debt relief initiatives in the past, normally, they will not restructure borrowers' obligations coming due.³⁴ Rather, they will strive to find ways to extend new credit to enable borrowers to service outstanding debts. The IMF typically leads in these efforts at the request of country authorities through various lending arrangements that assist with liquidity while fundamental adjustments to policies take place.

B. RESTRUCTURING OF BILATERAL AND PRIVATE LOANS

Most bilateral creditors are willing to consider debt relief operations when warranted. The Paris Club, created in 1956, is an informal group of 22 official creditors that coordinates solutions to the payment difficulties experienced by debtor countries.

Paris Club operations are guided by several principles. Most notably, the Paris Club only negotiates debt restructurings with debtor countries that have implemented or are committed to implementing reforms to restore economic and financial stability. This means in practice that the country must have a current program supported by the IMF, which will also be tasked to identify the financing gaps that need to be filled with debt treatment.

Paris Club creditors also require their debtors to seek debt restructuring terms from non-Paris Club creditor countries and private creditors that are “comparable” to those provided by the Paris Club. Yet the growing diversity of creditors and lending terms has increased coordination problems. Difficulties can arise due to the collateralization of lending (see **Box 8**), as well as to confidentiality, seniority, and “no Paris Club” clauses that can complicate debt restructuring and limit the debtor's crisis management options. Chad and the Republic of Congo provide cautionary tales of the macroeconomic consequences of collateralized borrowing by governments.

Box 8 The Risks of Collateralization: Chad and the Republic of Congo

In Chad, the government undertook commercial borrowings (oil sale advances) from international commodity trader Glencore starting in 2013. Falling oil prices over 2014-16 reduced the revenues available to repay oil sales advances and put fiscal policy under stress more generally. Glencore's debt—which accounted for about 50 percent of total external debt in 2016—has been restructured twice, most recently in early 2018, which has reduced the debt burden. Still, Chad's debt remains unsustainable and the country has requested additional debt relief from all of its creditors. While official creditors have committed to negotiate debt restructuring under an IMF program, a lasting debt restructuring process with private creditors is necessary to unlock the official financing.

Similarly, The Republic of Congo contracted commercial loans (with traders Glencore and Trafigura, among others) backed by oil shipments. Like Chad, the country was affected by the decline in oil prices, and gradually

³⁴ The [Catastrophe Containment and Relief Trust \(CCRT\)](#) allows the IMF to provide debt service relief for the poorest and most vulnerable countries hit by catastrophic natural disasters or public health crises. Financed by resources that include donor contributions, it provides grants to pay for debt service to the IMF for a limited time.

accumulated arrears with its creditors starting in 2016. The debt with oil traders, which represented 33 percent of total external debt in 2016, was restructured in 2021, allowing for new financial assistance by the IMF.

C. RESTRUCTURING OF SECURITIES

Committees of representative creditors are usually formed to discuss debt restructuring with debtors in distress.³⁵ Sovereign bond issuers negotiate the terms of the debt restructuring with these committees, which can include extending the bond's maturity, reducing the principal owed, or changing the interest rate, either individually or in combination. The result will be a reduction in the net present value (NPV) of the overall debt, which is the most common metric used to summarize the debt-relief effects of the restructuring.³⁶ This NPV reduction is commonly referred to as the *haircut*.

As in the restructuring of any other debt obligation, large haircuts improve the situation of the debtor at the expense of creditors. Countries may exercise restraint in a negotiation, seeking to avoid large NPV reductions, to improve their odds of regaining access to bond markets in the future.

Negotiations with bondholders are complicated by the diverse nature of participating investors (from long-term holders of debt to speculators) and the variety of securities being restructured. Different investors may have different tolerance for haircuts or may have different preferences with respect to the tools used in the restructuring. In negotiations, some creditors may *hold out* from participating in a deal if they believe they can get better terms by waiting and suing the debtor in court.³⁷

There are ways to encourage the participation of creditors in a debt restructuring when presenting a restructuring offer. The most common tools are Collective Action Clauses (CACs) embedded in bonds. CACs enable a qualified majority of bondholders to bind the minority to the terms of a restructuring.

Restructuring domestic debt securities. Local commercial banks will likely be significant holders of domestic debt instruments. Thus, an overly aggressive restructuring with a large haircut may hurt banks' net worth excessively, which in turn may lead to problems in the banking sector. When banks are constrained in their operations by lack of capital, they will react by reducing credit to the private and public sectors, with significant negative spillovers on economic activity. These negative spillovers were clear in many domestic debt restructuring episodes, including Russia (1998), Ecuador (1999), Argentina (2001), and Greece (2012).³⁸

³⁵ The Institute of International Finance, a global association of financial sector institutions, has issued best practices for the formation and operation of committees.

³⁶ As described in Annex I, the NPV of a debt instrument is the difference between the nominal amount outstanding and the sum of all future interest and principal payments on that debt, discounted at an interest rate (the discount rate) different from the contracted rate.

³⁷ Disputes between the issuing country and bondholders are settled by courts of the jurisdiction in which the bonds were issued. For external bonds, typically these jurisdictions are New York and London (see Annex II).

³⁸ For details on domestic debt restructuring, see *Issues in Restructuring Sovereign Domestic Debt*, IMF Policy Paper, 2021.

D. DEBT SWAPS

Beyond the restructuring options described above, countries that are financially distressed and experiencing difficulties repaying foreign debts may opt to consider *debt swaps*. Debt swaps are typically a voluntary transaction in which an amount of debt owed by a developing country government is cancelled or reduced by a creditor, in exchange for the debtor making financial commitments to specific policy objectives, such as conservation or climate action.

Bilateral debt swaps are conducted directly between a creditor, usually a developed country government, and the debtor government. The creditor will typically set the terms of the swap, including the price at which it sells the debt back to the debtor and the modalities to ensure that public funds are directed to intended policy goals.

Debt swaps can also be ‘trilateral,’ where a non-governmental organization (NGO) purchases outstanding debt from the creditor government at a discount, and then sells the debt back to the debtor government under the condition that the proceeds will be directed to agreed policies or programs. For an illustration of a trilateral debt swap, see **Box 9**. For a real-world example, Gerretsen (2020) profiles the first-ever climate adaptation debt swap, in which Paris Club creditors and The Nature Conservancy combined to convert \$21.6 million of Seychelles’ debt into investments in coastal protection.

Box 9 A Debt Swap Example

Struggling to service its foreign currency debts, a debtor government enters into a debt swap deal with “NGO Conservation.” Under the deal, NGO Conservation buys \$100 million of the government’s foreign currency debt for \$40 million in the market. It then sells the debt back to the government for the equivalent of \$100 million in local currency, to be repaid at regular intervals over 5 years. The government sets up an extrabudgetary fund with the proceeds of debt repayment, which are used to protect rainforests in the country.

In this simple example, the debtor government has been relieved of its foreign currency obligations, and NGO Conservation has only had to invest \$40 million. Moreover, it could have swapped the debt with the government for less than it did, and still the transaction would have yielded benefits for the environment and the government. The key reason why the debt swap works well for both parties is that NGO Conservation was able to purchase the debt at a discount. To ensure the proper application of funds to the environment, the NGO could be given authority in the administration of the funds.

While useful, debt swaps are unlikely to offer a materially important solution to debt crises. They were popular in the 1990s but their popularity declined after other initiatives were launched to address debt sustainability issues (for instance, the Brady Plan to restructure debts in Latin America, and the HIPC initiative).³⁹ Some observers cited difficulties in enforcing environmental commitments as a reason for the low level of transactions.

VIII. HOW DEVELOPMENT PARTNERS CAN HELP

Transparent and effective debt management is critical to keeping countries’ public debt at safe levels. Section V of this primer introduces several metrics that can be used to assess debt sustainability and detect early signs of a debt problem. However, developing country governments and their development

³⁹ See Congressional Research Service: Debt-for-Nature Initiatives and the Tropical Forest Conservation Act (TFCA): Status and Implementation Updated July 24, 2018.

partners need not wait for the symptoms of a debt problem to emerge to invest in sound debt management policies and practices. In this section, we discuss various programmatic opportunities that international institutions and donors, can pursue to help countries use debt effectively to spur growth and inclusive development, and at the same time mitigate the risk of unsafe debt accumulation.

A. ENHANCING DEBT TRANSPARENCY

Increasing debt transparency will reduce the likelihood of encountering debt surprises. The World Bank (2021) offers several recommendations for improving debt transparency, particularly focused on LICs. These include developing a sound legal framework for PDM, and maximizing the coverage of debt reporting, to include both public and publicly-guaranteed debt and as well as reporting for government entities at all levels (central, provincial, and local). They also recommend avoiding confidentiality clauses that shroud the sources and terms of borrowing in secrecy, and adopting strict protocols for approving and monitoring the implementation of resource-backed (collateralized) loans.

Comprehensive, timely, and accurate reporting of debt data is one area where development partners can potentially lend critical support. USAID's Debt Transparency Monitor (2022) found that many countries produce debt reports, but these vary in depth and coverage, often lacking important information, and are not always up to date. In this regard, international assistance could help partner governments to develop and implement comprehensive debt reporting frameworks. Ideally, these frameworks should encompass the entire public sector, and build collaboration and cooperation among all of its constituent parts.

