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Making Debt Work for Development and Macroeconomic Stability

Attached is the document titled "Making Debt Work for Development and Macroeconomic Stability," prepared by the World Bank Group and International Monetary Fund for the April 22, 2022 Development Committee Meeting.

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Development Committee

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Abbreviations

CCRT	Catastrophe Containment and Relief Trust
CF	Common Framework
CoT	Comparability of treatment
DLP	Debt Limit Policy
DMF	Debt Management Facility
DPF	Development Policy Financing
DRF	Debt Reduction Facility
DRM	Domestic Revenue Mobilization
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
DSSI	Debt Service Suspension Initiative
EMDE	Emerging market and developing economy
FAIR	Forum for Asian Insolvency Reform
FCS	Fragile and conflict-affected states
FCV	Fragility, conflict, and violence
FDI	Foreign direct investment
FSAP	Financial Sector Assessment Program
FTE	Fiscal transparency evaluations
GDRM	Government Debt and Risk Management Program
HIPC	Highly Indebted Poor Countries Initiative
IAIR	International Association of Insolvency Regulators
IFC	International Finance Corporation
GDRM	Global Debt and Risk Management Program
IDS	International Debt Statistics
IFI	International financial institution
IMF	International Monetary Fund
J-CAP	Joint Capital Markets Program
LIC	Low-income country
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-income country
MIGA	Multilateral Investment Guarantee Agency
MSME	Micro-, small-, and medium-sized enterprise
ODA	Official development assistance
NPL	Non-performing loan
PER	Public Expenditure Review
PFRAM	PPP Fiscal Risk Assessment Model
PIM	Public investment management
PIMA	Public Investment Management Assessment
PPA	Performance and Policy Action
PPP	Public-private partnership
SDFP	Sustainable Development Finance Policy
SDGs	Sustainable Development Goals
SIDS	Small and Island Developing States
SOE	State-owned enterprise
SRDSF	Sovereign Risk and Debt Sustainability Framework
TA	Technical assistance
UNCITRAL	United Nations Commission on International Trade Law
WBG	World Bank Group

Making Debt Work for Development and Macroeconomic Stability

The coronavirus crisis has stiffened debt and development-related headwinds that had become strong even before 2020. Sustaining development while maintaining debt sustainability has been made harder by the protracted effects of the pandemic on public finances, earnings and employment, and human capital accumulation of vulnerable populations. The fiscal support programs financed by public debt provided relief and saved lives and livelihoods. But debt-induced uncertainty can now dampen investment and growth, especially given rising global interest rates. Bigger debt servicing burdens will reduce available fiscal space for development and stabilization and growing sovereign debt financing needs can crowd out domestic investment. Over-indebtedness can adversely affect economic development through many channels—"debt overhang," "fiscal space," "crowding out" and increased crisis risk —making countries vulnerable to abrupt changes in market sentiment, jeopardizing both stability and growth.

The likelihood of debt adversely affecting growth has risen sharply during the last two years. Debt of all types reached record levels during the pandemic in both advanced economies and emerging market and developing economies (EMDEs). The Russia-Ukraine war threatens to add to the problem. For the poorest and most fragile countries, high fiscal and debt vulnerabilities undermine macroeconomic stability and constrain broad-based growth that is necessary to reduce poverty and enable governments to provide essential services to their citizens.

EMDEs need to address debt challenges while making their economies greener, resilient, and inclusive. This requires improved fiscal policy, public investment programs, and debt management frameworks; reducing the cost of resolution for private and public debt; and fostering greater access to long-term finance by developing domestic debt and capital markets. The abilities of the World Bank Group (WBG) and other multilateral development banks to finance long-term development and support structural reforms and of the International Monetary Fund (IMF) to support stabilization and policy reforms are critical to achieving development outcomes such as ending extreme poverty and promoting shared prosperity.

Building on their expertise and experience, the IMF and the WBG can support EMDEs by providing policy advice, financial support, and technical assistance related to growth and stability, sectoral and national reforms, and financial sector capacity building. Such support aims to strengthen government capability for managing fiscal risks and improve private debt insolvency regimes, nonperforming loan resolution, and broader financial market development. Both institutions continue to provide support in the design and implementation of debt relief via the Paris Club and the G20. MIGA guarantees and IFC investment projects support the provision of long-term finance for governments, debt and non-debt financing for firms, and in the case of IFC, distressed asset management for financial institutions.

To address the growing debt-related risks to growth and stability, the WBG and the IMF will strengthen their financing, policy, and analytical work on creating fiscal space for priority public spending and build resilience for crises; on building the policy frameworks and institutions to preserve this space; and on broadening access to credit for a vibrant private sector. In particular, they will provide support for debt management, debt sustainability assessments, and debt restructuring arrangements. Because debt transparency is essential for all of this, it is a priority for both the WBG and IMF. New international financial institutions' (IFI) policies to support sound financing and debt resolution will also be essential, supplemented by technical assistance on resolving private debt. The two institutions will continue to advocate for more efficient resolution of public debt through initiatives such as the G20 Common Framework (CF), implementation of which should be strengthened to help the most vulnerable countries return quickly to stability, economic growth, and poverty reduction.

The global community can support EMDEs by providing development finance, increasing multilateral support for international trade and investment, fostering stable global capital flows, and improving the arrangements for debt transparency and restructuring.

I. Immediate action is needed to address rising debt risks

1. **Debt of all types has reached multi-decade highs.** In 2020, spurred primarily by a surge in government spending in response to the COVID-19 pandemic and lower revenues because of the recession and, reflecting the contraction in GDP, total gross global debt rose by 28 percentage points of GDP—the largest single-year increase since World War II. Borrowing by governments accounted for slightly more than half of the increase, as the global public debt ratio jumped to a record 99 percent of GDP. Private debt also reached new highs, with companies taking advantage of low interest rates amid exceptional monetary support (World Bank 2022a; Gaspar, Medas, and Perelli 2021). The increase in debt in 2020 followed a sustained rise in private and government debt over the past decade in response to a series of adverse shocks and facilitated by low borrowing rates due to accommodative monetary policy amid low consumer price inflation.

2. **The composition of debt in emerging market and developing economies (EMDEs) has changed, making these countries more vulnerable to financial market stress.** The composition of public debt has shifted away from traditional multilateral and Paris Club bilateral creditors towards non-Paris Club bilateral and commercial creditors, the latter particularly towards bonds. A growing portion of low-income countries (LICs) government debt is non-concessional (Kose, Ohnsorge, and Sugawara 2021). By the end of 2020, in part mirroring the global trend of larger deficits and accommodative monetary policy, external debt of EMDEs rose to 31 percent of GDP, 7 percentage points higher than in 2010. Domestic debt in EMDEs rose even more rapidly, to 174 percent of GDP. Debt held by non-residents or denominated in foreign currency accounted for 42 percent and 49 percent, respectively, of EMDE government debt in 2020, with average maturities considerably shorter than in advanced economies. In a quarter of EMDEs, foreign currency-denominated corporate debt was more than 20 percent of GDP. The COVID-19 market shocks underlined the continued vulnerability of EMDEs to international portfolio flows (IMF 2020a).

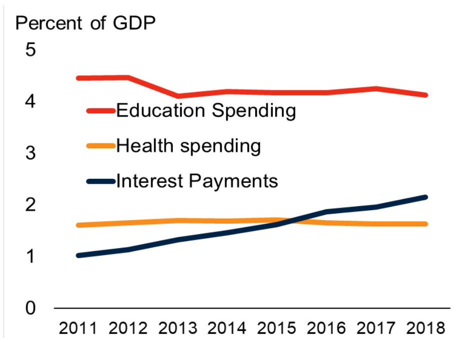
3. **Unsustainable debt compromises macroeconomic stability.** Past episodes of rapid accumulation of debt have been associated with increased risk of financial crises, and sovereign debt defaults or banking crises that are economically costly (IMF 2016; Kose et al. 2019). A wide range of shocks can provide the spark, but high debt levels are the fuel that allows a crisis to emerge suddenly and escalate rapidly. High public debt imposes constraints on fiscal policy when it is needed to address new crises or challenges (World Bank 2015). Unsustainable private sector debt, especially in EMDEs, if left unaddressed, could derail the recovery, because of the interconnection between households, firms, and the financial and public sectors.

4. **Growing debt burdens can weigh down on investment and derail development.** In IDA countries, for example, government interest outlays have been rising steadily and in 2018 were twice as high as health spending (Figure 1). Similarly, while interest spending rose, education outlays in IDA countries have remained flat over the past decade. This contrasts with the increase of poverty-reducing expenditure and the reduction of debt service burdens that followed debt relief provided under the HIPC and MDRI Initiatives.

5. **The coronavirus crisis raised the risks of countries falling into debt distress, and the Russia-Ukraine war will likely exacerbate their economic weaknesses.** Actions to address rising debt vulnerabilities have become progressively more urgent. Today, 60 percent of the countries eligible for the Debt Service Suspension Initiative (DSSI) are assessed at high risk of debt distress or are already in debt distress. Fragile and conflict-affected states (FCS) and small

island developing states (SIDS) were hit especially hard by the 2020 recession and their fiscal buffers have been substantially eroded (World Bank 2022a). A further escalation of geopolitical tensions from the Russia-Ukraine war could lead to tighter global financial conditions, higher inflation, lower growth, and higher stress on public finances and have adverse implications for EMDEs' debt dynamics.

