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## STAFF GUIDANCE NOTE ON THE IMPLEMENTATION OF PUBLIC DEBT LIMITS IN FUND-SUPPORTED PROGRAMS

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May 27, 2015

## STAFF GUIDANCE NOTE ON THE IMPLEMENTATION OF PUBLIC DEBT LIMITS IN FUND-SUPPORTED PROGRAMS

### EXECUTIVE SUMMARY

Effective date

In December 2014, the Executive Board approved new guidelines on the use of public debt limits in Fund-supported programs. The new guidelines enter into effect on June 30, 2015. The key changes with respect to the existing debt limits policy include, inter alia, the broadening of the policy to encompass all public debt rather than only external public debt; an integrated treatment of external public debt, covering both concessional and non-concessional debt; and closer links between public debt vulnerabilities and the use and specification of public debt conditionality.

This note provides operational and technical guidance related to the implementation of the debt limits policy. In particular, it sets out how the policy should be implemented in country-specific circumstances.

*For countries that normally rely on official external financing on concessional terms,* public debt sustainability analysis is typically undertaken using the Low Income Country Debt Sustainability Framework (LIC-DSF), conducted jointly by World Bank and Fund staff. For this group of countries, the assessment of public debt vulnerabilities is informed by the risk of external debt distress and, where relevant, the overall risk of debt distress. For countries assessed to be at low risk of external debt distress, limits on external public debt would typically not be required as part of program conditionality. For countries assessed to be at moderate or higher risk of external debt distress, debt limits would be required as part of program conditionality, with the specification of debt conditionality appropriately reflecting country circumstances.

*For countries that do not normally rely on official external financing on concessional terms,* debt sustainability assessments are undertaken using the Market Access Country DSA (MAC DSA) tool. Public debt limits for these countries would typically be established in nominal terms and could take the form of limits on total public debt or limits on sub-categories of total public debt.

The guidance note is intended for use by both IMF staff and country officials. In this regard, in addition to the guidance presented in the main body, the note also contains several annexes that cover definitional, technical and operational issues arising in the determination of public debt limits.

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# I. INTRODUCTION

1. **In December 2014, the Executive Board approved new guidelines on the use of public debt limits in Fund-supported programs.**<sup>1</sup> The new debt policy is based on a set of robust principles guiding the use of public debt conditionality in all Fund-supported arrangements across the membership. The key changes with respect to the existing debt limits policy include i) the broadening of the policy to focus on all public debt rather than on external public debt; ii) an integrated treatment of external public debt, encompassing both concessional and non-concessional borrowing; and iii) tighter links between debt vulnerabilities and the use and specification of debt conditionality.
2. **The changes introduced in the December 2014 reforms primarily affect countries that normally rely on official external financing on concessional terms.** For these countries, the new framework provides more flexibility to manage their financing needs in the context of a Fund-supported program, while safeguarding debt sustainability. The new policy framework also provides greater clarity in regard to the role of debt conditionality in other country cases.
3. **The general policies and guidelines governing the use of public debt limits in Fund-supported programs are laid out in the decision taken by the Executive Board on December 5, 2014 ([Reform of the Policy on Public Debt Limits in Fund-Supported Programs—Proposed Decision and Proposed Guidelines](#)).** This guidance note elaborates on how these policies should be implemented in specific country circumstances. Section II of the note recaps the core principles guiding the new policy; Section III discusses the appropriate use of debt limits in countries that do not normally rely on official concessional external financing; Section IV discusses the appropriate use of debt limits in countries that normally rely on official concessional external financing; and Section V discusses the definition of public sector debt for the purposes of the debt limits policy. Additional technical considerations, elaborations and examples are provided in Annexes I–III.
4. **The new guidelines on public debt limits in Fund-supported programs will enter into effect on June 30, 2015.** Conditionality on the basis of the new guidelines—for existing and new Fund supported programs—will be introduced in the context of program discussions that are concluded on or after June 30 and approved by the Board in the subsequent Board meeting. Until changed by the Board in individual cases, any existing debt limit conditionality will remain applicable according to its terms.

<sup>1</sup>See [Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#) and [Reform of the Policy on Public Debt Limits in Fund-Supported Programs—Proposed Decision and Proposed Guidelines](#).

## II. CORE PRINCIPLES FOR THE USE AND SPECIFICATION OF DEBT CONDITIONALITY

### A. When is the Use of Public Debt Limits Appropriate?

**5. In general, the use of debt conditionality is justified under either of the following conditions:**

- a. When a country has significant debt vulnerabilities, as assessed using debt sustainability analysis (DSA); or
- b. When the quality and coverage of fiscal statistics produced by the national system of fiscal accounting and budgeting favor the use of debt conditionality instead of, or as a complement to, “above-the-line” fiscal conditionality. The circumstances justifying the use of limits on debt accumulation as a “below the line” approach to framing fiscal conditionality are long-established (see Box 1) and will not be discussed further in the body of this note.

**6. The methodological approach taken to analyzing debt vulnerabilities is dependent on the importance of official concessional finance as a source of public external financing.** For countries where official external financing on concessional terms is a key source of public external financing, debt sustainability assessments are typically undertaken using the Low Income Country Debt Sustainability Framework (LIC-DSF), conducted jointly by World Bank and Fund staff. For all other countries, debt sustainability assessments are undertaken by Fund staff using the Market Access Country DSA (MAC DSA) tool, which yields a very different set of outputs to the LIC-DSF.