Specifically, reporting should bring together all levels of government, from local to provincial to national, along with SOEs and other public sector entities that may be operating outside the national budgeting process.⁴⁰ Systems for compiling, reconciling, and transferring data may need to be developed or enhanced, while procedures must be codified, either in laws or regulations. This may not be straightforward, as USAID experience has shown. For example, the final project report of the USAID-funded Angola Fiscal Reform Project (Gallagher, 2009) notes considerable progress in building the capacity of the Ministry of Finance to better report and project central government debt statistics, while also clearly indicating that information from extrabudgetary operations, and especially from the national oil company, continued to remain outside of public sector financial and debt accounting and reporting.

Tools such as the Debt Management and Financial Analysis System (DMFAS) or the Commonwealth Secretariat Debt Recording and Management System (CS-DRMS) are used by many nations and can enhance debt management capabilities, and produce most of the reports required for debt transparency, but there are still challenges. For instance, these systems may be rolled out covering only a portion of the public sector, often just the central government. Expanding coverage to incorporate all public sector debt will often require assistance from the relevant international organization. For instance, DMFAS is a

⁴⁰ Similar to SOEs, subnational governments may accumulate debt or other financial obligations that later they find themselves unable to meet. These contingent liabilities can suddenly become actual liabilities for the central government, which may need to step in and assume the debts. Because of these kinds of fiscal risks, the standard practice is for sovereign debt reporting to include debt from all levels of government. See Annex I for more discussion of the institutional coverage in debt reporting.

product of the UN Conference on Trade and Development (UNCTAD), but UNCTAD may not be able to provide the necessary assistance without funding (see **Box 10**).

Box 10 USAID Helps Bosnia and Herzegovina Determine Debt Data Systems Needs

Bosnia and Herzegovina does not have an overarching system for public debt information and management. The various levels of government are using independent and old Access databases to record and monitor external debt, and using Excel files to record domestic debt. Risk management and analysis are also inadequate.

USAID experts helped government partners to analyze existing software solutions, including their functionality and data exchange capabilities. They also evaluated the availability of interface and help subsystems in the three local languages, implementation requirements, as well as technical prerequisites for the solution. The report helped government partners evaluate the costs of each system relative to local needs. Eventually, they opted for DMFAS.

B. DEVELOPING AND IMPROVING MEDIUM-TERM DEBT STRATEGIES

International support can be provided to help partner countries to develop robust MTDSs, an area in which USAID has notable experience (see **Box 11** on Jordan and **Box 12** on the Maldives). Producing or refining a strategy for debt management can directly address two issues. First, it can identify policies to avert or overcome a rapid increase in debt levels, while at the same time providing a roadmap for financing long-term development priorities and recovering from shocks. Second, a well-developed MTDS, can, by its very nature, generate the kind of data and information needed to measurably enhance debt transparency. Donor assistance might also include reviewing and updating the templates and manuals for creating these strategies and supporting public dissemination, outreach and dialogue on the substance of the strategies.

Box 11 USAID Helps Jordan's Ministry of Finance Develop its First MTDS

Professionals in the Jordanian Ministry of Finance's Public Debt Department (PDD) had little support for determining the best way to fund government deficits. USAID experts worked collaboratively with PDD staff to develop a MTDS, the first of its kind in the country. Assistance first focused on training counterparts to use a customized analytical tool. After learning how to populate the tool with macroeconomic and primary deficit data, and using it to generate forecasted market variables, PDD staff then used the tool's outputs to draft the country's first MTDS. This strategy laid out the composition and vulnerabilities of Jordan's debt portfolio, and presented seven alternative paths for future debt strategies, assessing each for four distinct risk scenarios. The PDD was able to propose various strategies that ensured an appropriate balance between cost and risk, lessened Jordan's currency risk, and extended average maturities, thereby reducing the risk that the government would find itself unable to service or refinance debts coming due in the near term. (Fahey et al., 2011)

Donors can also help partner countries prepare or strengthen debt sustainability analysis, a crucial input into debt strategies. While the World Bank and the IMF will produce DSAs for the countries they lend to periodically, the local DMO should also be preparing and disseminating its own analysis on a regular basis. This will contribute to the ownership of the assessment and possibly improve the traction of homegrown debt-management strategies. Once these strategies have been defined, donors can support the steps toward implementation of their objectives. For instance, if one objective is to reduce foreign-currency debt, support can be targeted to achieve this objective with concrete actions, such as the

development of the domestic debt market (see below). Donors can also help DMOs to plan for the roll-over or refinancing of international bonds that are approaching maturity.

Box 12 The Government of Maldives Strengthens Debt Management with USAID Support

The Maldives' public debt has risen rapidly in recent years. At the end of 2019, total PPG debt reached 78 percent of GDP, and soared to 147 percent of GDP by the end of 2020 amid a pandemic-induced slowdown. Borrowing was mainly used to respond to the COVID-19 crisis, including to provide fiscal stimulus and augment spending on healthcare and social and economic relief measures.

USAID/Maldives' Public Financial Management (PFM) activity supported debt management and administration in several areas. Among others, it assisted the Debt Management Department (DMD) with automation of debt management functions, introducing an electronic debt management (eDM) portal. Automation is needed to carry out debt management functions in a timely manner, and aids decision-makers in obtaining and acting on information more quickly. USAID experts provided the DMD technical assistance and training on the eDM portal, helped move debt management functions to the portal, and helped to make the process and workflow more efficient.

The PFM activity also assisted with the preparation of debt statistics, forecasts, debt sustainability analysis, and a borrowing plan. The USAID team assisted the DMD to prepare the debt statistics and forecasts for the National Budget, training DMD middle office staff to prepare the budget tables, assisted the DMD to adjust debt figures based on changes to fiscal projections, and helped complete the country's debt sustainability analysis. Additionally, they assisted the DMD in preparing its External Borrowing Plan and the Medium-Term Debt Management Strategy 2022-2024.

In addition to the technical work, the USAID team designed trainings and conducted capacity building within the DMD on elements of debt, innovative financing, debt recording systems, and preparation of the MTDS, DSA, and other tools. They also assisted with arrangements for debt restructuring and helped the government with its first-ever *sukuk*, or Islamic bond, to raise \$500 million from international investors in 2021 (See Annex I for more on Islamic financing). (USAID, 2021a)

C. UNDERSTANDING FISCAL RISKS BETTER

Greater understanding of and attention to fiscal risks can contribute to enhanced transparency and better fiscal management. Medium-Term Fiscal Frameworks (MTFFs) project and articulate the government's outlook for fiscal policy, present risks affecting public finances, and alert stakeholders to unsustainable debt dynamics. As mentioned earlier, a well prepared MTFF will include a fiscal risk statement (FRS), which discusses possible factors affecting government revenue, spending, and debt creation, including explicit and implicit contingent liabilities. For instance, an FRS that meets standards (see IMF, 2016, Chapter V) will include the debt and guarantees of SOEs, public sector guarantees or other government commitments to PPP deals, and other guarantees the public sector provides the private sector.

Ready examples of FRSs include (click to follow the links):

- [Côte d'Ivoire's Fiscal Risk Statement](#)
- [Rwanda's Fiscal Risk Statement](#)
- [Maldives' Fiscal Risk Statement](#)

Guidance for fiscal risk management and preparing FRSs is available in the IMF's Fiscal Transparency Handbook (2018). The IMF and World Bank have each developed handy tools to assist governments to identify, evaluate, and mitigate fiscal risks. USAID Indonesia's Economic Growth Support Activity has also developed several tools for developing an FRS, as well as for fiscal risk assessment and mitigation, which can be adapted for use in other countries. (USAID, 2021b) In addition, in 2021, USAID helped the Government of Maldives develop its first FRS.

D. DEVELOPING DOMESTIC DEBT MARKETS

The development of domestic debt markets is almost universally needed among LICs as well as some LMICs, especially those with limited access to international capital markets or declining access to concessional financing. Surely, a track record of macroeconomic stability is necessary to spur local market development and demand for government debt. But there are many technical assistance and capacity building needs that donors can help address. From the supply side, predictability in domestic issuance is important, which entails developing or strengthening capacity to project government cash flows and borrowing requirements. Developing securities market regulation and a safe and competitive trading infrastructure will also support issuance and trading of debt among local investors.

In addition, development partners can help governments to develop effective investor relations and a broad investor base for domestic debt instruments. This requires creating or improving rules, systems, and processes for both primary and secondary markets for government securities. This may include assistance to foster transparency and predictability around the timing and terms of new primary market issuances, or to help the Ministry of Finance and central bank build or strengthen the systems needed for settlement of financial transactions involving government securities in the secondary market.

E. STRENGTHENING FISCAL BALANCES

Public debt growth is determined by fiscal balances since most debt creation is the result of either short- or long-term budget deficits. Therefore, containing fiscal deficits and achieving surpluses in government operations is a fundamental way of reducing debt over time. USAID and other donors can help countries improve domestic revenue mobilization as well as the prioritization and efficiency of public expenditure. On the revenue side, USAID's Tax Policy Reform Primer (USAID 2022b) offers sound principles to support tax reform to increase the government revenue base. Strengthening tax administration to increase efficiency, reduce fraud and corruption, and improve the business environment through simplification can also help. On the expenditure side, donors can help governments find efficiencies in operational spending and reform subsidies when needed, as they tend to be onerous and inefficient. In addition, IMF analysis suggests that, on average, more than one-third of the resources spent on public investment—and over 50 percent in LICs—are lost due to inefficiencies in investment management processes, making this another area where reform can yield significant results. Indeed, more efficient spending, and more effective controls on corruption, waste and abuse of public resources, can go a long way to strengthening the overall financial health of the public sector.