Figure 1. Interest, education, and health spending in IDA countries



Source: World Development Indicators, World Health Organization, World Bank.
Note: GDP-weighted averages. Domestic health spending in 68 IDA-eligible countries from 2011-2018. Education spending in 31 IDA-eligible countries from 2011-2018.

6. **Attenuating the risks of unsustainable debt and insufficient development finance has to be done simultaneously.** IMF and WBG policy support, technical assistance, and analytical work can help countries navigate acute debt-related challenges as well as develop institutions, legal frameworks, and policies that reduce future debt vulnerability (Table 1). The WBG—and especially the IFC and MIGA—work with local financial institutions and the private sector to provide appropriate financing, including non-debt finance such as equity and venture capital. The IMF and WBG can also facilitate enduring debt solutions for EMDEs facing protracted economic scarring.

7. **This paper outlines how the WBG and IMF are working to address these challenges.** The paper encompasses multiple types of debt in both low-income countries (LICs) and middle-income countries (MICs), though it focuses on public debt in low- and lower-middle income economies. It presents the broad range of approaches with which the IMF and the WBG help countries address debt challenges. Finally, it discusses policy reforms to strengthen country capacity for debt management and sustainability, proposals to increase debt transparency and debt resolution mechanisms, and the roles of the WBG and IMF in their implementation.[1]

8. **The paper's main conclusion is that multilateral frameworks for debt restructuring and for development finance need to be simultaneously strengthened.** Having an efficient mechanism to restructure sovereign debt when necessary is an essential complement to actions to

[1] The paper builds on previous Development Committee papers by providing a more detailed and updated exposition of debt-related financial and institutional issues. A 2018 paper addressed concerns about government debt, whereas this paper covers both government and private debt (IMF and World Bank 2018). More recently, the Development Committee considered papers on the implementation of the DSSI and the Common Framework (IMF and World Bank 2020a, 2021b).

make development finance better suited to development needs. The paper urges immediate action to make the G20 Common Framework deliver on its potential. Priorities should cover clarity of timelines and processes; providing a debt service suspension during the restructuring negotiation; clarifying how the comparability of treatment will be implemented; and expanding coordinated debt treatments to highly indebted countries besides those that were eligible for the DSSI.

II. Why are debt-related risks rising?

Debt of all types has risen to multi-decade highs. The composition of EMDE government debt has become more diversified, thus finding consensus for restructuring when needed is more challenging. At the same time, it has become more vulnerable to financial market stress over the past decade and—especially in low-income economies—its creditor composition has become more fragmented. The debt build-up in EMDEs was not accompanied by rapid growth.

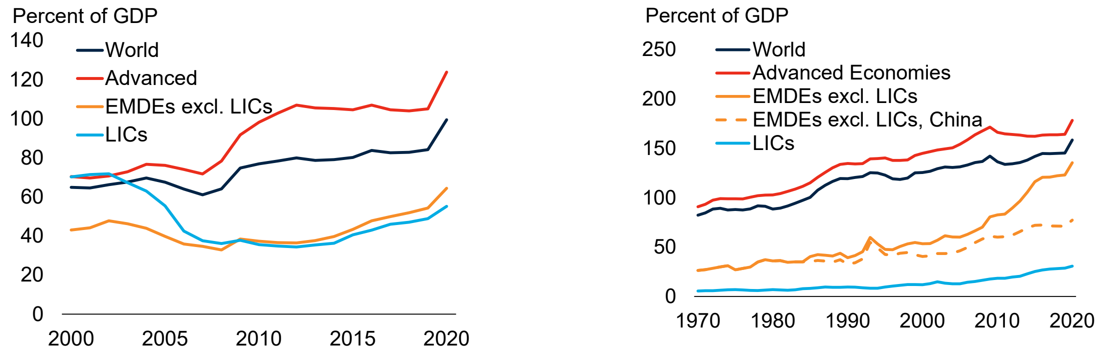
9. **In 2020, the debt increase relative to GDP was the largest in a single year since the end of World War II, accelerating the pre-pandemic increase across all countries.** The largest increases were in the advanced economies and China, with other EMDEs following closely (Figure 2). Lower lending rates in advanced economies supported debt portfolio flows to emerging markets and led often to stretched valuations, particularly for lower-rated issuers (IMF 2019a). According to the IMF's *Global Debt Database*, total global debt rose to 256 percent of GDP in 2020, while EMDE debt reached 198 percent. The increase in global private debt from 2011 to 2020 was primarily due to a rising corporate debt to GDP ratio, which increased by more than a fifth to 98 percent of GDP, though the household debt to GDP ratio also rose by over a tenth to 58 percent of GDP. Private debt led the pre-pandemic increase in EMDE debt, with debt higher in 2019 than in 2010 in four-fifths of EMDEs.[2] The pandemic added a further debt surge. Private EMDE debt reached a record 135 percent of GDP (77 percent of GDP in EMDEs excluding China), while government debt in EMDEs climbed to 64 percent of GDP (259 percent of government revenues). In LICs, government debt rose by 9 percentage points and external debt reached 39 percent of GDP (Kose et al. 2021b), although private debt was stable. Due to prior debt accumulation and diminished debt capacity, countries in sub-Saharan Africa were less able than those in other regions to access international financial markets (Gill and Karakülah 2019a).

10. **Policy responses to COVID-19 have led to the largest fiscal risk accumulation since the Second World War.** Policy measures by governments included foregone revenues, additional spending, guarantee and lending programs, equity injections, quasi-fiscal operations, liquidity support and others. Globally, according to the IMF's *Fiscal Monitor Database of Country Fiscal Measures in Response to the COVID-19 Pandemic*, above-the line budget measures reached 10.2 percent of GDP while the below-the-line (off-budget) support amounted to 6.2 percent since January 2020. The materialization of fiscal risks can lead to further increases in global debt levels.

[2] Despite the increase in private debt in the majority of EMDEs, financing gaps persist for medium, small, and micro enterprises, women-owned companies, and rural firms, and for key development needs such as housing and infrastructure. These financial services are often provided by Microfinance Institutions, and, most recently, by fintech.

Figure 2. Government and private debt

A. Government debt **B. Private debt**



Sources: IMF Global Debt Database.
Note: "EMEs" stands for emerging market economies; "LICs" stands for low-income countries.
A. Sample includes up to 189 countries, of which 37 advanced economies, including 69 LICs and 93 EMDEs.
B. Data are available until 2020 for up to 157 countries. Nominal GDP-weighted averages.

11. **The creditor base has become more heterogenous underscoring the need for greater debt transparency**. The private creditor composition has become more fragmented, with a higher share of non-traditional lenders, raising challenges in some recent debt restructurings (IMF 2020b). In 70 EMDEs, most of the official bilateral debt is owed to non-Paris Club creditors; China is the largest official bilateral creditor for 42 of the 68 DSSI-eligible countries with available IDS data. There are regional differences in DSSI-eligible countries' public debt exposures as well as among DSSI-eligible countries assessed at high risk of or in debt distress (see Figure 3). The non-concessional component of LIC debt is elevated at 50 percent of public and publicly guaranteed external debt at end-2020. The proliferation of debt-like instruments and commodity-based lending, together with the opaque financials of some state-owned enterprises, can obscure total government debt levels (World Bank, 2021a-c). Pandemic-era private debt forbearance schemes have made the health of bank balance-sheets harder to ascertain. In part, rising private debt in EMDEs may reflect reduced access to foreign direct investment (FDI), in addition to low borrowing cost over the past decade. Growth in FDI inflows to EMDEs (especially to commodity importers) slowed markedly after the global financial crises in comparison to the preceding decade (World Bank 2017a).

12. **Debt is not good or bad on its own.** It can support growth and its costs and benefits depend on many factors. Public debt facilitates consumption smoothing and counter-cyclical fiscal policy, as well as enabling greater investment (Box 1). Over-reliance on public or private debt poses risks to economic growth and stability by increasing susceptibility to roll-over difficulties and abrupt changes in market conditions, constraining fiscal policy and weighing on private investment (Panizza, Huang and Varghese 2018). To achieve the Sustainable Development Goals (SDGs), debt must therefore be used carefully: it can provide resources for quicker development, but its overuse invariably jeopardizes economic progress.

Box 1. Costs and benefits of debt

Prudent use of debt is an important part of an effective development strategy. It enables governments in EMDEs facilitate growth take-offs by investing in a critical mass of infrastructure projects and in the social sectors when taxation capacity is limited or when the alternative would be to print money and compromise macroeconomic stability. Debt also facilitates tax smoothing and counter-cyclical fiscal policies, essential for reducing output volatility; and it permits an equitable alignment of benefits and costs for long-gestation projects by shifting taxation away from current generations. (Gill and Pinto, 2005). Companies need both short-term credit to finance daily operations (e.g., trade finance, working capital, supply chain finance) and long-term debt to fund investments in plant, equipment, and technology. Debt-financed investment in export capacity and technology can help boost private sector dynamism.