### B. Specification and Coverage of Debt Conditionality

**7. As noted in the Reform of the Policy on Public Debt Limits in Fund-Supported Programs, Section III.B, the specification of debt conditionality needs to appropriately reflect country circumstances.** Relevant factors include the composition of public sector financing, the objectives of the program, the extent and type of debt vulnerabilities, the quality and timeliness of the financial information produced by the country’s public sector accounting system, and other macroeconomic circumstances of member countries. Depending on the circumstances, debt limits could be set on total public debt or on public external debt; be specified in nominal or present value terms; cover debt stocks or new flows.

**8. As outlined in the Reform of the Policy on Public Debt Limits in Fund-Supported Programs, the appropriate form of debt conditionality differs between countries that normally rely on concessional external financing and those that do not.**<sup>2</sup> The term “normally rely on” is

<sup>2</sup>This term is used as shorthand for “countries that normally rely on official external financing provided on concessional or near concessional terms.”

taken to mean countries for which concessional financing has long been, and continues to be, a key source of public external financing over time, if not every single year ([Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#), paragraph 10). For operational purposes, all countries for which staff has been using the LIC-DSF through end-2014 are considered as countries normally reliant on concessional external financing at that point in time.

**9. Countries reliant on official concessional financing are expected, as they develop, to improve their credit-worthiness and increasingly tap international capital markets to meet their public financing needs.** Over time, their reliance on (and indeed access to) official concessional financing will decline and be replaced by reliance on market-based funding. For purposes of implementing the debt limits policy, a determination by Fund staff is needed, based on an assessment of financing trends, as to when countries should no longer be viewed as normally reliant on official concessional financing. This determination would be expected, absent exceptional circumstances, to hold over time, as it should be reflective of a fundamental, rather than transitory, evolution in public financing patterns.<sup>3</sup>

**10. In making this determination, staff should look at several indicators, such as:**

- The relative magnitudes of official concessional/near-concessional external financing and of external financing on market terms, averaged over at least four years. **Averaged over four years**
- The significance and stability of private foreign investor participation in domestic government debt markets throughout the years since significant portfolio inflows first began.<sup>4</sup>
- The trend evolution of official financial assistance (grants and concessional loans) as a share of GDP over time.<sup>5</sup>
- The demonstrated ability of the sovereign to tap international bond markets on more than a once-off basis.

**11. When staff assesses on the basis of such indicators that financing patterns have evolved to the point where** a) the nonfinancial public sector can predictably rely on external private finance to meet its external financing needs at levels similar to that of emerging market peers and b) foreign aid (concessional loans and grants) as a share of GDP is on an established downward trend and c) these developments are not expected to be markedly reversed in the foreseeable future, **a determination that the country no longer “normally relies” on official concessional external financing would be appropriate.**

<sup>3</sup>Shifting back and forth between the two categories would be operationally disruptive and not conducive to the provision of consistent policy advice.

<sup>4</sup>If private investors largely disappear from the domestic market in bad times, such inflows cannot be viewed, at this juncture, as a significant source of stable funding.

<sup>5</sup>One would expect this share to be declining noticeably over time as a country shifts to reliance on commercial external funding.

**12. Within the broad classification of countries normally reliant on concessional financing, there can be differences in the extent to which they are integrated with international financial markets.**

- Countries normally reliant on concessional financing would, in most cases, not be closely integrated with international financial markets. In these cases, it would be appropriate to use separate measures to contain the evolution of domestic and external debt. The specification of external debt limits, where needed, should be guided by the extent and type of debt vulnerabilities, as discussed in Sections III and IV below.<sup>6</sup> Specification of limits on the accumulation of domestic debt, where warranted, should be tailored to fit alongside fiscal conditionality while paying due attention to institutional considerations, including domestic debt market development objectives.
- For the few countries that are normally reliant on concessional financing but significantly integrated into international financial markets, debt conditionality would generally not distinguish between domestically-held and externally-held debt: a limit on debt accumulation would typically cover total public debt. Factors indicating significant integration with international financial markets would include: a) a largely open financial account, including easy exit for foreign portfolio investors; b) a significant and well-established presence of foreign investors in domestic capital markets; and c) well-developed primary and secondary capital markets for public debt and other financial instruments.

**13. Public debt limits would normally cover public and publicly guaranteed (PPG) debt or targeted sub-components of such debt.**<sup>7</sup> However, country institutional circumstances or program objectives could justify the use of a different specification or a narrower coverage. The definition used should be clearly specified in the Technical Memorandum of Understanding (TMU).

**14. Debt limits may be set either on a contracting or a disbursement basis when debt conditionality is warranted:**

- In cases where much of the external financing takes the form of project loans that are disbursed over an extended period, it would typically be appropriate to specify debt conditionality in terms of the contracting of new debt (typically under the control of the authorities) rather than on the disbursement of new debt, driven by the uncertain pace of project implementation over time.<sup>8</sup>
- Since country practices differ as to the procedures to be followed in regard to the contracting of public external debt, program documentation should include a clear indication of the precise

<sup>6</sup>For a discussion of the appropriate definition of external debt in these cases (whether the residency or currency definition) see Section V.

<sup>7</sup>See Section V for a detailed discussion of the definition of public debt for the purposes of debt conditionality.

<sup>8</sup>See [Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#), paragraph 21.

stage in these processes at which, for program purposes, the debt is viewed as having been contracted (i.e., when a loan is deemed to become effective; see also Annex II).

**15. Debt limits may also be established on sub-components of public debt to address specific debt vulnerabilities.** Debt vulnerabilities related to the composition and structure of public debt can be significant even when the overall level and trajectory of debt do not signal the presence of debt vulnerabilities. In such cases, the use of specifically targeted debt conditionality may be justified to address the identified risks (for example, foreign currency limits or limits on specific maturities where bunching of repayments are a cause of concern).

