

The joint World Bank–International Monetary Fund (IMF) Debt Sustainability Framework (DSF) was introduced in April 2005 to address this challenge. It has become an important instrument for analyzing debt-related vulnerabilities and guiding the design of policies to help prevent the reemergence of debt distress.

The main objectives of the DSF are to:

- guide the borrowing decisions of LICs in a way that matches their financing needs with their current and prospective repayment ability, taking into account each country's circumstances;
- provide guidance for creditors' lending and grant-allocation decisions to ensure that resources are provided to LICs on terms that are consistent with both progress towards their development goals and long-term debt sustainability;
- improve World Bank and IMF assessments and policy advice in these areas; and
- help detect potential crises early so that preventive action can be taken.

Under the DSF, debt sustainability analyses (DSAs) are conducted regularly. They consist of:

- an analysis of a country's projected debt burden over the next 20 years and its vulnerability to external and policy shocks—baseline and shock scenarios are calculated;
- an assessment of the risk of debt distress in that time, based on indicative debt burden thresholds that depend on the quality of the country's policies and institutions; and
- recommendations for a borrowing (and lending) strategy that limits the risk of debt distress.

How does the DSF work?

The DSF analyzes both external and public sector debt. Given that loans to LICs vary considerably in their interest rates and length of repayment, the framework focuses on the net present value (NPV) of debt obligations. This ensures comparability over time and across countries.

To assess debt sustainability, debt burden indicators are compared to indicative thresholds over a 20-year projection period. A debt-burden indicator that exceeds its indicative threshold suggests a risk of experiencing some form of debt distress. There are four possible ratings for the risk of external debt distress:

- **low risk**, when all the debt burden indicators are well below the thresholds;
- **moderate risk**, when debt burden indicators are below the thresholds in the baseline scenario, but stress testing indicate that the thresholds could be breached if there are external shocks or abrupt changes in macroeconomic policies;
- **high risk**, when one or more debt burden indicators breach the thresholds under the baseline scenario; or
- **in debt distress**, when the country is already having repayment difficulties.

LICs with weaker policies and institutions tend to face repayment problems at lower levels of debt than countries with stronger policies and institutions. The DSF, therefore, classifies countries into one of three policy performance categories (strong, medium, and poor) using the World Bank's Country Policy and Institutional Assessment (CPIA) index, and uses different indicative thresholds for debt burdens depending on the performance category. Thresholds corresponding to strong policy performers are highest—indicating that in countries with good policies debt accumulation is less risky.



The Joint World Bank–
International Monetary Fund

Debt Sustainability Framework for Low-Income Countries



Low-income countries (LICs) have often struggled with large external debts. Now debt burdens have been reduced, thanks in large part to international debt relief initiatives. As part of the Monterrey Consensus to meet the Millennium Development Goals (MDGs), the IMF and the World Bank have developed a framework to help guide countries and donors in mobilizing the financing of low-income countries' development needs, while reducing the chances of an excessive build-up of debt in the future.

Debt Burden Thresholds under the DSF

	UPV of debt in percent of			Debt service in percent of	
	exports	GDP	Revenue	Exports	Revenue
Weak Policy	100	30	200	15	25
Medium policy	150	40	250	20	30
Strong Policy	200	50	300	25	35

How do the IMF and the Bank use the DSF?

The DSF has enabled the IMF and the Bank to integrate debt issues more effectively in their analysis and policy advice, through improved frequency and quality of the analysis. It has also allowed comparability across countries.

The DSF is important for the IMF's assessment of macroeconomic stability, the long-term sustainability of fiscal policy, and overall debt sustainability. Furthermore, debt sustainability assessments are taken into account to determine access to IMF financing. IDA uses the assessment of the risk of external debt distress from the DSF to determine the share of grants and loans in its assistance to each low income country.

The effectiveness of the DSF in preventing excessive debt accumulation hinges on its broader use by borrowers and creditors. The IMF and the Bank encourage LICs to use the DSF or a similar framework as a first step toward developing medium-term debt strategies. Creditors are encouraged to take into account the results of debt sustainability assessments in their lending decisions. In this way, the framework should help LICs raise the finance they need to meet the MDGs, including through grants when the ability to service debt is limited.

Information about the DSF

The IMF and the Bank have dedicated web pages where recently published DSAs can be accessed easily:

<http://imf.org/dsa>

<http://www.worldbank.org/debt>