But excessive reliance on debt or its use for unproductive purposes poses serious risks to economic growth and stability. Debt overhangs can reduce debt sustainability; increase the risk of fiscal or financial crises; weigh on investment; and, in the case of government debt, constrain fiscal policy room or effectiveness. While low interest rates and high growth rates may improve debt dynamics, any favorable differential between interest and growth rates may be offset by the sheer magnitude of borrowing by corporates or governments. As a result, interest spending by EMDE governments has risen steadily since 2010, to 2 percent of GDP in 2020, despite interest rates being below growth rates in 69 percent of EMDEs on average during the 2010s (Kose, Ohnsorge, and Sugawara 2021). In addition, countries with high debt tend to have higher interest-rate growth differentials and these differentials deteriorate faster in times of financial stress (Mauro and Zhou, 2020; Lian, Presbitero and Wiriadinata. 2020; Gill and Karakulah 2019).

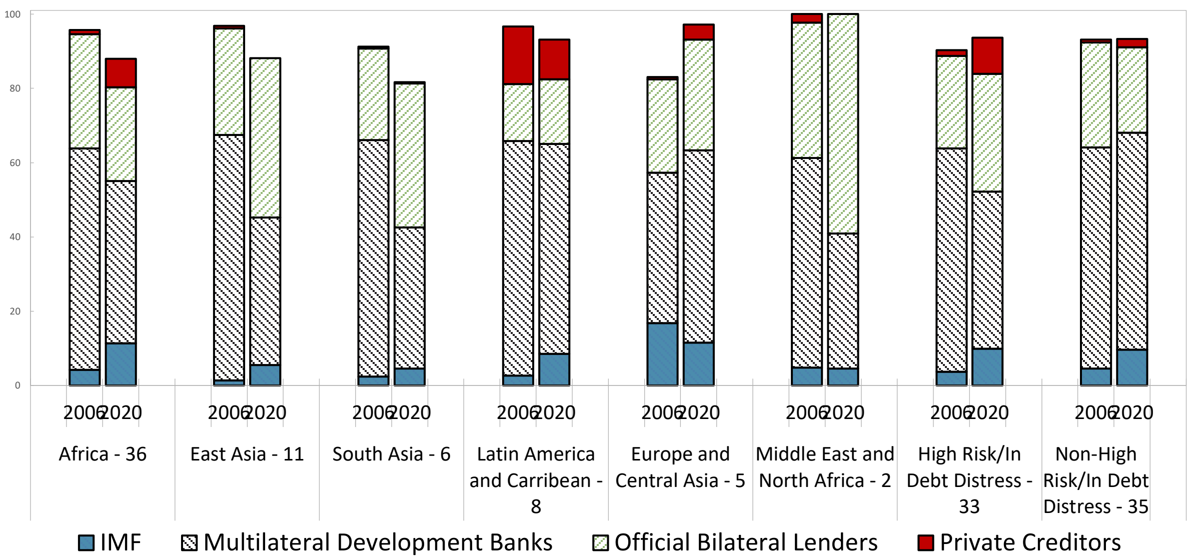
Elevated debt levels increase susceptibility to financial crises, including sovereign debt crises, which are economically costly (Moreno Badia et al. 2020). Shocks can cause risk premia to rise suddenly. The associated increase in yields can cascade into a sovereign debt crisis, if investors lose faith in the government's ability to service debts; a currency crisis, if concerns about the ability to repay foreign-currency denominated debt spark a speculative attack on the currency; or a banking crisis, if private sector balance sheets are vulnerable to rising interest rates or a sharp currency depreciation. Such crises can feed into each other. For example, banking crises increase the risk of a sovereign debt crises: tax revenue falls, tighter credit to firms squeezes employment, often prompting calls for transfers to households, while governments guarantee private sector liabilities to restore confidence in the financial system.

High debt can siphon resources away from productive uses. Where large sovereign debt loads—or uncertainty associated with policy responses to high debt—raise risk premia, the cost of capital increases, weighing on investment and slowing productivity and income growth over the medium and long term. Private entrepreneurs may be "crowded out" from accessing debt by excessive government borrowing, particularly when an underdeveloped banking sector comes under pressure to finance the government. Servicing debt also reduces resources available for present-day spending needs, creating political economy issues if the interests of those borrowing and those who will incur the debt costs are not well aligned. Meanwhile, more leveraged firms tend to invest less. They may also refrain from investment with higher but delayed returns—such as in research and development—in favor of investments that yield more predictable but lower cash flows. Over the long term, these forces may hold back productivity and output growth.

Developing stronger domestic government debt markets in EMDEs is key for growth. A sovereign yield curve provides a benchmark to price risk, facilitating the development of broader capital markets that can increase the availability and lower the cost of long-term capital (World Bank 2020a). For governments, deep domestic debt markets offer considerable policy flexibility. Governments can finance themselves at longer maturities, reducing rollover risk and risks from rising external debt service due to currency depreciation. Once the basic market infrastructure is in place (an expanded local yield curve, settlement and clearing houses, transparent taxation, and legislation on the issuance and trading of capital market instruments), corporate debt markets can flourish, enabling companies to borrow, often in local currency, to fund growth at lower rates than banks can offer and at longer maturities. The results are more resilient markets and lower dependence on cross border finance, in support of more resilient growth.

The balance of costs and benefits that determines an appropriate level of debt depends on country and, for private debt, firm characteristics. In particular, elevated levels of debt may be more sustainable when debt is denominated in local currency and at longer maturities and, for private debt, when repayment profiles match reliable cash flows.

Figure 3. DSSI-Eligible Countries: Median Public External Debt Exposure by Type of Creditor in 2006 and 2020 (in percent of total public external debt)



13. **Low interest rates are helpful but do not eliminate sustainability challenges.** Debt-to-income ratios fall only when growth outweighs both debt costs and new borrowing, which has not happened on aggregate in EMDEs since 2010 (Kose, Ohnsorge, and Sugawara 2021). Debt can increase because of widening primary deficits (e.g., because of crisis-related policy measures), stock-flow adjustments (e.g., due to changes in the debt ratio resulting from factors such as bailouts or changes in exchange rates), or interest rates rising further above growth rates. For low-income countries, the debt increases during the global financial crisis and in 2020 were driven mainly by valuation adjustments (IMF 2021a). In the years since the global financial crisis, a disappointing growth performance and larger-than-expected primary deficits pushed up debt ratios in LICs and other EMDEs, despite favorable global interest rates. Sufficiently developed domestic bond markets and appropriate debt management can limit interest rate and currency mismatch risks for issuers but in many developing countries financial markets are shallow.

14. **The recent debt build-up in EMDEs was not accompanied by quicker growth.** The pre-pandemic decade saw repeated growth disappointments and signs that debt and government resources were not used well. In 2017, for example, the government capital stock-to-GDP ratio was estimated to be below its 1992 level in advanced economies, EMDEs excluding China, and LICs (IMF 2020c).

15. **Over the next few years, macroeconomic risks from high debt burdens and uncertainty from the Russia-Ukraine war are likely to rise, but EMDE investment needs remain large.** In the short-term, the main global impact from the conflict stems from flight to quality, higher commodity prices and increasing inflationary pressures. Countries would be impacted differently depending on the strengths of their trade linkages to Russia and Ukraine, the effect of reduction of remittances for countries with substantial shares of residents employed in Russia and increased costs for hosting refugees. Global interest rates are expected to rise starting in 2022, increasing the

probability of large capital outflows and currency depreciation in EMDEs, many of which have already raised domestic interest rates to respond to increasing inflation. Growth in the United States and China could slow, weakening demand for EMDE exports. While the recent firming of commodity prices could ameliorate risks for commodity exporters, softer external demand would coincide with a period of tighter financial conditions and large EMDE debt redemptions coming due.

16. **Severe damage to human capital during the pandemic means EMDEs must cope with productivity losses.** The pandemic degraded human capital on multiple dimensions, including by interrupting schooling and healthcare, and increasing long-term unemployment. An additional 10 percentage points of 10-year-olds in EMDEs may now be unable to read at age-appropriate levels (Azevedo et al. 2020). Reversing falls in productivity will require years of intervention, meaning further calls on limited resources. The need for post-pandemic outlays comes atop already large investment needs. IMF (2021b) estimates that low-income countries need US$200 billion up to 2025 to respond to the pandemic and an additional US$250 billion to accelerate their income convergence with advanced economies.

III. How do the WBG and IMF help debt promote development and stability?

Through their policy advice, grants and lending, technical assistance and analytical work, the IMF and WBG support fiscal and debt management, debt resolutions, and access to long-term development finance in EMDEs.

