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**CIVIL SOCIETY POLICY FORUM**



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## Does the G20 Stimulus Signal the End of the Debt Sustainability Framework? <sup>1</sup>

*April 25, 2009*

This session was organized by Evangelischer Entwicklungsdienst (EED) of Germany, and co-sponsored by EURODAD and AFRODAD. Session participants included representatives from African, North America, European and international CSOs and networks, from UNCTAD, the German Ministry of Development Cooperation, as well as from the IMF and the World Bank.

The following is not a summary note of the entire session, but rather summarizes the important statements made by the two main speakers of the session: *Carlos Braga* (Director of the Poverty Reduction and Economic Management Network of the Economic Policy and Debt Department of the World Bank), and *Hervé Joly* (Deputy Division Chief, Debt Policy Division, Strategy, Policy, and Review Department of the IMF). *Vitalis Meja* (Policy Director, AFRODAD) and *Peter Lanzet* (Policy Director, EED) commented on the Bank and IMF presentations, while *Nuria Molina* (Policy Officer, EURODAD) chaired the session. The side event was sponsored by all three Civil Society organisations.

*Carlos Braga* began by informing that the DSF was revised in 2006 to include some of the scenarios that by the end of 2008 became a reality. As a result of the implementation of the HIPC and MDRI debt relief programs, 33 LICs were in a much better position at the start of the financial crisis than they would have been without the debt relief. He informed that Nepal does not want to avail itself of HIPC-initiative opportunities. Now all depends, how long the crisis will last and how deep it cuts.

*Carlos* then proceeded to explain some of the origins and contagion channels of the Financial Crisis for LICs. He presented several shocks scenarios against a baseline. (see presentation attached). If one were to envision only a mild shock and with the support of IDA terms concessional financing, a model HIPC representative country could be expected to be back on track of debt sustainability after two years. But if this same country were offered loans on commercial rates, it would take many more years to be back on track. If the crisis is deeper in its scope and lasts much longer, the situation could be quite serious for this HIPC country. A lot depends on the way the debt is managed,

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<sup>1</sup> This summary note was prepared by Peter Lanzet of EED. If you have any comments or questions on the note please send an email to [peter.lanzet@eed.de](mailto:peter.lanzet@eed.de)

and at present strong technical input is being provided by the Fund, Bank, regional development banks to help countries to manage the debt.

*Carlos* underlined that as of now the Bank is expecting that a recovery will set in by 2010. If this does indeed happen, one would not need to expect a severe sovereign debt crisis. All depends how much further global trade is contracting (so far 6-11%), how much further private flows will dwindle (in 2007 flows amounted to \$1 trillion, but by the end of 2008, they only reached \$165 billion), how much lower net prices fall, how much further private creditors disinvest (\$632 billion in 2007, while 2008 has registered a \$30 billion negative growth), and remittances have dramatically declined. Much depends also on the ODA. Although donors say their commitments are firm, *Carlos* noted that in order to keep just the aid commitments made at Gleneagles to provide \$50 billion to Africa, a \$20 billion increase in donor aid would be required in the next two years. This increase would need to come within the backdrop of the worst financial crisis in since the Great Depression, while previous experience shows a significant decline of ODA in times of crisis.

*Carlos* finally focused on the Development Sustainability Framework (DSF) and how it will react to growing deficits. Will the DSF permit developing countries to mobilise cheap financing to muddle through and address the financing gap? The World Bank's assessment of current account debts is 10% of GDP for LICs in 2009. Therefore the DSF criteria could be relaxed to allow countries to have better access to borrowing. But if countries borrow on non-concessional terms it could have a punitive impact. LICs must be aware of the consequences of non concessional borrowing. They need concessional finance or grants. Yet the DSF has some room for more flexible treatment. One can change the criteria combinations and the staff will go to the board with suggestions along these lines before the annual meetings. However one must keep in mind that the DSA as such and the treatment suggestions are two separate things.

*Hervé Joly*, said that like the World Bank, the IMF does not expect a major debt crisis in LICs, provided the recovery starts in 2010. But in any case, the crisis is going to increase the debt vulnerability of LICs. Therefore, following up the G20 expectations on the IMF, the Fund will provide more concessional lending to LICs, which could triple over the next few years. Resources to finance this increase could come from windfall profits from the agreed sale of IMF gold. The IMF will also double the access limits to concessional resources of the IMF, because the countries need money now. An important source of financing for LICs will be the creation of Special Drawing Rights (SDRs) to the tune of 19 bn \$ SDR. But the G20, the Bank and the Fund most certainly don't want LICs to contract additional (non-concessional) financing beyond their debt sustainability.

*Hervé* said that, as *Carlos Braga* had already pointed out, the DSA and the policy on external borrowing must be seen as separate steps. One wants more flexibility on the policy side. For some countries more borrowing is simply not the right approach, especially if non- concessional; they need more international concessional support. Other countries might have more space for additional borrowing, possibly on non-concessional terms, depending on their fiscal situation. The IMF is reviewing the DSF but would not loosen the DSF in such a way that all countries can borrow more, irrespective of their debt situation.

On policies of external borrowing, *Hervé*, informed that the IMF has a paper on “Changing Patterns in Low-Income Country Financing and Implications for Fund Policies on External Financing and Debt”. It suggests flexibilization to adapt debt limits and concessionality requirements to the variety of country situations. Instead of proposing a single design for all LICs, it suggests to use a menu of options with some basic elements:

1. The extent of debt vulnerability: when the latter is low, debt limits should be looser.
2. The better a country’s macro-economic and public financial management capacity, the better it can handle non-concessional borrowing. In such cases the IMF would move away from loan by loan assessment of concessionality to an averaging approach over a period of time. This would provide flexibility to the authorities in the selection of loans and loan conditions. Targets on the present value of debt could be considered for vulnerable countries

An IMF paper specifying this approach will be submitted to the board before the annual meetings. Other concerns and questions to be addressed include: Do the Fund and the Bank sufficiently take into account the growth dividend from investment finance? This is considered important, since the dividend can change the economic basics, i.e. in cases where public investment is having good return.

Carlos Braga and Hervé Joly answered a number of questions from participants, a selection:

- They confirmed that there is no new mechanism for insuring debt sustainability for post CP countries.
- Debt relief is only a fraction of the new financing countries need to cover the cost of their development. They need new aid.
- The World Bank is publishing a book on “Debt Relief and Beyond”. It will also contain three articles on illegitimate debts. One should be clear whether to look at odious debts at the level of a country or an individual loan. If one wants odious debts prevented in an *ex-ante* process, an institution like the UN Security Council would have to identify a country has having an odious regime, then all creditors will refrain from providing loans to this country. But if you strive for an *ex-post* mechanism one would have to go case by case. One must be aware that both approaches have their cost/ benefits and may have costs when attempting to drawing new resources.

*Vitalis Meja* of AFRODAD said that debt cancellation must be complementary to other efforts of development finance. At the moment debt servicing is a liquidity issue, thus if a moratorium on debt servicing is done as Civil Society demands to ease their burden during the financial crisis , it will not be the same as after the Tsunami, where countries were afraid of disturbing their access to the financial markets.