F. VENTURING OUTSIDE THE MINISTRY OF FINANCE

Most policies and decisions taken to address the debt burden or improve debt management are likely to be initiated by the Ministry of Finance, as the institution primarily responsible for executing fiscal policy. In particular, the DMO is likely to be a key counterpart to engage in discussions on debt challenges and

ways to help in their resolution. Still, there are other counterparts that can be useful to engage to gain a broader understanding of debt issues and possible constraints to reform.

Central Banks. Engaging with the central bank will provide broader perspectives on debt management challenges. Central banks conduct monetary policy with the objective of achieving low inflation and the smooth operation of the domestic financial market, which both support economic growth and stability. Fiscal operations have an important impact on domestic credit conditions given the magnitude of the public sector's flows of money relative to the rest of the economy. Debt transactions in particular affect the availability of credit for the private sector. External debt obligations will also have an impact on a country's foreign currency reserves, which can affect both the stability of the local currency and domestic credit availability. The central bank will need to smooth out these flows to mitigate their impact on the local economy and, therefore, effective coordination with the Ministry of Finance becomes essential.

While its primary focus is monetary policy, the central bank, as discussed in Section VI, may also play an active role in sovereign debt markets. In many countries, the central bank acts as the government's fiscal agent for running bond auctions, separate and distinct from the purchases and sales of government securities it undertakes in the secondary market to regulate the money supply. Understanding the central bank's role in sovereign debt markets, and the legal, institutional, and governance arrangements under which it executes those authorities, can provide important insights for addressing a country's PDM challenges

The Legislative Branch. Parliaments play a central role in the approval and oversight of both the budget and public debt operations, and they normally do this through committees whose members have expertise in fiscal issues. Frequently, these committees receive input from technical bodies, such as a parliamentary or congressional budget office, which are designed to provide legislators and their committees with the objective and timely analysis required for evaluating budget proposals, their debt implications, as well as fiscal risks, including those relating to the financial health of SOEs. USAID has supported the establishment and capacity building of parliamentary budgetary offices (PBOs) in a number of countries, including in Uganda (2001) and Bangladesh (2009).

Meeting key legislators as well as the staff of relevant committees and the PBO, when one exists, will help illuminate priorities and constraints to reform. Donors, in turn, may be able to use these opportunities to voice their concerns in the areas of debt transparency and debt management, and fiscal policy more generally.

Supreme Audit Institutions (SAIs). The SAI supports the legislative branch in exercising external oversight of public debt, and its audit results are a central tool for scrutiny of public debt by the legislature and the public. Development partners, such as USAID, can help a country's SAI to develop or update guidance and manuals for auditing public debt, build SAI expertise and capacity in public debt audit, as well as support other efforts to help the SAI fulfill its role in informing various constituencies on debt-related areas of concern. More generally, donors can work with SAIs to understand and refine the scope and frequency of debt audits, and seek their views on improvements to the governance of debt management, the strength of ex-ante controls, and proper recording and disclosure of debt.

Civil Society Organizations (CSOs). Both international and local NGOs have long played a role in international debt relief campaigns, mobilizing their networks to lobby the international community to write off the unserviceable loans of poor countries. Over the years, however, many local CSOs have ramped up efforts to advocate for prudent debt management at home—to hold their own governments accountable to taxpayers for their borrowing decisions. In this respect, CSOs can be important local partners in pressuring governments to take debt transparency and sustainability seriously. There might also be a role for development partners to help CSOs that are not necessarily steeped in fiscal issues to better understand debt and broader aspects of public finances.

Annex V contains a list of relevant activities, projects, and assessments that USAID has supported.

IX. TOOLS AND RESOURCES

The list below features several tools and resources that readers may wish to consult to gain a deeper perspective on public debt or to better understand the debt situation in a given country.

A. PUBLIC DEBT STATISTICAL DATABASES

Debt Statistics, World Bank: Includes data for the International Debt Statistics, which covers more than 120 low- and middle-income countries reporting to the World Bank Debtor Reporting System. In addition, the World Bank collects and publishes quarterly debt data including Quarterly External Debt Statistics for more than 130 countries, Quarterly Public Sector Debt statistics for around 100 countries, and the Joint External Debt Hub. These three quarterly databases also provide information on high-income countries.

<https://www.worldbank.org/en/programs/debt-statistics>

Fiscal Monitor Database, IMF: The Fiscal Monitor, a biannual report by the IMF, includes an excel database with countries' main fiscal variables for recent years and 5-year-ahead projections. Among others, reports total general government's debt, revenue, expenditure and balance.

<https://www.imf.org/en/Publications/FM>

OECD Debt Transparency Initiative: This OECD program, an outgrowth of the Institute of International Finance's Voluntary Principles for Debt Transparency, provides a repository and reporting mechanism for private sector creditors to report their lending to governments and other public sector entities in developing countries.

<https://www.oecd.org/finance/debt-transparency/>

B. DEBT TRANSPARENCY INDICES

Debt Reporting Heat Map, World Bank: Assesses public debt dissemination practices in IDA countries based on information available on official websites. The assessment covers public debt statistics dissemination practices; publication of key debt management reports; and publication of other country-relevant debt data, including identification and quantification of contingent liabilities. The results of the evaluation are presented in a heatmap showing strengths and weaknesses.

<https://www.worldbank.org/en/topic/debt/brief/debt-transparency-report>.

Debt Transparency Monitor, USAID: Assesses and scores low- and middle-income countries on how well their governments report public debt information and data to their citizens. This is done through a Debt Transparency Scorecard (DTS) that measures the breadth and depth of debt reporting across five dimensions: (1) high-level and strategic information, (2) breakdown of information about domestic and external debt servicing, (3) debt maturities, (4) planned new financing from domestic and external sources, and (5) specific reporting on debt owed to official PRC creditors.

https://pdf.usaid.gov/pdf_docs/PA00Z727.pdf

C. DEBT SUSTAINABILITY TOOLS AND RESOURCES

Debt and Fiscal Risks Toolkit page, World Bank: Provides information by country and on DSAs, Debt Management Performance Assessments, and MTDS.

<https://www.worldbank.org/en/programs/debt-toolkit>

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ANNEX I. PUBLIC DEBT: DEFINITIONS AND COVERAGE

An analyst seeking to understand the debt situation in any given country will encounter a multitude of challenges related to the definitions and coverage of public debt. When analyzing a country's debt, should we focus only on the debts of the central government, or also those of the broader public sector? What kinds of liabilities should we include? And, how should we value these liabilities? The sections below address these questions one by one.

A. INSTITUTIONAL COVERAGE

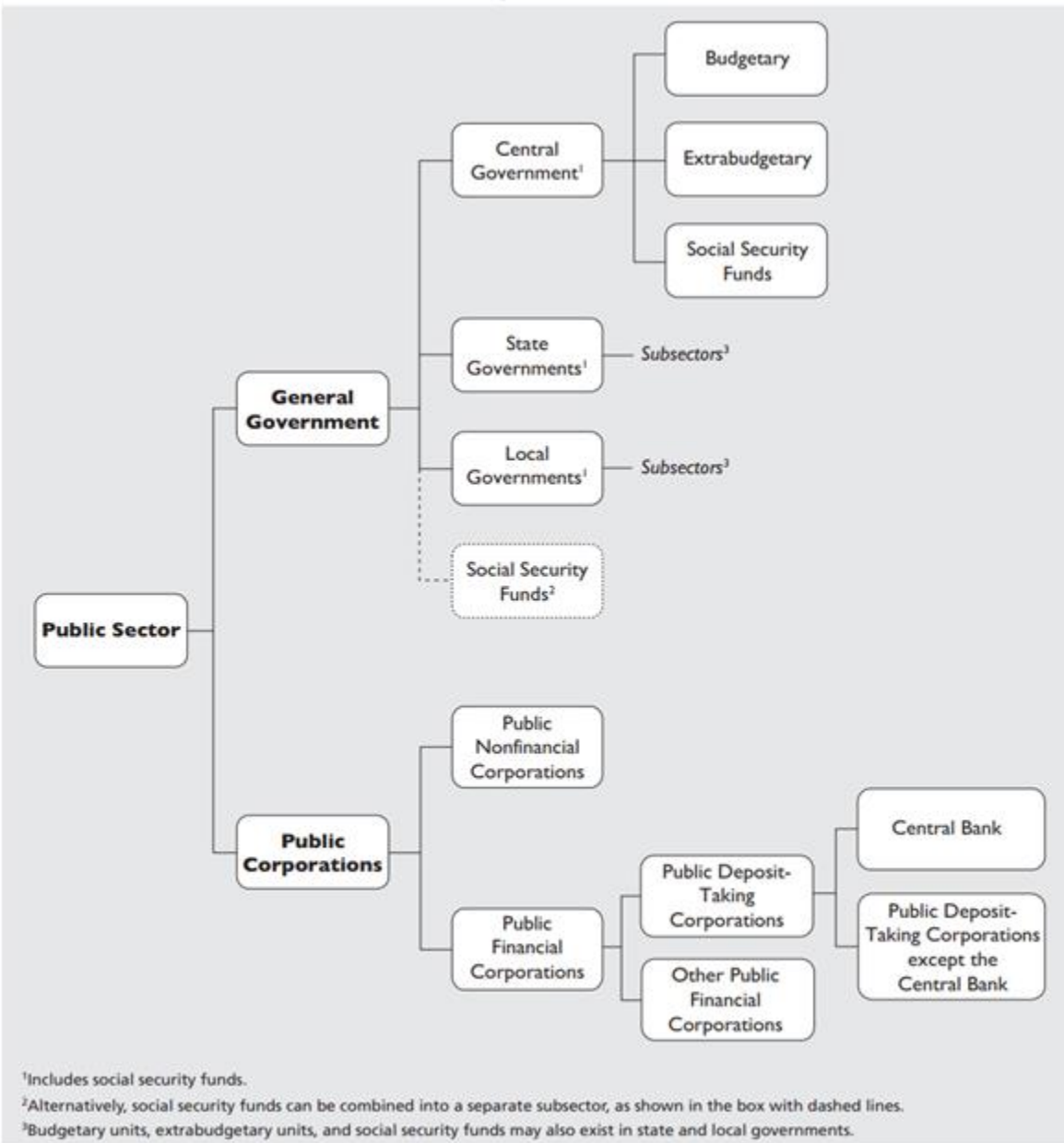
Simply defined, public debt comprises the debt-related liabilities, domestic and external, of the public sector. However, which parts of the "public sector" to include in reporting and analysis of public debt is not always clear.