17. **Consistent with their mandates, the IMF and the WBG engagement with member countries on debt issues aims to promote macroeconomic stability and development.** This engagement has three major modes: supporting debt sustainability and robust fiscal and public debt management frameworks; facilitating access to finance, including for the private sector; and supporting debt resolution when needed. Effective frameworks to manage debt and fiscal risks and support public expenditure and debt transparency can prevent the emergence of unsustainable debt and help to reduce elevated debt (World Bank 2021a). Deep and liquid domestic financial markets and access to long-term debt markets abroad can help governments and firms contract debt on terms that match risk profiles. Efficient debt resolution for private and government debt can help remove the debt overhangs that can weigh on investment and growth; such resolution requires appropriate domestic and international policies.

Fiscal and public debt management

18. **The IMF and the WBG help countries maintain macroeconomic stability and advance structural reforms needed to sustain long-term growth.** This is being done through using:

- **IMF surveillance**: assessments of debt sustainability, fiscal policy, exchange rate policies, and structural reforms are aimed at promoting domestic and external stability, including debt sustainability, and supporting sustained, inclusive, resilient growth, and macroeconomic stability.
- **IMF-supported programs:** Fund-supported programs help member countries to resolve their balance of payments problems and support sustained, inclusive, and resilient growth through a combination of reforms and financing.

- **IMF general SDR allocation.** In August 2021, the IMF approved a general allocation of Special Drawing Rights (SDRs) equivalent to US$650 billion, the largest in the IMF history. The SDR allocation addresses the long-term global need for reserves, builds confidence, and fosters the resilience and stability of the global economy. It particularly helps the most vulnerable countries struggling to cope with the impact of the COVID-19 crisis.
- **WBG advisory services and analytics**: advice and analysis provided to client countries to design and implement better policies, strengthen institutions, build capacity, and inform development strategies or operations. For example, the Debt Management Performance Assessments help tailor TA for reforms of debt management frameworks.
- **WBG Development Policy Financing (DPF).** This is an important WBG instrument to boost structural reforms and long-term growth in developing countries. Between 2015 and 2021, about one-third of all DPFs and almost half of DPFs in fragile, conflict and violence (FCV)-affected countries focused on fiscal and debt-related reforms.
- **WBG investment and Program-for-Results (PforR) projects. Project-specific and sector-wide investment operations** provide financing and technical assistance for improved public financial management and public expenditure efficiency, including procurement, crisis response, and ex ante disaster and crisis preparation
- **Innovative financial products.** The WBG is the biggest multilateral funder of climate investments in developing countries. The WBG has introduced financing products to help countries manage the most devastating effects of climate change-induced weather extremes and respond to and prepare for pandemics. To help finance the long-term structural transformation in low-income countries at affordable interest rates and long maturities, the IMF's new Resilience and Sustainability Trust (RST) is also being developed.

19. **The WBG Sustainable Development Finance Policy (SDFP) and the IMF Debt Limit Policy (DLP) encourage sustainable borrowing and lending.** Both are binding in the context of lending arrangements and rely on adequate information about debt and analytical tools that identify vulnerabilities. Both incentivize countries to improve debt management capacity. They serve as an important reference framework for guidelines and lending decisions by other creditors and institutions, including other multilateral development banks, the OECD, and export credit agencies.

20. **IDA's SDFP aims to incentivize IDA-eligible countries to move towards transparent, sustainable financing and to address debt-related vulnerabilities**. Under the SDFP adopted in 2020, 55 countries at moderate, high risk of debt distress or in debt distress (including five countries with market access) agreed to implement performance and policy actions (PPAs) and 58 countries are doing so in FY22. In FY21, in the context of the pandemic and the significant fiscal constraints faced by governments, most PPAs focused on debt management (mainly debt ceilings) and debt transparency. Debt ceilings have limited new borrowing on non-concessional terms, incentivizing the selection of investment projects with credibly high rates of return. The SDFP also supported countries' capacity to appropriately contract loans and issue guarantees and identify and manage fiscal risks from contingent liabilities from state-owned enterprises (SOEs) and public-private partnerships (PPPs), the latter of which often arise from large infrastructure projects. Implementation challenges remain due to uncertainty regarding the global economic recovery and limited implementation capacity, particularly in FCS countries and Small States (IEG 2020). In addition to the SDFP, IDA19 has also supported improvement in debt transparency, with an increase of 20 percentage points in the share of IDA countries that make debt data available in line

with best practices between end-2019 and end-2020. Several IDA countries have improved their fiscal risk management frameworks.

21. **IDA's financing framework provides grants to countries based on risk of debt distress assessed using the joint IMF-WBG Low-Income Countries Debt Sustainability Framework (LIC DSF).** Under this framework, the IDA-only countries at high risk of debt distress or in debt distress receive 100 percent of their IDA allocation on grant terms; those at moderate risk of debt distress receive 50 percent of their IDA allocation on grant terms and 50 percent as loans, while low risk is associated with 100 percent credits. IDA19 grant financing reached US$17.2 billion as of end-February 2022, or 35 percent of total IDA19 financing. The implementation of the SDFP is critical in offering incentives to countries to improve debt management by linking core allocations and grant allocation framework to the successful implementation of their PPAs. Unsatisfactory implementation of PPAs for two consecutive years results in loss of the set-aside amount. WBG Management also has the option to harden IDA financing terms when a country repeatedly fails to satisfactorily implement its PPAs.

22. **The IMF's DLP establishes the framework for using quantitative conditionality to address debt vulnerabilities in IMF-supported programs.** Its November 2020 reform provides countries with more financing flexibility while maintaining the same risk-based approach setting conditionality according to debt vulnerabilities as identified through a Debt Sustainability Analysis. In the revised DLP, critical debt data disclosure gaps need to be addressed upfront in program cases with a requirement for a debt holder profile table in all program documents. As part of the implementation of the new DLP, of 18 program requests and reviews approved by the IMF Executive Board so far, all staff reports have included information on the debt holder profile with 11 out of 18 countries already meeting all data requirements (countries have two program reviews to complete the requirements). Although the DLP and SDFP are closely aligned in their implementation, there are differences in how the two policies work. The DLP applies to all IMF members with Fund-supported programs, whereas the SDFP applies to all IDA-eligible countries.

23. **The World Bank and the IMF provide coordinated technical assistance on debt management and debt transparency.** The Joint World Bank-IMF Debt Management Facility (DMF) provides technical assistance (TA) and advisory services to IDA countries.[3] TA mainstreamed by the DMF has helped countries enhance performance in areas related to the debt management legal framework and managerial structure, debt management strategies, coordination between debt and cash management, and debt reporting. Debt transparency indicators have improved, though significant gaps remain, especially in the comprehensiveness of debt coverage and the frequency of debt audits (DMF 2020). The Government Debt and Risk Management Program (GDRM), managed by the World Bank, provides customized technical advisory services to middle-income countries in a programmatic approach.[4]

24. **IMF and World Bank TA cover aspects of debt management made more difficult by the pandemic.** These include revisions of debt strategies and annual borrowing plans, reform of

[3] DMF is a multi-donor trust fund launched in 2008 by the World Bank and is administered jointly with the IMF. (World Bank 2020c). The DMF prepared a new guidance note Crisis-Response Framework for Debt Managers and introduced just-in-time TA to member countries (World Bank 2021a). In FY21, switching to virtual training and Massive Online Open Courses (MOOCs), the DMF scaled up new offerings of TA and training for debt-related contigent liabilities and related fiscal risk and debt reporting and monitoring.

[4] The GDRM was established in 2011 and is funded by the Swiss State Secretariat for Economic Affairs (SECO).

domestic market auctions, review of the operational risk management framework, investor communication, and cash flow forecasting and management.[5] These reforms will improve countries' preparedness for increased debt vulnerability in future crises. During the past five years, one in four countries with a World Bank DPF had at least one prior action supporting improvements in debt management policies and institutions in 2020-21, and half of IDA countries had DPFs with debt management-related prior actions. TA has been delivered to help countries fulfill these requirements. In addition, in recent years, about one in five IMF-supported programs have had structural benchmarks tied to the improvement of debt management capacity. The IMF is also delivering a significant volume of TA through existing regional debt management advisors stationed in IMF Regional Capacity Development Centers in the Caribbean, Pacific Islands, and West and Central Africa.

25. **The WBG and the IMF have developed practical tools and guidance notes to help countries identify, quantify, disclose, and manage fiscal risks**. The World Bank's *Fiscal Risk Toolkit* helps countries manage debt-related contingent liabilities and quantify the expected impact on the budget and debt sustainability analysis. The IMF's Fiscal Risk Assessments and Fiscal Transparency Evaluations (FTEs) help countries to identify the scope and scale of their fiscal risks, evaluate fiscal risk management practices, and propose actions to help address them.[6] The IMF's expanded *Fiscal Risk Toolkit* was released in November 2021. Both institutions work closely with member countries to build their capacity to identify, analyze and manage fiscal risks, strengthen institutional arrangements for monitoring and managing fiscal risks, and enhance fiscal transparency by disclosing fiscal risks, including through the development of comprehensive fiscal risk statements.[7] [8] Complementary to the efforts on debt transparency, the IMF has been also expanding the *Public Sector Balance Sheet Database* which shows comprehensive estimates of public sector assets and liabilities, using the framework of IMFs Government Finance Statistics Manual 2014.[9] Regular reporting of contingent liabilities including those arising from public-private partnerships and domestic arrears as memorandum items to debt statistics and in fiscal risk statements could be useful. Data on debt redemption profiles and refinancing costs would also be beneficial.