**16. The decision as to whether debt conditionality should be set as a performance criterion or an indicative target will continue to be guided by the Fund's guidelines on program conditionality.** Where the use of debt conditionality is so critical for achieving program objectives or monitoring implementation that interruption of disbursements under a Fund arrangement would be warranted in case of nonobservance, limits on debt should take the form of performance criteria (PCs). Where debt conditionality is critical to achieve objectives or monitor program implementation, but not so critical as to warrant interruption of disbursements, debt limits could take the form of indicative targets (ITs).

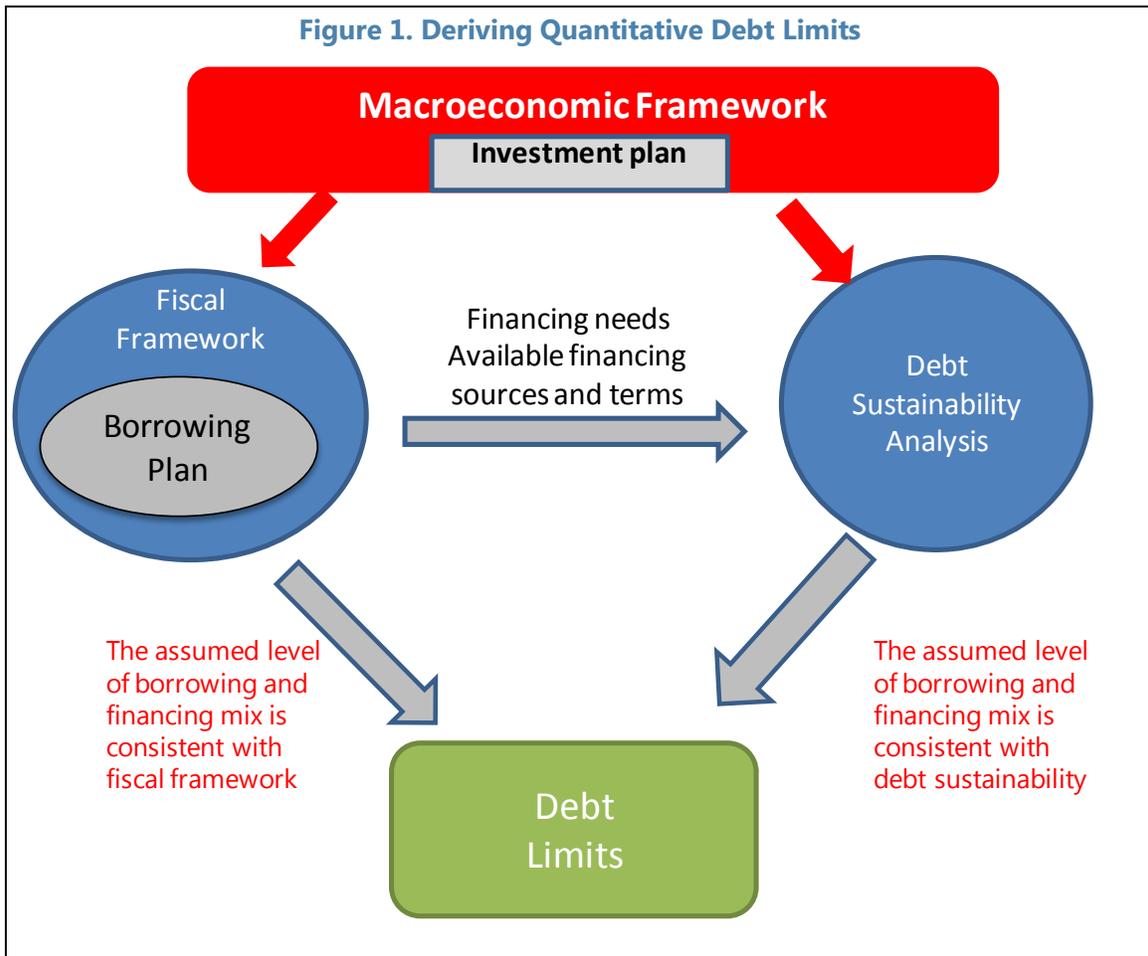
### C. How are Quantitative Debt Limits Derived?

**17. Several factors play a role in determining the appropriate level of borrowing in a Fund-supported program.** As discussed in the [Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#), Section III C, a public borrowing plan is an integral component of a country's fiscal framework, the assessment of which represents one component of the overall assessment of a fiscal framework. Compatibility of a borrowing plan with maintaining debt sustainability over the medium-term is a key concern and thus the borrowing space available would depend on the extent and nature of the country's debt vulnerabilities. Another consideration would be the assessment of the feasibility of achieving planned borrowing levels at the envisaged terms.

**18. The assessment of the appropriate level of borrowing should also reflect a wider assessment of the proposed macroeconomic policy framework.** From this perspective, relevant factors to consider include the appropriateness of the fiscal deficit from a demand management perspective, the composition of public spending associated with the new borrowing (including the feasibility of implementing new investment plans), the implied trajectory for public savings, as well as the implications of the proposed level of new borrowing and financing mix on debt sustainability (See Annex I for specific examples on how to include this information in program documents).

**19. DSAs play a key role in the process of reaching understandings on a fiscal framework, including a borrowing plan, and on macroeconomic policies more generally.** In practical terms, the key elements of an agreed fiscal framework, including public investment and borrowing plans to meet financing needs, are determined through an iterative process. An initial proposal is assessed in terms of its feasibility, given the planned program measures, and its adequacy for achieving program objectives: the DSA is used to assess whether the envisaged levels and mix of borrowing pose threats

to medium term debt sustainability (Figure 1). If the proposed borrowing program poses significant risks to debt sustainability, the fiscal program and borrowing plan are adjusted in a manner that reduces these risks. This process involves a dialogue between staff and country authorities until understandings are reached on an acceptable fiscal program, including a realistic borrowing plan that does not pose undue risks to debt sustainability.