As illustrated in Figure 3, the IMF's Government Finance Statistics Manual defines the public sector as comprising several components, categorized as either part of general government or public corporations. "General government" includes the central government, consisting of the budgetary central government, extra-budgetary funds, and social security institutions, as well as subnational (e.g., state and local) governments. Public corporations include both financial corporations (e.g., state-owned or controlled banks) and non-financial corporations (e.g., SOEs). The central bank, when it exists, is considered a special financial corporation.

There are good reasons to include public corporations in the coverage of debt, but also good ones to keep tabs separately. For instance, normally central bank debt is not aggregated into debt statistics because it is operationally independent from the government, and it only issues debt for the conduct of monetary policy. Similarly, public corporations that operate on a commercial and competitive basis may not represent a risk to the budget and, therefore, may be excluded in a government's accounting of public sector debt.

Still, experience shows that both central banks and public corporations may be important sources of debt creation and fiscal risk in low- and middle-income countries. Central banks may issue excessive debt when financial crises occur or when they act as creditors to the central government. Public corporations may undertake important quasi-fiscal operations, such as subsidizing energy consumption, which could necessitate transfers from the government budget from time to time. Moreover, the debts of public corporations may be backed by an implicit or explicit guarantee from the central government, in which case they represent a fiscal risk for which the government should, in principle, account. (See 'Contingent Liabilities below)

Figure 3 The Public Sector and Its Main Components



Source: Government Finance Statistics Manual 2014, International Monetary Fund

When a broad definition of the public sector is applied to debt, it is important to bear in mind that the debt issued by some public sector entities may be held by others within the public sector. For instance, pension funds may hold central government debt among their investments. Thus, an appropriate consolidation of debt should be made to net out these intra-public sector holdings and obtain a better measure of the government's true debt exposure.

Public sector entities may also have liquid assets (for instance, deposits at the central bank) that could eventually be used to service debt. If these assets are sizable, some countries may find it appropriate to publish their net debt levels (as opposed to gross debt levels), subtracting these assets from gross debt to produce a lower overall debt exposure. However, as a matter of practice, for the purposes of public debt reporting, the World Bank and the IMF recommend the use of gross debt to facilitate cross-country comparisons, while allowing for the consideration of liquid assets in the context of debt sustainability discussions.

For purposes of debt sustainability analysis, the IMF's MAC DSF guidelines suggest considering at least the debt of the general government when assessing middle-income and emerging market economies. Additional coverage is suggested when it captures material fiscal risks arising from public corporations or public banks involved in quasi-fiscal activities.⁴¹ While generally excluded, central bank debt may be integrated into analyses if the central bank has a large negative capital position or if monetary financing of government operations is prevalent.

In contrast, the LIC DSF recommends broader public debt coverage for LICs, for comparability across countries and because historical experience shows that a narrow definition of public debt can contribute to debt surprises. The framework also recommends the inclusion of both public and private sector debts guaranteed by the government. When these are considered, the debt is usually referred to as public and publicly guaranteed (PPG) debt.

B. INSTRUMENT COVERAGE

Public debt can also be thought of in terms of instrument coverage. The most common debt instruments include debt securities, loans, and accounts payable. Each of these instruments has its own features.

DEBT SECURITIES (BONDS)

Debt securities—in particular, bonds—are the most common form of debt for advanced and emerging market economies. A bond is a debt instrument that represents a loan by an investor to a borrower (in the context of this primer, the government). Bonds represent a promise to repay the amount borrowed at some time in the future (the bond's *maturity*) and compensate the investor with regular interest, or coupon, payments at a fixed or variable rate.

The *bond market* is the marketplace where investors buy and sell government debt securities. Bonds are either issued on the *primary market*, where governments issues new debt, or on the *secondary market*, in which investors buy and sell existing debt via brokers or other intermediaries. Secondary markets play a crucial role in bond markets by providing *liquidity*, i.e., the ability to buy or sell a security quickly.

Without a market where investors can sell their bonds before their maturity date, investors would be hesitant to tie up large amounts of money in bonds for extended periods.

⁴¹ A quasi-fiscal activity is defined as one generating public sector spending that normally should be included in the budget of the government, but undertaken outside the general government, for instance by state-owned banks or enterprises.

Bonds and other debt securities can be issued in domestic or external markets, in local or foreign currency, and at maturities that range from a few months to several decades. When issued in local currency, the principal and interest of the security may be indexed to inflation or the exchange rate to give additional protection to investors; this is common in countries with a history of high inflation and currency volatility. With the development of the international sovereign debt market since the early 1990s and the low interest rate environment that followed the Global Financial Crisis of 2008-09, more and more countries have been issuing debt securities in global markets. As a result, an international market for *frontier economies*⁴² has developed.

For domestic debt securities, *primary* issuance is made through auctions where domestic banks and other local investors participate. In these auctions, bidders specify either the price they want to pay for the bond or the interest rate they want to earn. Based on these offers, the government determines the price or the interest rate it is willing to accept, issuing the amount of debt that is consistent with the offers received.⁴³ Central banks may assist with the issuance, setting up the auction on behalf of the government, or holding part of the issuance, to later resell it to private investors in the *secondary* markets, where investors can buy and sell previously issued securities. In countries with well-developed domestic financial markets, market makers (usually a group of domestic commercial banks) take this role. In both primary and secondary markets, the central bank or the market makers may have an important role in ensuring the liquidity of domestic bond markets. For a detailed discussion on issuing bonds in international markets, see Annex II.

LOANS

While most countries can issue short-term securities, some countries, particularly LICs, may be more constrained than market-access countries⁴⁴ (MACs) in issuing bonds with longer maturities. LICs tend to feature low savings rates, and shallow and poorly developed domestic markets, and may lack access to international credit markets. Many LICs rely instead on direct loans obtained from commercial banks, domestic and foreign; bilateral creditors, including government banks, development finance institutions and export credit agencies; and multilateral institutions, such as the World Bank and the IMF, often on a concessional basis.

Bilateral and multilateral loans can be granted on concessional terms, with low interest rates, long maturities, and often extended grace periods which make them a suitable instrument for LICs and more vulnerable countries. The degree of concessionalism in a loan is measured by its *grant element*, as explained in **Box 13**.

⁴² Frontier markets, or frontier economies, is a term generally used to refer to developing countries that have made inroads in accessing international capital markets. Many of these countries had their first international bond issuance in the 2010s.

⁴³ Alternatively, governments may set the amount to be issued and be prepared to take any price or interest rate that equates such amount with market demand.

⁴⁴ Market-access countries are those that typically have significant access to international capital markets.

Box 13 Calculating the Grant Element of a Loan

The grant element of a loan is the measure of its concessionality. It represents the difference between the loan's principal—its nominal or face value—and the sum of the discounted future debt-service payments to be made by the borrower (its present value), expressed as a percentage of the loan's face value.

Let's suppose a loan of \$100 million extended to a country with an interest rate of 2 percent per year and the principal to be repaid in one final payment 20 years from today. In this example, we will assume that the current market interest rate for a non-concessional loan of this maturity is 5 percent. How do we calculate the grant element of the loan? Note that the country will pay \$2 million per year in interest, instead of \$5 million under market terms. The measure that allows us to calculate the savings, valued in today's dollars, is called the present value of the loan.

The present value is calculated using a *discount rate* reflecting the rate that a creditor would have required from the borrower under market conditions (5 percent in this example). The present value will give us the amount that, at a yield of 5 percent, generates a cash flow equivalent in financial terms to that of the loan. That amount is \$62.6 million (any financial calculator, or Microsoft Excel, can perform this calculation automatically). Thus, the grant element of this loan is 37.4 percent = $(100-62.6)/100$.

The grant element of a concessional loan varies from transaction to transaction and is dependent on the discount rate used for its calculation. The IMF considers a loan to be concessional if it carries a grant element of at least 35 percent calculated using a discount rate of 5 percent. For the Organization for Economic Cooperation and Development (OECD) and its Development Assistance Committee (DAC), a loan must have at least a 25 percent grant element to be classified as Official Development Assistance (ODA).