26. **Assistance on public investment management (PIM) is critical to help countries reserve limited resources for investments with the highest returns.** Countries with significant debt burdens face difficult trade-offs between scaling up public investment to meet development objectives and containing debt vulnerabilities. Higher official development assistance (ODA) and efforts to boost domestic revenue, attract foreign direct investment, and improve efficiency of investment expenditures can ease this trade-off. Economies with strong management and

[5] For instance, thanks to the TA provided by the WB and the IMF, Mongolia and Benin succesfully swapped short-term debt into a longer-term debt in 2020, significantly reducing roll-over pressures.

[6] The FTEs include an assessment of fiscal risks based on Pillar III of the Fiscal Transparency Code, including an analysis of the scale and sources of fiscal vulnerability based on a set of indicators.

[7] In 2021, the IMF's Fiscal Affairs Department and Regional Capacity Development Centers had nearly 100 fiscal risk capacity development activities for more than 50 member countries. The IMF's fiscal risk assessment tools have been applied in around 40 countries over the past two years and fiscal risk assessments have been undertaken as part of 35 Fiscal Transparency Evaluations completed since 2014.

[8] In 2021, the World Bank rolled out the revised Fiscal Risk Framework with 22 technical assistance activities, and 7 activities on the WBG Integrated State-Owned Enterprises Framework (iSOEF).

[9] The database will cover 50 countries by July 2022, up from 38 in 2018. Time series data is available for 25 countries compared with 17 in 2018.

accountability systems can better ensure value for money by minimizing the cost and time overruns more effectively than the typical developing country (Anand *et al.* 2014).

- Since 2008, the WBG PIM diagnostic framework for assessing the extent to which the must-have principles are reflected in country systems has been applied in more than 70 countries. Follow-up work has included support for building PIM institutional frameworks, developing PIM regulations and guidelines, and launching capacity-building programs.
- The Public Investment Management Assessment (PIMA) developed by the IMF in 2015, provides a framework to assess infrastructure governance. As of 2021, PIMAs had been conducted in over 70 countries across all regions and income levels. In December 2021, a new module to the current PIMA framework was introduced, i.e., the climate-PIMA (C-PIMA).[10]
- The PPP Fiscal Risk Assessment Model (PFRAM), jointly developed by the IMF and the World Bank, helps assess the potential fiscal costs and risks arising from public–private partnership projects. Since it was launched in April 2016, PFRAM has been used IMF and WBG technical assistance programs, as well as by country authorities to better understand the fiscal implications of PPPs.

Access to long-term finance

27. **The WBG and the IMF also support member countries to develop domestic debt markets and improve long-term finance for both government and private borrowers.** WBG support for domestic debt market development has reached over 50 low- and middle-income countries in the last five years, through its direct advisory support, training, and operations-related work, and as part of broader country engagements supported by the Debt Management Facility (DMF), the Global Debt and Risk Management (GDRM) Program, and the Joint Capital Markets Program (J-CAP; World Bank 2022c). J-CAP is designed to develop local capital markets by mobilizing domestic and international private capital in low- and middle-income countries to invest in strategic sectors such as housing and infrastructure as well as providing longer-term local currency funding, especially for banks and nonbank financial institutions. Its approach targets supply-side bottlenecks (e.g., lack of assets, advisory to issuers) and demand-side bottlenecks (e.g., concentrated investor base) and is complemented by efforts to deepen markets through innovative de-risking instruments, including climate-linked products. WBG guarantee program (Partial Risk Guarantees [PRGs] and Public Credit Guarantees [PCGs]) also help mobilize private capital. The IMF supports development of local currency government bond markets through its training and technical assistance programs to help countries avoid risks from currency fluctuations, support the development of a robust financial system, finance budget deficits in a non-inflationary way and improve resiliency to sudden movements in foreign capital flows. MIGA and the IFC are actively engaged in catalyzing FDI in a wide range of sectors, including in the establishment of sound public-private partnership projects and frameworks. IFC plays a key role investing directly in corporate equity, including for firms focused on infrastructure, and indirectly via private equity and venture capital funds that provide critically needed risk capital to younger firms with potential.

[10] The C-PIMA aims to help governments identify potential improvements in public investment institutions and processes to build low-carbon and climate-resilient infrastructure. Five C-PIMAs have been conducted thus far (for Anguilla, Costa Rica, Croatia, Nepal, and the United Kingdom). Two additional C-PIMAs are underway for Argentina and Haiti.

28. **For member countries with moderately developed domestic debt markets, the IMF and WBG provide targeted assistance to improve the depth, functioning, access, and efficiency of these markets** (Box 2). This has included innovative programs such as the Issuer-Driven Exchange Traded Program (ID-ETF), which was launched in Brazil in 2018, and advisory services for the quickly evolving sustainable finance agenda (World Bank 2018a).

Box 2. WBG and IMF support for domestic debt market development

The IMF and WBG have a long history of supporting countries in developing local debt markets. The WBG-IMF joint analytical guidance note on developing local currency bond markets and the guidelines on public debt management, which were published in the early 2000s, have anchored much of the work on developing local debt markets over the last two decades (IMF and World Bank 2014, 2021a). Since then, the IMF and WBG have supported both MICs and LICs, in both the design and implementation of domestic debt market development. Work on domestic debt market development, facilitated by various trust fund facilities (e.g., DMF, GDRM, SECO, FIRST initiative) has focused across the development spectrum, on issues ranging from developing the pre-conditions for domestic debt market development to leveraging financial innovation, using instruments such as the issuer driven ETF in Brazil (which is also being implemented in Colombia and Peru). Moreover, successful work programs on domestic debt development have supported broader capital market programs such as J-CAP, which is a key enabler for longer term finance provision to the private sector.

The launch of a new joint WB-IMF framework for local currency bond debt market development in March 2021 formalizes much of the experience garnered over the last two decades into a systematic framework (IMF and World Bank 2021b). It will form the foundation of future TA on domestic bond market development. The framework provides a systematic roadmap for policymakers conducting analysis of EMDE local currency bond markets and identifies six key building blocks of development: (i) money market, (ii) primary market, (iii) investor base, (iv) secondary market, (v) financial market infrastructure, and (vi) the legal and regulatory framework. It also presents *enabling conditions*, for market development. The framework allows for the identification of development gaps, which can be used to identify priorities, and be compared with peers to inform the local debt market development plan.

The work on developing local currency debt markets feeds into the WBG-IMF core areas of work. This includes fiscal and monetary policy, financial stability, capital market development, management of foreign flows, business cycles, and economic growth. In many cases, a wide spectrum of reforms is needed to help develop local currency bond markets, and often careful consideration is needed to determine optimal sequencing and timing of the reforms. The WBG and IMF will continue to play a catalytic role in helping coordinate reforms through regular monitoring of economic and financial conditions, as well as through ongoing dialogue with authorities.

29. **MIGA supports access to long-term finance through credit guarantees, such as non-honoring of financial obligations (NHFO), for debt issued by eligible sovereigns.** NHFOs support public finance by helping sovereign borrowers obtain lower interest rates and longer tenors (as long as 20 years) for their debt. NHFO protects the lender (typically a commercial bank) against losses resulting from a failure to make a payment when due under an unconditional financial payment obligation or guarantee (MIGA 2021). IFC encourages long-term finance through risk-sharing and capital relief transactions with banks and other lenders, with proceeds freed directed to key development priorities, including MSMEs, rural and agribusiness borrowers and women-owned firms.

Debt resolution

30. **As part of its mandate to foster economic and financial stability, the IMF plays a central role in the prevention and resolution of sovereign debt crises**. The IMF (i) conducts

surveillance of its members policies for domestic and external stability, including through debt sustainability analyses (DSAs) prepared jointly with the WBG for those countries using the LIC DSF, (ii) assists members in solving their balance of payments problems through IMF-supported programs to help them achieve macroeconomic stability, and (iii) in particular, in cases of unsustainable debt and a request for an IMF-supported program, assists the member in designing a macroeconomic adjustment framework as well as setting the debt restructuring envelope that is necessary to put debt on a sustainable path while being consistent with the IMF-supported program's parameters.

31. **The two Bretton Woods institutions also support global and bilateral sovereign debt restructuring initiatives and facilitate creditor coordination where appropriate.** The WBG and the IMF led the design and implementation of the HIPC Initiative and the complementary Multilateral Debt Relief Initiative (MDRI), which was successful in reducing the debt stocks of poor countries with unsustainable debt (IEG 2006; World Bank 2022a).[11] Under the two initiatives, the WBG and IMF had provided debt relief of US$50.9 billion and US$7.4 billion, respectively, to 38 countries as of end-2021. The IDA-administered Debt Reduction Facility (DRF), set up in 1989, has supported operations that helped extinguish US$10.3 billion of external commercial debt owed by 21 countries, providing a significant contribution in terms of commercial creditor participation under the HIPC Initiative and helping address litigation challenges.[12] The institutions support global debt initiatives while preserving their financial integrity and fiduciary responsibility, with the WBG maintaining an unchallenged AAA credit rating. Moreover, the two institutions have continuously supported the work of the international community on debt, in particular through the G20, the G7 or the Paris Club.