### Box 1. The Use of Debt Conditionality to Support Fiscal Conditionality

*Limits on debt accumulation can feature in the specification of fiscal conditionality, whether to directly monitor fiscal performance or as a targeted complement to other conditionality on the fiscal position.*

#### **Using Debt Conditionality to Monitor Fiscal Performance**

Fiscal targets are usually a central component in a Fund-supported program, sufficiently critical to achieving program objectives that they warrant monitoring via the use of one or more performance criteria (PCs).

The specific formulation of fiscal PCs depends on several factors, including both program objectives and the quality and timeliness of the fiscal data generated from the budgetary accounts and from other available data sources (including financial sector accounts). Data available with long lags, or subject to substantial revisions as new information is acquired, are ill-suited to monitoring program performance, given both the timeliness in data reporting needed for the program review cycle and the risks of producing frequent misreporting.

Fiscal targets may be specified and measured using budget-generated data on expenditures and revenues, the so-called “above-the-line” approach. Fiscal performance may also be tracked using data on financing flows, the so-called “below-the line” approach—where the data in question is derived from sources other than budgetary data, such as the evolution of government borrowing from the banking system (available from the monetary survey) or data on bond issuances (potentially available from the debt management office).

The approach to specifying fiscal conditionality adopted by country teams should reflect an assessment as to the key fiscal variables that need to be monitored, coupled with a pragmatic assessment as to the quality, timeliness, and the adequacy of coverage of fiscal operations.<sup>1</sup> In cases where country teams propose to change the specification of a performance criterion or indicative target from that used previously, the program documentation should explain the factors justifying this change.

#### **Using Debt Conditionality as a Complement to Other Conditionality on the Fiscal Position**

Where important public debt-creating activities are not adequately captured in the fiscal accounts, the use of targeted debt conditionality could be justified as a complement to “above-the-line” fiscal conditionality, if the scale of these operations poses a risk to program objectives. Examples of such activities include bank recapitalization, privatization, and the operations of noncommercial SOEs and other important agencies outside the budgetary framework. Debt limits can be used to complement fiscal conditionality in such circumstances, for example, by establishing a limit on the issuance of government guarantees to public enterprises, limiting the debt of specific SOEs or by limiting the scope of expenditures under bank recapitalization programs. As in the above case, the design of debt conditionality for this purpose will depend of the specific vulnerability that from the fiscal perspective is meant to be addressed.

<sup>1</sup>For more information on assessing fiscal data adequacy, see IMF (2007), “Manual on Fiscal Transparency” and IMF (2001), “The Quality of Fiscal Data and Designing Fiscal Performance Criteria in Fund-Supported Programs”.

### III. DEBT LIMITS IN COUNTRIES THAT **DO NOT NORMALLY RELY ON OFFICIAL CONCESSIONAL EXTERNAL FINANCING**

**20. We consider here the role of debt conditionality in Fund-supported programs with countries that do not normally rely on concessional external financing,** focusing on when, and in what form, conditionality is justified by the presence of significant debt vulnerabilities.

#### A. Using the MAC DSA to Inform the Use of Public Debt Conditionality

**21. For these countries, the MAC DSA is the main tool for identifying the extent of debt vulnerabilities.** While the MAC DSA does not have a specific risk of debt distress rating, the judgment on the extent of debt vulnerabilities is informed by a set of tools provided within the MAC DSA framework; specifically, it is based on a set of benchmarks related to the debt level, the gross public financing needs and a number of other indicators related to the debt profile.<sup>9</sup>

**22. The heat map summarizing the risks to debt sustainability in the MAC DSA is the first step to gauge the extent of risks and inform the assessment of debt vulnerabilities.** Typically, heat map indicators exceeding their benchmarks under the baseline (either for debt levels or gross financing needs) would signal significant debt vulnerabilities. At the same time however, country-specific circumstances will also need to be taken into consideration. Specifically:

- **Debt levels:** debt levels exceeding their benchmark under the baseline (first row of the heat map flashing red) would typically signal significant debt vulnerabilities. However, the magnitude and persistence of the breach should also be taken into consideration: in general, large, protracted breaches are more worrisome than small, temporary ones. Similarly, whether the debt is on a stabilizing path or not should also be taken into consideration when determining if the risk from debt levels is significant.
- **Gross financing needs (GFN):** GFN indicators exceeding their benchmark under the baseline (second row of the heat map flashing red) would typically signal significant debt vulnerabilities. The magnitude and persistence of breaches would also matter for this assessment. Other considerations to be taken into account include whether or not the country is likely vulnerable to a sudden-stop in financing flows and the sufficiency of asset buffers to meet maturing obligations.

**23. Information from the other tools in the MAC DSA should also be used to inform the assessment of debt vulnerabilities:**

<sup>9</sup>For the specific benchmarks and their use for the identification and assessment of risks see [Staff Guidance Note for Public Debt Sustainability Analysis in Market-Access Countries](#).