Loans can also be *collateralized*, also referred to as resource- or asset-backed loans. This practice is found in commercial lending to public corporations and more recently has been used by some bilateral creditors, particularly the People's Republic of China (PRC) and India. In these cases, the financing is provided against a pledge on either a future revenue stream or an asset. Examples are common in natural resource exporting countries where lending is secured by pledges against future oil exports (Angola, Chad, Ecuador, Venezuela) or metal exports (Zimbabwean collateralized debt is backed by platinum exports). Paris Club members⁴⁵ and the World Bank do not engage in collateralized lending and their loan agreements often include a Negative Pledge Clause, which restricts a borrower from pledging an asset or revenue stream to another creditor. Such clauses are designed to prevent the subordination of the creditor's claims to those of other creditors in case of debt restructuring. (See Section VII)

ISLAMIC FINANCING

In countries with deep Islamic traditions, Sharia law forbids the payment of interest. *Sukuk*, also known as Islamic bonds, are Sharia-compliant instruments that allow financing but do not bear interest, which makes them a common alternative to conventional bonds in Islamic countries. While bonds represent a promise to repay investors at maturity, with *sukuk* the investors gain partial ownership of the issuer's

⁴⁵ The Paris Club is an informal group of bilateral creditors that coordinates solutions to payment difficulties faced by debtor countries. See Section VII.

assets until maturity. Bondholders also receive regular interest payments, whereas sukuk holders receive a share of the profit generated by the underlying asset.

Sukuk could be well suited for infrastructure financing, as they resemble PPP financing where investors finance the assets and own them until maturity when assets are transferred to the government.

OTHER ACCOUNTS PAYABLE

Accounts payable are accrued liabilities that the government is legally or contractually obligated to pay at a certain point in time. These can include anything from civil servant salaries to contractor fees. Accounts payable do not necessarily represent payment obligations that are overdue or in arrears. However, government suppliers may end up acting as unintended creditors to governments in the event that the government fails to pay them on time; unpaid bills can really pile up in the context of fiscal crises. When arrears become endemic, suppliers may respond by charging higher prices for the provisioning of goods and services to the government, reducing spending efficiency. Accounts payable are reported in the public sector balance sheet, but they are not typically included in debt statistics or analysis of debt sustainability.

CONTINGENT LIABILITIES

Contingent liabilities are obligations that only arise if a particular event occurs in the future. These include both explicit and implicit contingent liabilities. Contingent explicit liabilities are legal obligations for governments to make payments only if particular events occur. A prime example is when the government issues a loan guarantee to a public corporation or development project. Because their fiscal cost is conditional, they are easily overlooked until the triggering event (e.g., the public corporation defaults on the loan) occurs. Contingent implicit liabilities are those that, while not legally binding, are likely to be borne by the government because of public expectations or political pressures. A quintessential example of an implicit guarantee is the “too big to fail” phenomenon associated with financial sector institutions in some countries. National authorities are also often forced to cover the obligations of subnational governments when the latter’s deficits or arrears have become unsustainable. The practice with respect to the disclosure of these liabilities varies from country to country, and their omission oftentimes leads to “debt surprises.”

C. VALUATION CONCEPTS

All debt instruments—bonds, loans, and even accounts payable—have a *face value*, which is the principal amount to be paid by the borrower when the debt comes due. As most debts carry interest, at any given moment in time it is possible to calculate the amount actually owed by the borrower, including the interest that has been accrued and not yet been paid: this is referred to as the *nominal value* of the debt. Finally, when debt instruments are traded in the marketplace, there will be a public quote which reflects the price investors are willing to pay to buy the debt: this is the *market value* of debt.

ANNEX II. RAISING FUNDS IN INTERNATIONAL CAPITAL MARKETS

To raise money in international capital markets, countries use two common instruments: external (international) bonds and syndicated loans. Credit ratings are necessary to issue external bonds and are beneficial to obtain better terms in loans from international banks. This annex discusses these topics.

A. INTERNATIONAL BONDS

KEY CHARACTERISTICS OF INTERNATIONAL BONDS

For countries, bond financing provides a source of funds without conditionality and generally provides a signal of macroeconomic strength. On the other hand, the cost of financing tends to be higher than concessional loans, and issuing bonds creates the challenge for debt managers to handle large repayments when they mature. This is because the size of a bond issue is normally above \$500 million, which may be a significant figure to repay or refinance, especially for smaller countries. Such a challenge is compounded by the inherent uncertainty of market conditions, where the cost of borrowing or refinancing can vary for reasons that are not controlled by the issuers.

Issuance of international bonds is governed by the laws of key jurisdictions (for instance, the United States, the United Kingdom, and the European Union). The term “Eurobond” refers in general to a bond that is listed, trades and settles in the European Union, although the bond can be issued in any currency denomination. Eurobonds are not allowed to be sold in the United States unless they contain a “144A clause,” which allows the sale of bonds to qualified institutional buyers in the US. Global bonds, in turn, are regulated by the U.S. Securities and Exchange Commission and are issued simultaneously in the Eurobond market and in the United States. While global bonds may potentially reach a larger market, they carry heavier disclosure and legal requirements and, thus, higher issuance costs.

A country’s ability to access international bond markets depends on its credit risk, as perceived by market participants. Credit risk is measured by credit ratings, which are issued by credit rating agencies. The ratings will have a significant influence on the interest rates countries will need to pay on international bonds. And in general, the higher (better) the credit rating, the more investors (pension funds, mutual funds, insurance companies, or hedge funds) will be able and willing to purchase the bonds.

Typical maturities for international bonds range between 5 and 15 years, and could be longer for established issuers. The size of bond issues is normally between US\$500 million and US\$1 billion, to ensure that the bond has adequate liquidity to trade after issuance. Smaller issues may attract less demand across investors since it will be more difficult for them to sell their positions before maturity.

Bonds contain Collective Action Clauses (CAC), which are rules designed to make debt restructurings easier. The standard clauses are published by the International Capital Markets Association, and allow a supermajority of bondholders (say, 75 percent) to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring.

ISSUING INTERNATIONAL BONDS: KEY STEPS

When a country considers issuing international bonds, the first step consists of analyzing how the issuance will affect the country's debt profile and debt strategy going forward. In particular, debt managers will need to assess the impact on future annual debt amortizations (debt falling due each year). But fundamentally, issuing external bonds implies a long-term commitment by the country to disseminate the information that will be required by investors to assess macroeconomic developments, and to engage with them in frequent interactions to support their concerns.

There are many practical steps to be taken by the DMO or their delegates (this list is not exhaustive):

- **Selection of legal counsel.** The documentation required for international bond issuance, while largely standardized, is significant. DMOs will have their own legal experts in-house, but external legal counsel with expertise in international securities laws and markets is essential, especially to identify areas in which room for negotiation exists. The prospectus is the basic legal document that supports the issuance. Its structure is largely prescribed by securities laws and includes risk factors potentially affecting debt service (the macroeconomic outlook, macro-fiscal risks, political and security risks), the terms of the issuance, information about the issuer (history and current affairs, government and politics, overview of the economy, the use of the proceeds from issuance), restrictions on selling (to unauthorized investors), and other technical aspects (such as clearance systems, taxation issues, and listing in formal exchanges).
- **Selection of lead managers.** The placement of an international bond is executed by an international investment bank, alone or with other banks, and the success of the operation relies on its technical capacity, experience, and its ability to reach potential investors.⁴⁶ Lead managers also advise issuers on the features of bond issuance and specific markets to be tapped. Selecting a lead manager also involves considering fees and expenses charged for the transaction and the manager's ability to provide post-transaction support (i.e., price stabilization of the bond during an initial trading period). Possible conflicts of interest may arise if lead managers are also providing their services to other issuers at the same time.
- **Issuance or update of credit rating.** Ratings are issued for the country and for the specific bond being issued. Normally, the country hires one or two credit rating agencies for this purpose. The process takes time (depending on the case, between 2-4 months), and therefore countries need to start early. (See below for more on Credit Ratings.)
- **Structuring of the bond.** Bonds can be issued in different international currencies (U.S. dollar, euro, yen, British pound being the most common),⁴⁷ with different interest rate types (floating, fixed, indexed), at different tenors (5, 7, 10, or 15 years being the most common) and with different redemption features. Regarding the latter, there are two typical alternatives: *bullet*, which means full repayment of the principal at the end of the bond's life, or *amortizing*,

⁴⁶ The appropriate number of lead managers depends on several factors, including the relationship with the issuer, distribution capacity, execution experience, and size of the transaction.

⁴⁷ International bonds can be issued in local currency as well, but this is generally limited to countries with a track record of macroeconomic stability and strong domestic institutions.

Egypt's Commercial International Bank, with assistance from the IFC, issued the country's first private sector green bond valued at \$100 million.

Nigeria: Nigeria raised \$4 billion via a Eurobond issue in September 2021 after investors demanded more than four times the amount on offer.⁵⁰

USAID'S LOAN GUARANTEE ASSISTANCE

The U.S. Government, acting through USAID, has provided loan guarantees for certain payment obligations with regard to new debt that partner governments are expected to incur. These guarantee assistance programs support economic transition and reform initiatives, so that a stable, democratic partner country can provide broader economic opportunity for its citizens. Since 2010, the US Government has supported Tunisia, Jordan, Iraq, and Ukraine with these programs, as presented in Table 7, below.

Table 7 Loan Guarantees between the US and partner countries since 2010

Country	Year	Principal amount guaranteed
Tunisia	2012	US \$30 million
Jordan	2013	US \$1.25 billion
Ukraine	2014	US \$1 billion
Jordan	2014	US \$1 billion
Tunisia	2014	US \$500 million
Ukraine	2015	US \$1 billion
Jordan	2015	US \$1.25 billion
Tunisia	2016	US \$500 million
Ukraine	2016	US \$1 billion
Iraq	2017	US \$1 billion

Source: US Department of State⁵¹

⁵⁰ <https://www.reuters.com/article/nigeria-eurobond/update-2-nigeria-raises-4-billion-eurobond-on-healthy-investor-demand-idUSL1N2QN2WP>

⁵¹ <https://www.state.gov/tias/>

These loan guarantees have conditions attached. Conditions usually include disclosure of financial information to the U.S., participation in IMF programs, and the development of PDM measures.⁵²

B. SYNDICATED LOANS

When individual banks extend loans, they need to weigh the constraints imposed by their capital and liquidity needs against their credit risk tolerance. Syndicated loans, i.e., loans extended by a group of individual creditors (the *syndicate*), allow them to lend large amounts to a single borrower, while respecting the aforementioned constraints. Syndicated loans, which also may allow non-bank investors (e.g., insurance companies, pension funds, or mutual funds) to participate, are extended on common terms and conditions. The bank leading the deal is referred to as the *arranger*. See **Box 16** for a description of Egypt's 2021 syndicated loan.