32. **Since the onset of the pandemic, the WBG and IMF have supported the G20 and other debt service relief initiatives for IDA- and PRGT-eligible countries.** Following the call by the WBG President and the IMF Managing Director, the G20 set up the Debt Service Suspension Initiative (DSSI) in April 2020. By suspending payments on official bilateral debt, the DSSI helped countries free resources to increase social, health, and other critical spending in response to COVID-19. Between its initiation and its expiration in December 2021, the DSSI temporarily suspended US$12.9 billion of 48 countries' debt service payments and provided liquidity support to participating countries estimated to average about 0.5 percent of GDP in 2020. However, the debt service suspended in 2020-21 will add to the debt service of those countries starting in 2022. In the context of the DSSI, the WBG began to publish external public debt and debt service data by creditor on its International Debt Statistics (IDS) website thereby supporting enhanced debt transparency. The IMF and the WBG have been strong supporters of the Common Framework (CF) to provide debt treatments to DSSI-eligible countries facing unsustainable debt situations or high liquidity pressures, and have been working with the G20 to improve the implementation of the CF. The IMF also provided debt service relief through grants to the 31 poorest countries under the Catastrophe Containment and Relief Trust (CCRT). Debt relief under the CCRT has so far

[11] The WBG has a restrictive non-direct advisory stance on the restructuring of debt owed by member countries to other creditors. As a result, it does not provide direct advice to member countries on whether and how to restructure debt owed to other creditors. This restrictive stance reflects the World Bank's policies and practices to protect the World Bank's preferred creditor status and financial strength.

[12] Since 2020, the mandate and scope of the DRF has been expanded to meet the demand of IDA eligible countries for legal advisory services not linked to debt reduction operations.

been approved to cover debt service to the IMF falling due between April 2020 and April 2022. Total debt service relief for five tranches amounted to about US$1 billion.

33. **The WBG and the IMF support countries in improving domestic private sector debt resolution and insolvency mechanisms.** On average, less than 30 cents on the dollar is recovered by secured creditors in private sector insolvencies in EMDEs, compared to 70 cents on the dollar in OECD high-income countries (World Bank 2020b). In both middle- and low-income countries, the disparity can be attributed to weaknesses in the insolvency systems, including the lack of workable options to preserve viable enterprises, and inefficient processes that make debt recovery and restructuring costly and slow, and inadequate courts and insolvency administrators. Low creditor recovery in turn affects loan pricing, loan availability, entrepreneurship levels and investor risk (World Bank 2014, 2022b). WBG support is provided through technical assistance, lending, advisory services, and the development of alternative dispute resolution (ADR) systems. The IMF's support includes policy and technical assistance and analytical work during surveillance, IMF-supported programs and capacity development.

34. **IFC supports private debt resolution.** IFC invests in distressed bank assets, working with clients and partners, especially in middle-income countries, to establish and strengthen secondary markets for nonperforming loans. These activities support sizable amounts of debt restructuring for individual and corporate borrowers, mostly on retail bank credit. For financial institutions, IFC is helping to create large, well-functioning markets for distressed asset resolution in several countries in response to increases in nonperforming loans that threaten financial stability, undermine bank profitability and capital positions, and reduce availability of credit, especially for smaller, newer firms with potential that lack access to finance, along with other under- and unbanked firms and individuals. These investments are most successful when accompanied by appropriate changes in the regulatory frameworks, along with supportive tax treatment, that help raise the larger amounts of equity financing needed to reduce excess leverage among overindebted firms. Similarly, appropriate supervisory pressures and insolvency regimes are needed for banks to write down distressed assets sufficiently to clean their balance sheets, improve future profitability, and redirect financing going forward to its most productive uses.

35. **The WBG participates in global standard-setting initiatives for efficient private debt resolution.** As the designated co-standard setter in this area the WBG convenes a global task force of leading experts to issue principles for developing efficient and modern insolvency systems. This technical assistance spans a range of activities, including legislative support for governments reforming insolvency legislation; institutional developments such as establishing insolvency regulators and strengthening technical knowledge within commercial courts; and non-performing loan (NPL) resolution, including NPL trading on secondary markets and stakeholder capacity building. The WBG works with regulator groups such as the International Association of Insolvency Regulators (IAIR) and INSOL International on several initiatives, including the Africa Roundtable and the Forum for Asian Insolvency Reform (FAIR).

36. **The IMF and the WBG contribute to the research and development of private debt resolution techniques.** The IMF cooperates with the WBG and the United Nations Commission on International Trade Law (UNCITRAL) in the development of international standards and conducts its own research to develop cutting-edge analysis of private debt resolution techniques, including through dialogue with member countries and other international organizations.

IV. How will the WBG and IMF contribute to the debt and development agenda?

To support economic growth and progress towards broader development objectives, the WBG and the IMF will work with members countries and the global community to address the identified challenges from rapid debt build-up by further improving fiscal policy, strengthening debt transparency and debt management frameworks, expanding access to long-term finance in particular to micro-, small-, and medium-size enterprises (MSMEs), and contributing to timely and efficient debt restructuring processes where necessary.

37. **Record-high debt levels necessitate efforts to address the causes of increased debt vulnerabilities through improved fiscal policy, debt transparency, and debt management frameworks in EMDEs; expand access to long-term finance; and ensure timely debt restructuring where necessary.** In countries that do not face immediate refinancing risks and unsustainable debt situations, it is critical to strengthen fiscal policy, public investment management, and debt transparency and management frameworks. Developing credible and sustainable medium-term fiscal frameworks can help reduce debt vulnerabilities by facilitating political consensus on debt objectives, improving market confidence, and thus reducing borrowing costs. Incorporating climate considerations could diversify funding sources and help address a source of growth risks. Enhanced debt transparency is essential for adequate borrowing and lending decisions and efficient debt resolutions. Improved efficiency of public investment is critical to the use of borrowed funds. Policies promoting access to long-term debt and equity finance for development also need to be employed to address debt vulnerabilities for firms and households. In countries where debt is unsustainable or liquidity pressures are high, case-by-case debt restructuring should be implemented rapidly and ensure the effective participation of all creditors, including non-traditional lenders and private sector creditors.

Strengthening fiscal and debt management, debt transparency, and debt sustainability

38. **The IMF and WBG will continue to help countries create fiscal space to finance their growth and development.** This includes efforts to improve the credibility of public finances, strengthen public spending efficiency, mobilize domestic revenues, and boost private sector growth.

- Governments should adopt policies that credibly commit them to reduce deficits. This would improve creditors' confidence and thus reduce borrowing costs.
- Government spending can be reallocated to more growth-enhancing uses, including education, health, social transfers shown to have large multipliers and poverty alleviation effects, and climate-smart infrastructure investment. Large, regressive energy subsidies need to be removed (Kojima 2018). Better targeting will allow reduced expenditure whilst maintaining protection for the vulnerable (achieving this may require combatting entrenched budget rigidities).
- Government revenue bases can be broadened by removing tax exemptions and strengthening tax administration (Gaspar, Ralyea, and Ture 2019; IMF 2019a; World Bank 2017b). Actions to broaden revenues, e.g., taxing digital services, need to consider effects on private sector growth and distributional impacts over the medium-term. The PERs and the WBG's Domestic

Revenue Mobilization (DRM) activities will support countries in these efforts. The IMF also provides significant tax policy and tax administration support for broadening revenue bases.

- Governments can also take action to foster private sector-led growth. Reform agendas to improve business climate and institutions have resulted in significant gains in investment and productivity in EMDEs (World Bank 2018b). Attracting FDI, a stable and significant source of financing in many EMDEs, helps to link a country's economy to global value chains and brings investment, jobs, increased exports, supply chain spillovers, new technologies and business practices to countries.

39. **The two institutions provide debt sustainability frameworks for supporting sustainable debt and managing unsustainable debt.** The two IFIs will continue to prepare joint Low-Income Countries Debt Sustainability Analyzes (LIC DSAs) to help the poorest countries achieve their development objectives while maintaining debt sustainability.[13] Since the onset of the COVID-19 crisis, these assessments have been instrumental in forging a consensus on the need for debt service suspension under the DSSI and for debt restructuring cases, and in informing lending decisions of many bilateral and multilateral institutions to ensure countries would receive financing at terms adequate to their risk of debt distress. LIC DSAs will continue to emphasize near-complete coverage of public debt and debt disclosure. The staffs are closely monitoring debt vulnerabilities based on the DSAs, including to provide early warning to countries and assess countries' debt risks.

40. **The IMF will commence the rollout of the new Sovereign Risk and Debt Sustainability Framework for market access countries (SRDSF) after March 2022.** This will help signal sovereign stress more accurately and better assess debt sustainability in these countries, which is a prerequisite for most IFI lending. Compared to its predecessor, the SRDSF will provide more comprehensive and consistent debt coverage, enhanced debt transparency, clearer signals of sovereign debt risks based on improved analytical methods, and new risks assessments at three different horizons (short, medium, and long term).