- **Stress tests:** breaches of the relevant debt and GFN benchmarks under stress tests (yellow cells in the heat map) should generally be considered as signals of potentially significant vulnerabilities. The precise extent of the debt vulnerabilities should take into account other factors such as the magnitude of breaches.
- **Debt profile indicators:** debt profile indicators breaching their upper benchmarks (one or more cells in the third row of the heat map flashing red), would typically signal significant debt vulnerabilities especially if combined with the debt level or GFN also exceeding their benchmarks under the baseline or stress tests. Judgment on the extent of debt vulnerabilities should still be applied when some debt profile indicators breach their benchmarks but neither the debt level nor GFN are above their respective benchmarks.
- **Fan charts:** the fan chart tool provides a probabilistic view of the evolution of the debt-to-GDP ratio over the medium term. The significance of debt vulnerabilities would be informed by the width of the “fan” (distance between 10th and 90th percentile), as well as the portion of the “fan” that is above the relevant benchmark over the medium term. A larger portion of the “fan” exceeding the benchmark would typically signal significant debt vulnerabilities.

**24. Other risk amplifying or mitigating factors should also be taken into account when assessing debt vulnerabilities.** Such factors include the credibility of the baseline scenario and planned fiscal adjustment, pace of debt accumulation, adequacy of asset buffers, or characteristics of the creditor base. For example, a country with relatively low debt levels and GFN, but where debt is increasing rapidly against the background of a poor track record on adjustment could still be assessed as having significant vulnerabilities. On the other hand, mitigating factors should be taken into account when making risk assessments; for example, low external financing requirements and high international reserves could be considered as mitigating factors offsetting some of the risks posed by relatively high debt levels.

## B. What Form Should Public Debt Limits Take?

**25. Debt limits would be set in nominal terms and could take the form of limits on total public debt or targeted debt limits.** In general, the form of debt conditionality will be guided by the principles explained in Section II and by the type of debt vulnerabilities identified. Narrowly focused debt limits may be more appropriate in cases where significant vulnerabilities are limited to specific features of debt (e.g., only on issuance of guarantees or on public external debt, rather than on total PPG debt), or otherwise not captured by fiscal conditionality. For illustration purposes, Table 1 presents a non-exhaustive list of how different MAC DSA indicators can be used to inform the assessment of debt vulnerabilities, and what form of debt conditionality may be used to address the type of debt vulnerabilities identified. Annex III presents selected examples of how debt conditionality has been used in this group of countries.

**Table 1. Debt Vulnerabilities and Debt Limits: Illustrative Examples**

<b>Public debt vulnerabilities</b>	<b>MAC DSA indicators</b>	<b>Possible debt conditionality<sup>1</sup></b>
Debt level	heat map (1 <sup>st</sup> row) is red or yellow stress tests show vulnerabilities to certain shocks	ceiling on total public debt <sup>2</sup>
Gross financing needs	heat map (2 <sup>nd</sup> row) is red or yellow heat map (change in short-term debt) is red stress tests show vulnerabilities to certain shocks	ceiling on total public debt <sup>2</sup> ceiling on short-term public debt
External financing needs	heat map (external financing requirement, FX debt or nonresident debt) are red or yellow	ceiling on public external debt
Contingent liabilities	customized scenarios	ceiling on guaranteeing of debt

<sup>1</sup>In line with Section II the limits could be set on either stocks or flows depending on what better captures identified vulnerabilities.  
<sup>2</sup>Debt limits may not be needed if debt accumulation is adequately captured and identified vulnerabilities are addressed by the fiscal conditionality.

## IV. DEBT LIMITS IN COUNTRIES THAT NORMALLY RELY ON OFFICIAL CONCESSIONAL EXTERNAL FINANCING

26. This Section provides guidance on debt conditionality justified by the presence of significant debt vulnerabilities in countries that normally rely on official concessional financing.

### A. Debt Vulnerabilities and the Specification of Debt Conditionality

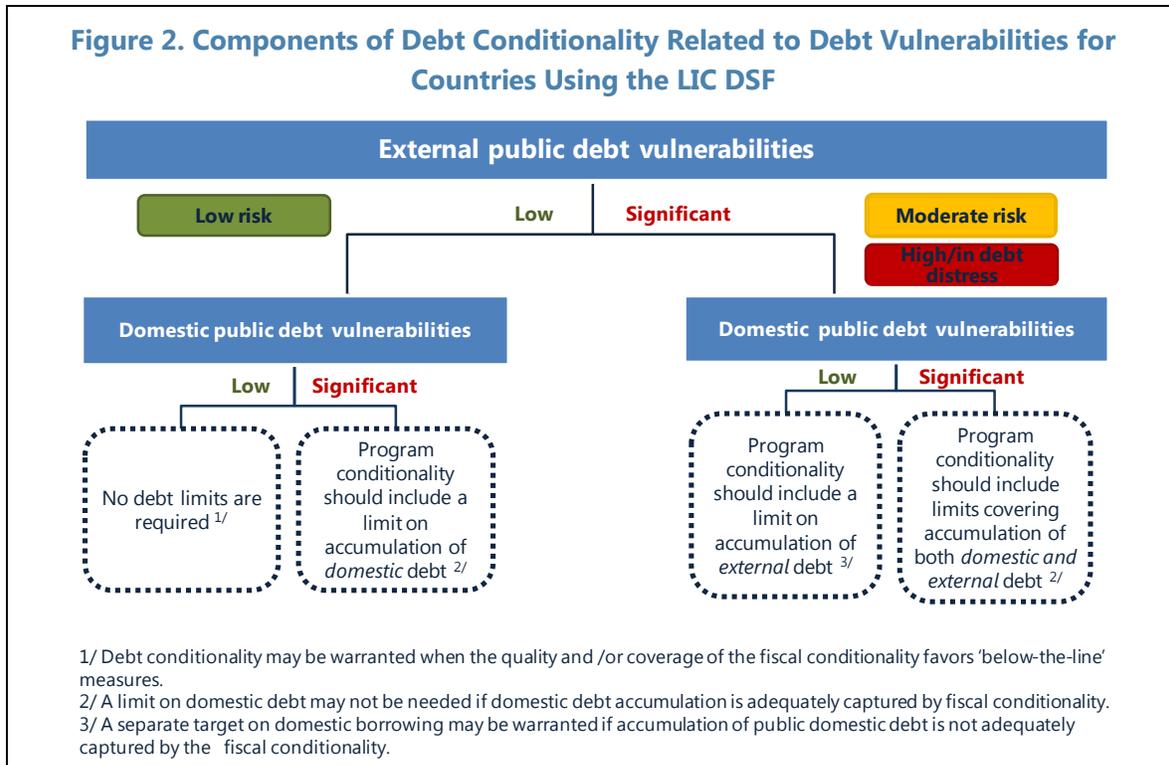
27. For countries in this group, the assessment of debt vulnerabilities is informed by the risk of external debt distress and, where relevant, the overall risk of debt distress.<sup>10</sup> An external risk rating of moderate, high or in debt distress would signal the presence of significant external debt vulnerabilities. The extent of debt vulnerabilities related to domestic debt will be determined by the analysis of the public DSA and reflected in the overall risk of debt distress, as contained in the conclusions of the LIC-DSF.