Box 15 Example of a Syndicated Loan

In 2021, Egypt secured a \$3 billion loan arranged jointly by a group of Gulf banks. The financing closed in December 2021. A portion of the loan's proceeds were earmarked to finance environmentally sustainable projects, and a portion was Sharia-compliant. A group of conventional and Islamic banks took part in the syndication process. Two banks, Emirates NBD and First Abu Dhabi Bank, were the arrangers. Other banks participating in the financing arrangement included Abu Dhabi Islamic Bank, Al Ahli Bank of Kuwait, Arab Banking Corporation, Standard Chartered, National Bank of Kuwait and Warba Bank.⁵³ The transaction was initially marketed to banks as a \$2 billion loan, but was increased to \$3 billion after being over-subscribed (the demand for the loan issue was greater than the available shares).

TYPES OF SYNDICATED LOANS

Different types of syndicated loans include 1) *underwritten* deals, in which the arranger guarantees the entire commitment and then syndicates the loan, and commits to taking an additional participation in the loan if the total amount is not fully subscribed; 2) *best-efforts* deals in which the arranger commits to a partial amount of the loan and to do its best to find other creditors to provide the rest; and 3) *club deals*, where the borrower or the arranger seeks the participation of additional investors before committing to the overall loan amount and conditions.

There could be different types of loans in syndication agreements. *Revolving credit lines* allow the borrower to draw down, repay, and reborrow for up to a total amount over a specific period of time. *Term loans* are standard installment loans, which are repaid according to an agreed schedule. *Letters of credit* are guarantees provided by the syndicate to pay off certain debts or obligations of the borrower.

SYNDICATED LOANS: KEY ROLES AND MANDATES

The borrowing country will usually give a creditor or group of creditors the mandate to act as the arranger of the deal. One bank from the syndicate will typically be appointed as the agent of the

⁵² An example of these conditions can be found in Jordan's 2015 loan guarantee here: <https://www.state.gov/wp-content/uploads/2019/02/15-624-Jordan-Loan-Guarantee.pdf>

⁵³ <https://www.zawya.com/en/business/egypt-completes-3bln-loan-for-green-and-islamic-financing-fot9bqi6>

creditors to administer the loan. If the loan is guaranteed, one of the creditors will be entrusted with holding the documentation necessary to ensure execution of the guarantee upon non-payment. Fees will be paid for these three specific functions in addition to the financial terms of the loan. The latter will typically include an interest rate to be paid on borrowed amounts and commitment fees on the maximum borrowable amounts.

The mandate letter is the document where the borrower appoints the arrangers and sets out the terms of the engagement. The term sheet is a document that summarizes the commercial terms of the proposed financing and is used as a basis for preparing the first draft of the loan agreement (type of facility, amounts, fees, financial terms, covenants). The loan agreement specifies the detailed terms and conditions of the loan.

C. CREDIT RATINGS

Credit risk assessment is essential to any lending activity. For all debt instruments that trade publicly, there is a developed market for credit risk assessments that is dominated by three main credit rating agencies: Fitch, Moody's, and Standard and Poor's.

IMPORTANCE OF CREDIT RATINGS

Sovereign credit ratings provide an indication of the capacity and willingness of rated governments to repay their obligations in full and on time. Debt issuers demand ratings and pay for them as a means to broaden the pool of potential investors. Investors use credit ratings to support their decisions to buy or sell securities on the basis of the standard risk-return tradeoff present in the management of financial portfolios. Ratings are also attractive for their simplicity, as usually complex analyses of credit strength or possible defaults are summarized in a few letters, typically on a scale from AAA to D.

The importance of ratings goes beyond the valuation of debt securities. To the extent that a rating impacts the cost of sovereign borrowing, it may constrain countries' fiscal policy, introducing an element of market discipline to policy decisions. Given the unique features of governments, with the capacity to tax, regulate, and issue currency for the payment of some of their obligations, the credit quality of a sovereign government (its credit rating) will be above most, if not all, other issuers in its jurisdiction, setting a key benchmark for private borrowers. The sovereign rating will also influence risk considerations and costs for international bank loans taken by the public and private sectors. Moreover, the sovereign rating is a common reference for foreign investors at large, affecting foreign direct investment flows.

THE CREDIT RATING PROCESS

As described above in the steps for issuing international bonds, a government will hire one or two rating agencies to issue credit ratings, and the process can take between 2-4 months from start to finish.

Ratings are issued on the issuer (the government) and on specific obligations. Issuer ratings indicate the general credit standing of the rated government. Specific ratings indicate the specific credit standing of the individual debt instrument. At most rating levels, both ratings are the same, but when credit quality is low, the ratings may diverge. The reason for the divergence is that a default on all government obligations is rare; rather, defaults are selective and sequenced, reflecting different seniorities (*de jure* or

de facto) of certain classes of sovereign debt. Attached to the issuer credit ratings, agencies specify the outlook for the credit rating (stable, negative, positive) to alert of possible rating changes. When a rating is being reassessed, agencies communicate with markets accordingly.

The rating agencies' methodologies to produce the ratings entail a comprehensive analysis of country characteristics, including political stability, economic structure, macroeconomic policies (especially fiscal policy), and external conditions.

While the differentiation in credit ratings is ample (see Table 8), it is important to highlight two broad credit categories. *Investment grade* refers to countries or securities where the risk of default is assessed to be low. *Speculative grade*, in contrast, applies to countries or securities where the risk of default is higher. These categorizations inform the decisions of institutional investors worldwide, whose guidelines may constrain higher-risk exposures.

Table 8 Credit Ratings Summary

Category	Credit Rating (broad definition)	Fitch	Moody's	S&P
Investment Grade	Highest credit quality, lowest expectation of default risk	AAA	Aaa	AAA
	Very low default risk.	AA	Aa2	AA
	Very low default risk. The capacity for payment is strong but vulnerable to adverse economic conditions.	A	A2	A
	Expectations of default risk are currently low. The capacity for payment is adequate but adverse economic conditions are more likely to impair it.	BBB	Baa2	BBB
Speculative Grade	Elevated vulnerability to default risk; however, financial flexibility exists that supports the servicing of financial commitments.	BB	Ba2	BB
	Material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met.	B	B2	B
	Very low margin for safety. Default is a real possibility.	CCC	Caa2	CCC
	Default of some kind appears probable.	CC	Ca	CC
	A default or default-like process has begun, or the issuer is in standstill.	C	C	C
	Payment default or distressed debt exchange has occurred.	RD/D	C	SD/D

The descriptive language used for each rating category may not be exactly the same for all agencies.

There are subcategories for each rating not included. The minimum investment grade rating is BBB-/Baa3.

Source: Fitch, Moody's, Standard and Poor's

ANNEX III. ADDITIONAL DETAILS ON THE LIC-DSF

As discussed in Section V, the LIC DSF is used to assess the risk of debt distress in LICs, taking account of a country's capacity to carry debt and its projected debt burden under both baseline projections and shock scenarios.

Importantly, the World Bank uses the LIC DSF to determine the grant provisioning within a country's annual IDA resource allocation, while other creditors, including many multilateral development banks, use it to inform their lending policies. In addition, both IDA's Non-Concessional Borrowing Policy and the IMF's Debt Limit Policy rely on the LIC DSF to help define the room for non-concessional borrowing by LICs.

The analysis comprises the elaboration of 20-year projections for all relevant variables, from real GDP to external accounts, to fiscal balances. Projections are subject to assessment using realism tools, which aim at avoiding overoptimism. In particular, methods are included to capture the impact of public investment on growth in a realistic manner.

Debt-carrying capacity is established first to determine what debt and debt service thresholds will apply to the country being assessed. A composite indicator is calculated to capture the impact of different factors (quality of institutions and macroeconomic strength) on debt-carrying capacity. The composite indicator determines the classification of countries into one of three categories: weak, medium, and strong debt-carrying capacity.

For the calculation of the composite indicator, it is assumed that the likelihood of debt distress is positively correlated with the level of indebtedness, and negatively correlated with the quality of institutions and policies (measured by the World Bank's Country Policy and Institutional Assessment - CPIA⁵⁴), and with other country-specific factors (real GDP growth record, size of international reserves, relevance of external inflows of remittances). The higher the likelihood of debt distress as measured by the indicator, the lower the debt-carrying capacity.

The LIC DSF uses indicative thresholds or benchmarks (Table 3 in Section V) to analyze the risk of external debt distress. Thresholds are statistically determined; if country ratios climb above them, the risk of debt distress is considered elevated.

Table 9 lists countries assessed with the LIC DSF and their overall risk of debt distress, as rated in their most recent DSA (as of December 2021).

⁵⁴ CPIA is an index compiled for all IDA-eligible countries. The index consists of 16 indicators grouped into four categories: 1) economic management; 2) structural policies; 3) policies for social inclusion and equity; and 4) public sector management and institutions. Countries are rated on their current status in each of these performance criteria, with scores from 1 (lowest) to 6 (highest).