41. **The IMF and WBG will continue to support member countries in strengthening debt and fiscal transparency to address upfront some of the main drivers of past build-ups of debt vulnerabilities and ensure better monitoring of risks and analysis of debt sustainability.** Debt transparency is key for investors to assess adequately the risk they take in lending to a country. Inaccurate debt levels, or opacity in the restructuring terms of certain contracts (such as undisclosed collateral features) can sometimes bias lending decisions and lead to inappropriate capital allocation. They can also lengthen restructuring negotiations when creditors raise doubts about the size and composition of the debtor's debt portfolio or find it difficult to assess the level of debt relief needed to restore debt sustainability (World Bank 2021a). Considering this, and due to its pivotal role in reducing borrowing costs, limiting corruption, and promoting accountability, debt transparency is a priority in the development agenda (Box 3). The IMF provides Fiscal Transparency Evaluations and technical assistance on the development of fiscal frameworks and councils. The WBG and the IMF provide debt information through the World Bank's *International*

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[13] The Joint IMF-WB Debt Sustainability Assessments (DSAs) using the LIC DSF are conducted annually for 66 countries eligible for IDA financing. DSAs are typically also prepared in the context of IMF Article IV consultations as well as requests for IMF financing or modifications of debt limits.

Debt Statistics,[14] and the IMF's *Global Debt Database*. The two institutions are also supporting the efforts of the IIF and the OECD to build a commercial creditor database for LICs. Debt is a cross-cutting issue in IDA20. Going beyond IDA19 policy commitments, IDA 20 commits to support IDA countries in publishing comprehensive PPG debt reports or fiscal risk statements.

Box 3. Debt transparency in LICs

Debt transparency is the cornerstone of good debt management, reliable debt sustainability analysis, and appropriate and timely debt restructuring. Large and relatively rapid changes in the creditor profiles in low-income countries has increased the urgency of arrangements to ensure reliable and transparent accounting of debt.

Increased access to markets together with a more diversified creditor base has not been accompanied by the corresponding upgrade in capacity, institutions, or legal and operational frameworks for public debt management in many LICs. This results in the mis- or under-reporting of entire sectors or instruments (World Bank 2021a). The use of confidentiality clauses further adds to the problem.

Higher debt levels have highlighted the urgency for more transparency. Any deterioration in the fiscal space tends to increase the incentives for governments to hide the true extent of the government debt by moving it off-budget or to use financial or natural assets as collateral for additional borrowing. These operations are often omitted in sovereign debt statistics. No African country with outstanding collateralized debt, for instance, publicly discloses the details of the collateral (Mihalyi et al. 2022).

Debt transparency is critical to inform lender's decisions and facilitate debt restructuring. A comprehensive view of a country's debt situation is important for investors and lenders. Insufficient transparency can sometimes lead to inappropriate pricing of the risk and inadequate capital allocation. In case of debt restructuring, having a comprehensive view of a country's debt situation also helps ensure creditors can assess how the burden is shared among creditors.

The borrower has an important responsibility in fostering debt transparency. The borrower is the only one entity that knows at all points its debt exposure and the new borrowing it is considering. In this context, two areas of reforms are key. First, the adoption and implementation of a legal framework for the management of public debt that: (i) clearly defines public debt, debt instruments, and debt coverage; (ii) specifies the borrowing authority and the debt authorization cycle; (iii) clarifies the institutional arrangements of debt issuance, management, recording and reporting; (iii) discloses national debt strategies and borrowing; (iv) includes reporting, audit and accountability requirements and (v) regulates the consequences of non-compliance. Adequate requirements should apply also with respect to contingent liabilities. Second, debt management capacity needs skilled staff and the development of modern information technology systems for debt recording and management.

Creditors also play an important role in debt disclosure, which can help overcome capacity problems in debtor countries. While reporting by creditors on their lending cannot substitute borrowers' reporting, it helps in enhancing transparency and reconciling public debt data. The G20 Operational Guidelines for Sustainable Financing emphasize the need for official bilateral creditors to share information (guideline 2). The IMF-WB Diagnostic Tool on the implementation of the G20 guidelines identifies as a strong practice for transparency to publish loan-by-loan information by creditors, including terms, on a single website, with regular updates. In addition, strong practice requires creditors to use publicly available templates for their financing and refrain from confidentiality clauses.

IFIs, including the IMF and WBG, can promote reforms in national legal and operational frameworks. The IMF and WBG support for debt transparency has been integrated into policies and operations and supported by scaled-up TA (through the Multipronged Approach; IMF and World Bank 2020c). This comprehensive approach has proven effective: in 40 percent of the IDA countries, there has been a broad improvement in the quality of data dissemination practices compared to one year ago (World Bank 2021c).

[14] The World Bank is planning to extend the coverage of the IDS to include domestic debt and non-traditional debt instruments (e.g., resource-backed loans, central bank deposits, and others).

Increasing access to long-term finance

42. **The WBG and the IMF will continue to support member countries develop domestic local currency debt securities.** In market access countries with more developed financial infrastructure, WBG efforts will focus on the development of domestic capital markets and de-risking to attract long-term equity and debt investors. For less developed countries, WBG engagement for domestic debt market development will aim to create the conditions for viable market-based finance solutions. The IMF will also help support countries as they develop their legal frameworks through targeted technical assistance, e.g., on tax law frameworks.

43. **The non-debt financial market development that the WBG has supported can encourage non-debt finance among firms.** IFC can lead here not just through direct equity participations in infrastructure projects, mid-sized and larger corporates, and financial institutions needing equity risk capital but also via quasi-equity mezzanine structures and subordinated bonds, including capital-qualifying instruments for banks. MIGA, through its political risk insurance instrument, is also leading through its support to cross-border private equity investment, especially in the most challenging markets where the perception of elevated non-commercial risks can deter cross-border investors. IFC also leads with private equity and venture capital investments that provide critically needed growth capital for younger smaller firms, especially those deploying disruptive technologies to create new markets, transform industries, and drive inclusive growth. The WBG's engagement has a strong emphasis on MSMEs, as they are the most important contributors to employment in EMDEs.

44. **Policymakers can also catalyze more stable external financial flows by cultivating conditions conducive to increased FDI.** This could encompass a wide range of structural reforms, for example: enhancing the transparency and independence of regulatory structures; increasing trade-openness; strengthening corporate governance and property rights; addressing inflexible labor markets; removing preferential treatment for state-owned enterprises; developing credible PPP programs; and, prioritizing complementary public investments (e.g., infrastructure that reduces trade costs). MIGA and the IFC are actively engaged in catalyzing FDI in a wide range of sectors, including in the establishment of sound PPP projects and frameworks.

Improving debt resolution

45. **The IMF and the WBG will support countries resolve the pandemic's legacy of record-high private debt by strengthening insolvency and debt resolution frameworks.** Countries need to update their insolvency and restructuring regimes to provide a wide array of restructuring options for viable firms, and the swift liquidation of unviable firms to reallocate resources to more productive uses. Insolvency reforms are also needed to facilitate economic recovery and ensure regulators have the legal tools and the institutional capacity to manage a sharp rise in insolvencies in line with international best practices.

46. **The WBG and the IMF will help member countries develop tailored solutions depending on market needs.** In some countries, the focus may be on improving the basic enabling legislative framework, while in other countries the most important priority may be building up weak institutions and related stakeholder groups. The WBG and the IMF will work with member countries to explore how new developments in technology and use of data can help address debt challenges and will support efforts to ensure that platforms are effectively implemented with necessary safeguards, including for cybersecurity, and data regulation to support the integrity of

the data. The WBG will continue to leverage its prominent role among standard setters for insolvency law to promote the importance of these critical reforms.

47. **The IMF and WBG will support national regulators resolve bank balance sheet risks that accumulated during the pandemic.** For many EMDEs, the immediate challenge is to restore compliance with international standards and reverse support measures which unduly delay NPL recognition. Where credit quality has deteriorated, supervisors will need to promptly identify affected institutions, ensure they have adequate risk management, and impose time-bound actions to reduce NPLs. In many EMDEs, assessments of compliance with Basel Core Principles for effective banking supervision show that significant progress is needed (and in some cases, hard-won independence has been eroded during the pandemic). While situations vary greatly across jurisdictions, key priorities include ensuring that decisions are made without undue interference and then implemented by regulated institutions through supervisory actions and enforcement. IMF-WB FSAPs and other financial sector diagnostics will continue to play an essential role to assess supervisory arrangements and frame priority reforms and develop capacity. The two institutions assist countries improve their bank resolution and crisis management frameworks with the aim to minimize taxpayers' costs and preserve financial stability. With the advance in digital technologies, new providers are slowly gaining ground in the microfinance sector but with significant cybersecurity risks for consumers. The WBG can help countries put in place regulatory and supervisory frameworks to facilitate innovation in the microfinance market while strengthening financial stability.