28. The use of debt limits should be aligned with the extent and nature of identified vulnerabilities (Figure 2).

- *Limits covering external PPG debt* would be required as part of program conditionality for countries deemed to be at moderate or higher risk of external debt distress. Conditionality to address external debt vulnerabilities would typically not be warranted for countries with low risk of external debt distress (See Section IV.B.)
- *Debt conditionality explicitly covering domestic borrowing* would be warranted where the overall risk of debt distress signals the presence of significant vulnerabilities related to domestic debt unless accumulation of domestic debt is already adequately captured by fiscal conditionality.

<sup>10</sup>See [Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries](#).

**Figure 2. Components of Debt Conditionality Related to Debt Vulnerabilities for Countries Using the LIC DSF**



## B. Debt Limits to Address External Debt Vulnerabilities

**29. The specific design of external debt limits is a function of the risk of external debt distress (Table 2), as outlined below;** exceptions to this guidance are discussed in the sub-sections C and D.

### Countries at Low Risk of External Debt Distress

**30. For countries assessed to be at low risk of external debt distress, the use of debt conditionality will usually not be warranted.** Provided that the fiscal conditionality is comprehensive, there will generally be no need to offset the elimination of the debt ceiling with new conditionality in other areas. In cases where debt levels are projected to increase rapidly, even while the risk of debt distress remains low, the staff report should, however, discuss the underlying reasons for the debt build-up and how related risks are being addressed under the program.

**31. A macroeconomic program that is projected to result in an increase in the risk of debt distress from low to moderate would not be precluded.** However, in such instances, the debt conditionality relevant for countries at moderate risk of external debt distress would apply (see below).

## Countries at Moderate Risk of External Debt Distress

**32. For countries assessed to be at moderate risk of external debt distress, the use of external debt conditionality is warranted; it should normally take the form of a PC on the PV of new external debt contracted.** For the purposes of setting and monitoring debt conditionality, the following considerations apply:

- Given the specification of the PC in PV terms, there are strong technical advantages in setting the PC on the contracting of new debt, rather than on new disbursements.<sup>11</sup> The former approach requires calculating only the PV of new loans contracted during the period: the latter approach would require calculating the PV of all new disbursements of loans, which would involve a much larger set of loans (contracted over several years) and hence be more difficult to monitor.
- The manner in which the PV of external debt is to be calculated is discussed in Annex II and is broadly consistent with the approach used to calculate loan concessionality under the 2009 debt limits policy.

**33. A Fund-supported program should not itself generate a shift in the external debt distress rating from moderate to high.** Such a shift could, however, arise during the course of the program due to unanticipated exogenous shocks. In such cases, staff reports should provide a clear explanation of the factors driving the deterioration in the risk of external debt distress.

## Countries at High Risk of External Debt Distress or in Debt Distress

**34. For countries assessed at high risk of external debt distress or in debt distress, debt conditionality will typically take the form of:**

- i. *A PC on the nominal level of new non-concessional external debt contracted.*<sup>12</sup>
- ii. *A PC or IT on the nominal level of new concessional external debt contracted.* The use of an IT could be justified when any overshooting of concessional debt targets is not expected to have a significant impact on debt dynamics (and hence is not so critical to achieving program objectives).<sup>13</sup>

<sup>11</sup>This argument is separate from (but incremental to) the case made in paragraph 14.

<sup>12</sup>The contracting approach replicates the approach currently used: the general case for using this approach, rather than focusing on disbursements, was discussed above. The manner in which the grant element of external debt is to be calculated is discussed in Annex II.

<sup>13</sup>As discussed in Section II, the decision for setting debt conditionality as a performance criterion or an indicative target will continue to be guided by the Fund's guidelines on program conditionality, and thus will depend on the criticality of the variable for meeting program objectives or for monitoring program implementation.

**35. Non-zero limits on non-concessional external borrowing may be allowed only under exceptional circumstances.** Such exceptions may be warranted where: a) financing is needed for a project integral to the authorities' development program for which concessional financing is not available,<sup>14</sup> or b) non-concessional borrowing is used for debt management operations that improve the overall public debt profile. In either case, program documents should provide a clear explanation of the rationale for including non-concessional borrowing.