Table 9 Risk of Debt Distress in Countries Eligible for IMF Concessional Lending (Poverty Reduction and Growth Trust Eligible Countries), as Assessed in Last DSA Report

High		Moderate		Low		In Debt Distress	
Country	Date	Country	Date	Country	Date	Country	Date
Afghanistan	Jun-21	Benin	Jan-21	Bangladesh	Jun-20	Congo, Republic of	Jan-20
Burundi	Apr-15	Bhutan	Oct-18	Cambodia	Dec-19	Grenada	May-20
Cameroon	Nov-20	Burkina Faso	Nov-20	Honduras	Jun-20	Mozambique	Apr-20
Cabo Verde	Nov-20	Comoros	Jun-20	Moldova	Apr-20	São Tomé and Príncipe	Mar-21
Central African Republic	Feb-21	Congo, Democratic Republic of	May-20	Myanmar	Jan-21	Somalia	Nov-20
Chad	Aug-20	Côte d'Ivoire	Dec-20	Nepal	May-20	Sudan	Jun-21
Djibouti	May-20	Guinea	Jun-21	Tanzania	Mar-19	Zimbabwe	Mar-20
Dominica	Apr-20	Guyana	Sep-19	Timor Leste	May-19		
Ethiopia	May-20	Kyrgyz Republic	Jun-21	Uzbekistan	Apr-21		
Gambia, The	Jan-21	Lesotho	Jul-20				
Ghana	Apr-20	Liberia	Jan-21				
Guinea-Bissau	Feb-21	Madagascar	Apr-21				
Haiti	Apr-20	Malawi	Oct-20				
Kenya	Apr-21	Mali	Mar-21				
Kiribati	Apr-21	Nicaragua	Nov-20				
Lao P.D.R.	Aug-19	Niger	Nov-20				
Maldives	Apr-20	Rwanda	Jan-21				
Marshall Islands	May-21	Senegal	Jun-21				
Mauritania	Sep-20	Solomon Islands	Jun-20				
Micronesia	Sep-19	St. Lucia	Sep-11				
Papua New Guinea	Jun-20	Togo	Apr-20				
Samoa	Mar-21	Uganda	Jun-21				
Sierra Leone	Mar-21	Vanuatu	Jun-19				
South Sudan	Apr-21	Yemen, Republic of	Sep-14				
St. Vincent and the Grenadine	May-20						
Tajikistan	May-20						
Tonga	Feb-21						
Tuvalu	Jul-18						
Zambia	Aug-19						

Source: International Monetary Fund

ANNEX IV. HIPC AND MULTILATERAL DEBT RELIEF INITIATIVES

The Heavily Indebted Poor Countries (HIPC) Initiative⁵⁵ was launched in 1996 by the IMF and World Bank to reduce debt burdens in poor countries that were “heavily indebted,” while supporting their poverty reduction efforts. The initiative was strengthened and later supplemented in 2005 by the Multilateral Debt Relief Initiative (MDRI) to help accelerate progress toward the United Nations Sustainable Development Goals. The MDRI allows for 100-percent relief on eligible debts by three multilateral institutions—the IMF, the World Bank, and the African Development Bank—for countries completing the HIPC Initiative process. In 2007, the Inter-American Development Bank announced additional (“beyond HIPC”) debt relief to five of the poorest countries in Latin America and the Caribbean (Bolivia, Haiti, Honduras, Guyana, and Nicaragua).

Decision Point: To be considered for HIPC Initiative assistance (the so called Decision Point), a country must fulfill four conditions: 1) be eligible to borrow from IDA, which provides interest-free loans and grants to the world’s poorest countries, and from the IMF’s Poverty Reduction and Growth Trust, which provides loans to LICs at subsidized rates; 2) face an unsustainable debt burden that cannot be addressed through traditional debt relief mechanisms; 3) have an established track record of reform and sound policies through IMF- and World Bank-supported programs; and 4) have a Poverty Reduction Strategy (PRS) that is developed through a broad-based participatory process in the country.

Once a country has met or made sufficient progress in meeting these four criteria, the Executive Boards of the IMF and World Bank formally decide on its eligibility for debt relief, and the international community commits to reducing debt to a level that is considered sustainable. If deemed eligible, the country may immediately begin receiving interim relief on its debt service falling due.

Completion Point. In order to receive full and irrevocable reduction in debt available under the HIPC Initiative, a country must: 1) establish a further track record of good performance under programs supported by loans from the IMF and the World Bank; 2) implement satisfactorily key reforms agreed at the decision point; and 3) adopt and implement its PRS for at least one year. Once a country has met these criteria, it can reach its completion point, which allows it to receive the full debt relief committed at the decision point.

Countries receiving debt relief. Of the 39 countries eligible or potentially eligible for HIPC Initiative assistance, 36 are receiving full debt relief from the largest creditors (the World Bank, the African Development Bank, the IMF, the Inter-American Development Bank, and all Paris Club creditors). Smaller plurilateral institutions, non-Paris Club official bilateral creditors, and commercial creditors, which together account for about 26 percent of total HIPC Initiative costs, have so far delivered a small share of their expected relief.

⁵⁵ This annex has been prepared using information available at www.IMF.org. For more information on debt relief provided under HIPC and MDRI, see International Monetary Fund, Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Statistical Update, August 6, 2019. <https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/08/06/Heavily-Indebted-Poor-Countries-HIPC-Initiative-and-Multilateral-Debt-Relief-Initiative-MDRI-48566>.

ANNEX V. USAID SUPPORT RELATED TO PUBLIC DEBT

Country/ Countries	Project Title	Short Description
Bolivia	Country Risk/ Debt Service Analysis (1986)	The report provides an overview of Bolivia's situation of risk and debt service levels.
Bosnia and Herzegovina	Fiscal Sector Reform Activity (2015-2020)	The project supported: (i) development of a public debt management strategy; (ii) analysis of debt management software solutions; and (iii) selection of DMFAS as the most viable solution for PDM, which was supported by all levels of governments.
Croatia	Croatia Debt Market Assessment (2003)	The assessment provides an overview of issuers of and investors in debt instruments in Croatia, and the capital market setting for bond markets.
Egypt	Technical Assistance to Support the Reform Activities of the Government of Egypt and Provide Management Activities (1997-2004)	<p>With USAID support, the Ministry of Finance established a debt management unit and recruited and hired the core staff required.</p> <p>The U.S. Treasury, with USAID financing, assisted in drafting a new debt law. The U.S. Treasury also provided the government with an advisor on debt management.</p>
Egypt	Technical Assistance for Policy Reform II (2006-2011)	The project upgraded the Debt Management Financial System and provided training on the maintenance and use of the system. The project supported the addition of risk management indicators and analytical tools to the monthly external debt report. It also conducted training on risk indicators relevant to foreign-currency debt management, such as exposure reporting, sensitivity analysis, stress testing, scenario analysis, and value at risk.
El Salvador	Fiscal Policy and Expenditure Management Program (2011-2017)	The project successfully completed the software design for the Fiscal Transparency Portal, which provides up-to-date information on debt service levels and debt to GDP levels.

Gambia	The Gambia Debt Management Activity (2018)	The project team provided training and consultations on debt management, domestic market development, and on-lending and guarantees, which resulted in counterparts defining and committing to achieving specific action items. The team also developed an on-lending procedures manual defining the processes and guidelines for the government to lend money to SOEs, public enterprises and local governments.
Honduras	Internal Debt in Honduras (1992)	USAID produced a report evaluating the debt management systems, mechanisms, practices and procedures for obtaining, collecting, processing and exchanging debt information. The report also examines the global economic aspects of debt, and the relationship and coordination between debt and other macroeconomic variables, in particular monetary policy.
India	A Review of the Operational Impediments of the Debt Market in India (1996)	The paper identifies operational impediments to the development of the Indian debt market.
Indonesia	The Debt Trap and Monetary-Fiscal Policy in Indonesia: The Gathering Storm? (2002)	The paper evaluates the possibility of an Argentina-style default in Indonesia without the appropriate interventions. The paper was presented at a Convention of the East Asian Economics Association.
Indonesia	Debt Management Recommendations for the Medium Term (2004)	The paper provides a debt management strategy for the government, with a focus on the goals of lowering the cost of borrowing and reducing the vulnerability of the portfolio to shocks.
Iraq	Governance and Performance Accountability Project (Takamul) (2017-2023)	Takamul has provided technical assistance to the Debt Management Office in Baghdad and is currently providing technical assistance to the Kurdistan Regional Government (KRG) Debt Management Office. USAID support to the KRG DMO played a vital role in operationalizing the DMO to enable KRG and Federal government to make key budget and debt decisions, increase transparency, and collect public debt data for reporting and analysis.