48. **With the support of the two institutions the G20 is considering how to improve debt resolution, especially for the world's poorest countries, through the G20 Common Framework (CF).** In the absence of a bankruptcy regime applicable to sovereigns, the international sovereign debt restructuring architecture has relied on negotiated outcomes based on norms and practices that have evolved over many years. By bringing together Paris Club and non-Paris Club official bilateral creditors, the CF represents a breakthrough. But progress in implementing the CF has been slow and improvements are needed for the CF to deliver effectively (Box 4). The IMF and WBG will continue to offer technical support to facilitate the CF implementation and outreach. Analytical work, discussed in the context of the G20 International Financial Architecture Working Group, is ongoing to understand the limited participation in the CF so far, examine proposals to improve CF implementation, build confidence in the CF among eligible countries that need a debt treatment, and clarify how the COT will be implemented to ensure fair burden sharing from all participating creditors.

49. **Working in their supporting, technical capacity, the IMF and WBG have identified four priorities for strengthening CF implementation.** They are: (i) quicker and more efficient processes through clear and time-bound steps in the implementation of the CF; (ii) the introduction of a debt service standstill to immediately address the liquidity needs of countries requesting treatment, with no penalty interest; (iii) greater clarity on how official bilateral creditors will enforce and evaluate the comparability of treatment to private creditors; and (iv) the expansion of coordinated debt treatments to non-DSSI eligible countries with debt vulnerabilities. Fostering trust among creditors will be critical to make further progress on the CF. The WBG and the IMF will also enhance their support to the CF by laying out the circumstances under which countries can apply for a CF treatment, outlining the benefits from treatment, and providing outreach and technical assistance both to creditors and debtors.

Box 4. Options for Strengthening the Common Framework

There are several examples of coordinated debt relief frameworks which provide useful guidance for the present. Since its establishment in 1956, the Paris Club has provided 477 debt treatments and a set of standards and references for debt treatments involving official bilateral creditors. The Brady Plan, launched in 1989, helped resolve large sovereign debt overhangs in Latin America in the 1990s. The HIPC Initiative, launched in 1996 and followed by the MDRI in 2005, provided deep debt stock reduction and helped resolve sovereign debt overhangs in poor countries after a lost decade of growth. Debt relief under the HIPC and MDRI Initiatives also enabled recipient countries to increase their poverty-reducing expenditures, while reducing debt service. As an important lesson, past restructurings often initially provided limited relief, with a preference for rescheduling debt payments rather than outright reductions, but eventually shifted towards outright reductions once solvency problems were clearly identified. Comprehensive debt restructurings that took place before the onset of the pandemic outside a coordinated framework have been protracted, incomplete and non-transparent (IMF and World Bank 2020a).

Since its endorsement by the G20 and the Paris Club in November 2020, the pace of implementation of the CF has been slow. Three countries have made requests for CF debt treatments (Chad, Ethiopia, and Zambia). Some important milestones have been reached but a debt treatment has not been finalized for any of these applicants more than one year after their initial requests. Slower than expected CF implementation reflects, in part, coordination issues involving Paris Club and other creditors, as well as multiple government institutions and agencies within creditor countries, which can slow decisions taken. Delays have put pressure on the current CF countries, as they are unable to access new financing during a protracted restructuring phase. This could disincentivize new applicants. The expiration of the DSSI at end-2021 is increasing the financing pressures countries face as they resume full debt service payments to official bilateral creditors. With the ongoing tightening in global financial conditions, liquidity pressures will increase further in EMDEs.

With policy space tightening for highly indebted countries, the CF can and must deliver more quickly. IMF and WBG staff have identified four sets of improvements:

1. Greater clarity on the steps and timelines of the CF process. Official bilateral creditors should aim at forming a Creditors' Committee within 4-6 weeks after the request from the debtor country and providing financing assurances within three months of reaching a staff-level agreement (SLA) with the IMF staff. This would enable the early resumption of essential financing and support the implementation of a reform program.

2. Introduction of a debt service suspension for the duration of the negotiation. Such a standstill would be provided by official creditors, on request of the debtor country, to countries requesting a CF and having reached SLA, and until the actual debt treatment, to alleviate liquidity constraints, avoid the accumulation of arrears and incentivize quicker resolutions. The value of any payments received from non-participating creditors during the standstill should be fully accounted for in the assessment of the CF CoT.

3. Assessment of the parameters and processes for CoT and clarity on the rules for its implementation. Official bilateral creditors should provide more clarity on how CoT will be determined and enforced, beyond the parameters already included in the CF.

4. Expanding coordinated debt treatments to highly indebted non-DSSI eligible countries. Other countries with high debt vulnerabilities, including some LMICs and small island states, have also seen sharp increases in debt because of the COVID-19 pandemic. They would also benefit from greater coordination, as they are recipients of large financing from both official and private sector creditors.

50. **To enhance the process for sovereign debt restructuring, improvements to the market-based approach should also be considered.** The IMF continues to encourage and monitor the inclusion of enhanced collective action clauses in international sovereign bonds. Further work by the WBG and the IMF staff to limit holdout creditor behavior includes supporting the work of the G7 private sector working group on the development of majority voting provisions for modifying payment terms in syndicated loan agreements and reporting on the benefits of use of trust structures

in foreign law-governed bond offerings. Sub-sovereign entities will be encouraged to include enhanced collective action clauses in their foreign law-governed bonds.

V. Conclusions and questions for discussion

51. **Many EMDEs face large financing needs in the context of elevated debt and debt vulnerabilities, alongside urgent spending priorities.** Charting a path to a lasting recovery and long-term debt sustainability requires more than tackling debt issues. Restoring the damage done to human and physical capital by the pandemic will require sustained policy intervention by governments, the private sector, and the global community to help countries build back their human capital. This is in addition to large investment needs to make progress towards the SDGs.

52. **Addressing debt challenges will require coordinated prompt actions.** To prevent a recurrence of government debt overhangs, the two institutions are helping countries strengthen fiscal and debt management frameworks, including through greater transparency of spending and borrowing. To resolve private debt overhangs, the WBG and IMF support efficient bankruptcy frameworks and management of NPLs. Deeper financial markets can help expand access to domestic long-term finance for private and government borrowers. Where necessary, debt restructuring should be provided in a timely and coordinated manner, including through improvements in the G20 CF.

53. **The two institutions play a crucial role in addressing debt challenges and helping countries achieve lasting debt sustainability.** The IMF-WBG multipronged approach to address debt vulnerabilities is an important framework in this regard. Policy advice, lending operations, and technical assistance have helped reform legal frameworks, improve fiscal and debt management and transparency, and promote financial sector development. Close collaboration between the World Bank, the IFC, and MIGA can help amplify the contribution of each institution. The IMF and WBG will continue to leverage their expertise and experience to support member countries as they recover from the pandemic. The IMF and the WBG can also support member countries by strengthening further development finance as well as international trade and investment, fostering stable and sustainable international capital flows, and improving existing frameworks for debt restructuring.

Questions for discussion

- Do Governors agree with the assessment of the urgency of actions needed to address the risks to economic development and macroeconomic stability from the accelerated build-up of debt due to the COVID-19 pandemic, rising inflation, and imminent tightening in global financial conditions?
- Do Governors agree with the efforts of the WBG and the IMF to help countries improve fiscal policy, strengthen debt transparency and debt management frameworks, and expand access to long-term finance?
- Do Governors support the proposals of the IMF and the WBG to strengthen existing frameworks for debt restructuring? What are Governors' views regarding the options for strengthening the Common Framework presented in this paper?

Table 1. Debt-related analytical work and databases by the IMF and WBG since 2019

IMF	WBG
Analytical work	
October 2021: *Fiscal Monitor*. The report analyzes strategies to reduce debt and improve the credibility of public finances.	February 2022: *World Development Report*. "Finance for an equitable recovery."
April 2021: *Global Financial Stability Report*. "Nonfinancial Sector: Loose Financial Conditions, Rising Leverage, and Risks to Macro-Financial Stability" and "Commercial Real Estate: Financial Stability Risks During the COVID-19 Crisis and Beyond"	January 2022: *Global Economic Prospects*. "Resolving high debt after the pandemic: Lessons from past episodes of debt relief"
October 2020: *Global Financial Stability Report*. "Corporate Funding: Liquidity Strains Cushioned by a Powerful Set of Policies"	November 2021: *Debt Transparency in Developing Economies*.
April 2020: *World Economic Outlook* and *Global Financial Stability Report*. "Countering Future Recessions in Advanced Economies: Cyclical Policies in an Era of Low Rates and High Debt" and "Risky Credit Markets: Interconnecting the Dots"	January 2021: *Global Economic Prospects*. "How has the pandemic made the fourth wave of debt more dangerous?"
February 2020: *The Evolution of Public Debt Vulnerabilities in Lower Income Economies.*	
October 2019: *Global Financial Stability Report*. "Emerging and Frontier Markets: Mind the Debt."	January 2020: *Global Economic Prospects*. "The fourth wave: Rapid debt buildup"
April 2019: *Global Financial Stability Report*. "Downside Risks to House Prices"	December 2019: *Global Waves of Debt: Causes and Consequences*.
	June 2019: *Global Economic Prospects*. "Debt: No free lunch"
Databases	
Global debt database Public sector balance sheet database	International Debt Statistics Cross-country database of fiscal space

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