### C. Countries with Weak Capacity to Record and Monitor Public Debt

**36. In countries where the capacity to monitor the evolution of public debt is weak, but the risk of external debt distress is moderate or high, the specification of debt limits needs to make appropriate allowance for these capacity limitations.**<sup>15</sup> The most significant weaknesses in debt monitoring capacity are likely to lie in the area of adequately capturing and tracking the contracting and disbursement of new external loans. In such cases, specification of debt limits along the following lines are warranted:

- a. A PC, specified in nominal terms, on new non-concessional external debt contracted;<sup>16</sup>
- b. A limit, again specified in nominal terms, on new concessional debt contracted. This limit would be explicitly specified in program documentation and included as a memorandum item in the standard quantitative conditionality table.<sup>17</sup>

**37. As debt management and monitoring capacity is strengthened, the specification of these limits could be modified over time to converge to the relevant debt limit in line with the country's risk of debt distress.** As a way to assist in capacity-building efforts, for countries in moderate risk of the distress a benchmark PV indicator (equivalent to the corresponding PV debt limit that could apply if the country had the capacity to monitor and record debt) could be included as a memorandum item.

Potential for a PV debt limit as incentive

<sup>14</sup>Staff judgment, drawing on available information sources, will be required to assess whether these conditions are met.

<sup>15</sup>For countries where the risk of external debt distress is low, the use of conditionality in the form of debt limits will usually not be warranted.

<sup>16</sup>The manner in which the grant element of external debt is to be calculated is discussed in Annex II.

<sup>17</sup>Through the implementation of the 2009 debt limits policy, countries have established a track record in monitoring and recording the contracting of new non-concessional loans (which have typically been few in number): monitoring weaknesses are thus likely to lie in the area of recording/monitoring new concessional loans (not previously covered by conditionality). Inclusion of the programmed level of concessional borrowing as a memorandum item in the conditionality table will ensure that the level of borrowing is henceforth tracked by staff over time and reported in program documents.

## Assessing Monitoring Capacity Constraints

**38. In assessing debt monitoring capacity, staff will draw on various sources of information.** The capacity assessment will focus on a country's ability to adequately capture and monitor the contracting and disbursement of new external loans and will be guided along the lines of the methodology discussed in Annex III.C of the Reform of the [Policy on Public Debt Limits in Fund-Supported Programs](#).<sup>18</sup> Figure 3 below provides a step by step process for updating the capacity assessment. The preliminary assessment is informed by the 3-year average CPIA Debt Policy score. A score equal or below 3 indicates potential significant weaknesses in debt data monitoring. Recent DeMPA and PEFA ratings would be taken into account, when available, to support the assessment.<sup>19</sup> A D rating in selected DeMPA or PEFA dimensions may be used to justify weak quality of debt monitoring.<sup>20</sup> The final assessment of a country's capacity to adequately monitor its debt should take into account other evidence, such as recent track record of debt monitoring, and other relevant technical assessment reports.

**39. The assessment of capacity will be undertaken by the Strategy, Policy, and Review department (SPR) in consultation with area departments and World Bank counterparts.** Every year SPR will provide the preliminary classification to country teams based on the updated CPIA scores.<sup>21</sup> Country teams will assess the country's preliminary classification and make the case for any deviation from this assessment supported by additional relevant information. SPR, in close collaboration with the World Bank, will review the country teams' assessment, for which a 5 day review period would be provided. It is expected that Fund and Bank staff would arrive at a common capacity assessment for all countries.<sup>22</sup>

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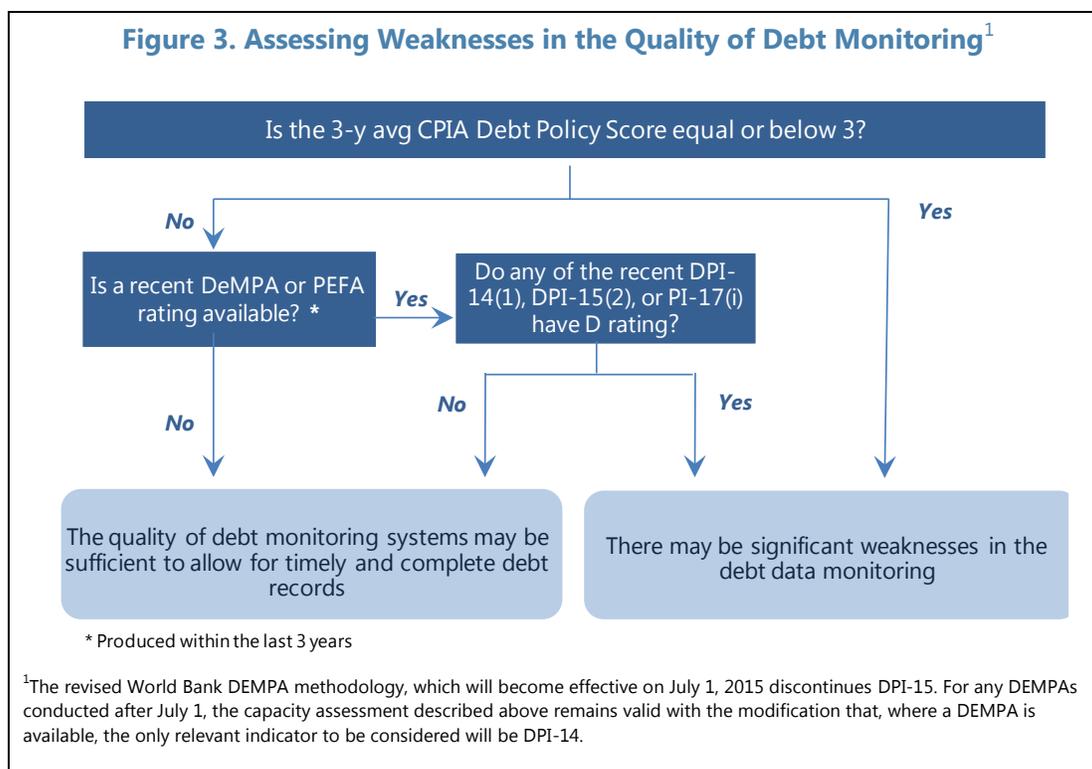
<sup>18</sup>The World Bank has recently revised the DEMPA methodology, which will become effective on July 1, 2015. Among other changes, the new methodology discontinues DP-15. For any DEMPAs conducted after July 1, the capacity assessment described above remains valid with the modification that, where a DEMPA is available, the only relevant indicator to be considered will be DPI-14.