Jordan	Jordan Fiscal Reform II Project (2009-2014)	The project provided support through assessing the organization and needs of the Ministry of Finance's Public Debt Department (PDD). The project created the first MTDS for Jordan and provided capacity building support using the MTDS, which helped maintain debt sustainability.
Jordan	Jordan Fiscal Reform Bridge Activity (2014-2016)	USAID assisted the PDD to strengthen its capacity to upgrade debt management and associated strategies. The project established operational guidelines within the PDD for streamlining processes and increased the capacity of analysts to perform risk and debt dynamics assessments.
Jordan	Fiscal Reform and Public Financial Management Activity (2016-2020)	The FRPFM team worked closely with the Studies and Economics Policy Directorate in preparing the Medium-Term Fiscal Framework for the period 2020-2022, outlining the fiscal policy for this period and providing estimates for the size of the required fiscal (including debt) measures needed to achieve fiscal targets.
Kosovo	Growth and Fiscal Stability Initiative (2010-2013)	USAID advisors built a comprehensive model for analyzing the debt sustainability of Kosovo.
Mongolia	Sovereign Guaranteed Loans and Borrowing Capacity (2002)	This report evaluates the past use of foreign loans in the energy sector and potential future use of such loans, and provides a preliminary statistical analysis of some of the issues raised.
Morocco	Secondary Market for Short-Term Debt Instruments (1991)	The paper studies the creation of a secondary market for short-term debt instruments.
Pakistan	Financial Market Development Activity (2016-2018)	USAID supported Government of Pakistan efforts to pursue financial sector reforms, which will strengthen Pakistan's debt markets and improve management of sovereign debt.
Paraguay	USAID Loan Rescheduling Feasibility (1989)	The paper assesses the feasibility of rescheduling two outstanding USAID loans.

Peru	Climate Economic Analysis for Development, Investment, and Resilience	USAID developed a roadmap for the development of a climate bond with Peruvian bank Agrobanco.
Philippines	Study on Philippines' Public Debt Management (1992)	The study examines fiscal trends and trends in the country's public debt.
Philippines	Support for Development Program II (1993)	USAID supported several studies of prospective financing mechanisms to improve the management of public debt financing.
Serbia	Business Enabling Environment (2011-2018)	USAID helped the Public Debt Authority to reduce the risk and cost of sovereign borrowing through the use of better IT tools and enhanced staff capacity.
Tanzania	Tanzania Debt Conversion Program (1989)	USAID helped the Bank of Tanzania to draft detailed debt conversion program guidelines and upgrade the computer-based information systems necessary to identify and verify the quantity and composition of debt available for conversion.
Tunisia	Fiscal and Accounting System of Tunisia (2019-2023)	USAID assessed the System for External Decisions (SIADE), the Tunisian government's public and private external debt management system, providing recommendations to improve efficiency in the monitoring of loan agreements and projections of debt.
Yemen	Economic Recovery and Livelihoods Program (2020-Present)	USAID support includes: (i) a report on the implementation status of the DMFAS system; (ii) a "white paper" on strategic options for addressing the current government overdraft balance; (iii) analysis/estimates of debt servicing obligations and disbursements for incorporation in the government's 2022 budget proposal; and (iv) training to MOF and central bank employees on debt and the utilization of DMFAS.

ANNEX VI. GLOSSARY

Amortization	A series of payments made on a loan or bond until it is repaid in full by its maturity date.
Contingent Liabilities	Obligations for governments to make payments only if particular events occur. Contingent liabilities constitute fiscal risks, and whether implicit or explicit, they affect a government's fiscal position and their ability to meet their spending obligations. For example, in the wake of a financial crisis, governments may issue guarantees on loans to state-owned enterprises. If the borrowing firm is unable to service its debt, the government is legally obligated to pay back this debt. Countries often detail their contingent liabilities in a fiscal risk statement.
Collateralization	<p>The use of an asset or revenue stream to secure a loan. If the borrower defaults on the loan (they do not or cannot service the debt), the creditors can lay claim to the asset or revenue stream to offset the loss.</p> <p>Collateralization can benefit both the creditor and the borrower: collateralization gives creditors a sufficient level of protection against default risk, and for some borrowers, it can help them obtain loans if they have a poor credit rating. Collateralization can also secure debt repayment by attaching specific revenue streams. For example, if a country borrowed to build a port and then was unable to service their debt, a collateralized loan would allow the creditor to collect a portion of the revenue from the port to service the debt obligation. On the negative side, collateralization can motivate creditors to lend in excess, especially to riskier borrowers.</p>
Concessional Debt	Lending extended by creditors to borrowers with more favorable terms than available to them in the market. Concessional debt is typically lent to borrowers to achieve a goal, such as the development of infrastructure. The concessionality of debt (also referred to as the grant element) is the difference between the face value of the loan and the sum of the discounted future debt payments made by the borrower.
Creditor	An entity to whom money is owed, either via a loan, a bond, or other debt instrument. The credit is typically repaid with interest.
Debt Relief	The act of reducing or refinancing the total or partial amount of debt owed by countries to make it easier for them to repay it. When providing debt relief, official creditors often set requirements that borrower countries must abide by, such as implementing a poverty reduction strategy and maintaining macroeconomic stability. In the early 21 st century,

the multilateral and bilateral lending institutions agreed to significant debt relief for developing countries who had accumulated unsustainable debt, referred to as the Heavily Indebted and Poor Countries (HIPC) initiative.

Debt Restructuring	The process used by governments to address unsustainable debt situations. The creditors agree to new terms with the borrower to make debt more affordable. A creditor has an incentive to support debt restructuring in order to receive payment after default or to increase the probability of being repaid, even if there is a loss on the principal of the loan (haircut).
Debt Service	The act of making interest and principal payments on outstanding debt.
Debtor/ Borrower/Issuer	A debtor is an entity who owes money. If the debt is in the form of a loan from a financial institution, the debtor is referred to as a borrower , and if the debt is in the form of securities—such as bonds—the debtor is referred to as an issuer .
Default	In the context of public debt, a default refers to a sovereign entity or state that is unable to pay back the principal and interest payments when they are due. When a country defaults on its debt, it typically receives a credit rating downgrade and faces increased interest rates, making it more difficult, if not impossible, to borrow domestically and internationally.
Domestic Debt Distress	A situation in which a country is unable to fulfill its domestic/internal financial obligations, there is a real risk of default on domestic debt, or debt restructuring is required.
External Debt Distress	Describes a situation in which a country is unable to fulfill its foreign/external financial obligations, there is a real risk of default, or debt restructuring is required.
Face Value of Debt	The sum of future principal repayments. The face value of debt may be a misleading indicator for comparing across time and countries because it does not include the contractual features of a debt portfolio. Creditors extend loans to LICs on concessional terms (interest rates lower than the market rates), while middle-income countries often borrow at market rates. Comparing this debt on the face value would thus not accurately represent the different debt burdens the countries face.
Fiscal Balance	The difference between a government's revenue and its expenditures. If the balance is positive, the government has a surplus (it spends less than it receives), and if the fiscal balance is negative, the government has a deficit (it spends more than it receives).
Grant Element	The grant element of a loan is the measure of its concessionality. It represents the difference between the loan's principal—its nominal or face

value—and the sum of the discounted future debt-service payments to be made by the borrower (its present value), expressed as a percentage of the loan's face value.

Haircut

Investor losses on the principal of a loan or bond. In other words, a haircut refers to the holders of debt receiving less than the stated value of said debt. During debt restructuring, loans or bonds with larger haircuts see higher holdout rates (the proportion of creditors that do not want to accept the new terms of the debt restructuring). In the context of the Greek Financial Crisis in 2009, the Greek government made it clear that creditors who continued to hold out would not receive a better deal (i.e., a smaller haircut), but they also made it clear that unless a haircut was completed, they could not continue servicing their debt.

Insolvency

A situation in which a country is unable to meet its current and future financial obligations. When faced with insolvency, a country often approaches its creditors in order to restructure its debts. Insolvency can arise from long-term overspending, a reduction in liquidity, or poor cash/asset management.

Liquidity

The funds that are unconditionally available to settle claims and obligations, or assets that can be quickly converted into cash. Having a certain amount of liquidity for a country is important in order to be able to pay off their short-term liabilities and debt. Chronic liquidity shortages, if not addressed, can gradually lead to a solvency problem. The term liquidity can also refer to market liquidity, or the extent to which assets, such as stocks or debt securities, can be bought and sold quickly without affecting their value. In this sense, strong liquidity conditions help to ensure that there is an active market for trade in government bonds and other public sector debt.

Liquidity Loss

A drying up of cash-like assets on a country's balance sheet. The loss of these assets results in the reduced ability of a country to pay their short-term liabilities.

Present Value of Debt

The present value (PV) of debt measures the actual financial burden of various types of debt for borrower countries, and allows for a more meaningful comparison of debt burdens across countries. Many LICs contract a significant portion of their debt on concessional terms, and the face value does not reflect this. The PV of debt is the sum of all future debt-service obligations (interest and principal), discounted at the market

interest rate. When the loan's interest rate is lower than the market's interest rate, the PV of debt will be smaller than the face value of debt. .

Paris Club

An unofficial group of major creditor countries, whose role is to find coordinated and sustainable solutions to the issues that debtor countries experience. The Paris Club comprises 22 permanent members: Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, South Korea, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom, and the United States. There are also *ad hoc* members, who can participate with the support of the debtor country and the Paris Club's permanent members.

Primary Market

Where debt (and equity) securities are issued. The primary market is where governments sell new bonds to investors that were not previously traded.

Public and Publicly Guaranteed Debt

Long-term external obligations of the national government, subnational governments, and public corporations (including state-owned enterprises and public banks), and the external obligations of private borrowers that are guaranteed for repayment by the government.

Refinancing Risk/Rollover risk

A general term referring to the possibility that a borrower (country, firm, or individual) would not be able to replace a current debt obligation falling due with new debt. High levels of short-term debt (debt issued at maturities of less than one year) increase rollover risk.

Secondary Market

The secondary market is where investors trade previously issued securities without the involvement of the issuers.

Shallow Market

A market with a smaller number of investors and creditors, fewer choices of financial instruments, and less diversified investors and creditors. The investors and creditors present in a shallow market tend to be more risk averse.

Solvency

The ability of a country to meet all of its debts and financial obligations in the long run. Solvency is a core condition of debt sustainability.