<sup>19</sup>No older than three years.

<sup>20</sup>Published Debt Management Performance Assessment (DeMPA) reports can be found [here](#). Published Public Expenditure and Financial Accountability (PEFA) assessment reports can be found [here](#).

<sup>21</sup>Timing will coincide with the annual updates of the CPIA.

<sup>22</sup>In the event any material difference/disagreement arises, the same dispute resolution mechanism as discussed in the Annex 5 of the LIC DSF guidance note ([Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework](#)) would be sought.



## Enhancing Capacity: the Transition

**40. Countries with weak capacity in monitoring debt are expected to strengthen this capacity over the course of Fund-supported programs, with the help of adequate external assistance.** The measures to be taken to improve the country's debt monitoring capacity should be spelled out clearly in program documentation. Staff should seek to mobilize technical assistance from the Fund, the Bank, and other interested development partners to support these capacity-building efforts. Improving the authorities' capacity to collect data on and monitoring the evolution of public debt should be an explicit objective of a Fund-supported program, supported by a structural benchmark, if warranted.<sup>23</sup>

**41. Modification of the specification of debt conditionality to reflect the adequacy of the country's capacity would be undertaken only when capacity has been assessed as sufficient, using the agreed methodology.** In the event that authorities wish to graduate to the standard debt conditionality, this preference could be accommodated in the context of a program review once the required level of debt monitoring capacity has been achieved, as assessed by the methodology described above.

<sup>23</sup>Should the assessment be made, prior to the commencement of a new program, that capacity-building efforts had failed to achieve this objective, an explanation of the factors impairing the capacity building effort, and a plan for overcoming these obstacles, would be needed in making the case for an ensuing Fund-supported program.

42. The decision that a country with weak debt monitoring capacity has achieved the required capacity to adequately track and monitor the evolution of public debt, once made, should, absent exceptional circumstances, be irreversible—and hence made only when there is sufficient confidence that the improved capacity can be sustained.

#### D. Countries with Significant Links to International Capital Markets

43. There are countries that normally rely on official concessional external financing, yet have attracted significant portfolio inflows into domestic government bond markets and into external sovereign bond issues.<sup>24</sup> In such cases, drawing a sharp distinction between domestically-sourced and externally-sourced financing is difficult, with foreign investors moving in and out of domestic instruments, as well as between domestic-currency and foreign-currency bond issues. Thus, in such circumstances and where there is a moderate risk of external debt distress, there may be operational advantages to monitoring debt accumulation through a performance criterion on total nominal public debt rather than impose separate limits on domestic and external debt, based on the residency definition.<sup>25</sup> Commensurate with their greater debt vulnerabilities, conditionality in cases of countries at high risk of external debt distress would follow the guidance in paragraphs 34–35, with the proviso that the limits would be specified in terms of foreign currency debt, rather than debts incurred externally.

Debt accumulation. See new. Para 34

<sup>24</sup>This case is flagged in [Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#), paragraph 34.

<sup>25</sup>To ensure that unanticipated fluctuations in the exchange rate do not affect the monitoring of performance, the PC should be constructed on the basis of a constant exchange rate, with the exchange rate specified in the TMU.

Table 2. Choosing the Form of Debt Conditionality for Countries that Normally Rely on Concessional Financing

	WEAK quality of debt monitoring <sup>2</sup>		SUFFICIENT quality of debt monitoring	
			limited financial integration	significant links to international capital markets
Risk of external debt distress <sup>1</sup>	High	PC on nominal external NCB + Memo item on nominal external CB +  Target on domestic borrowing, if needed <sup>3</sup>	PC on nominal external NCB + <u>PC /IT on nominal external CB +</u>  Target on domestic borrowing, if needed <sup>3</sup>	PC on nominal foreign currency NCB+ PC/IT on nominal foreign currency CB+  Target on domestic borrowing, if needed <sup>3</sup>
	Moderate	PC on Nominal external NCB + Memo item on nominal external CB +  Target on domestic borrowing, if needed <sup>3</sup>	PC on PV of new external debt +  Target on domestic borrowing, if needed <sup>3</sup>	PC on total nominal public debt
	Low	The design of debt limits, if needed, would be country specific <sup>4</sup>		

<sup>1</sup>As assessed under the LIC DSF.

<sup>2</sup>Memo items are not program conditionality.

<sup>3</sup>An explicit target on domestic borrowing would be required in cases where the overall risk of debt distress indicates significant risks related to domestic public debt, and where these risks are not adequately covered by fiscal conditionality.

<sup>4</sup>No limits on external debt are required. Debt conditionality may be warranted when the quality and/or coverage of the fiscal conditionality favors 'below-the-line' measures. An explicit target on domestic borrowing would be required in cases where the overall risk of debt distress indicates significant risks related to domestic public debt, and where these risks are not adequately covered by fiscal conditionality.

## V. DEFINITION OF PUBLIC SECTOR DEBT FOR THE PURPOSES OF THE DEBT LIMITS POLICY

### A. Coverage

#### 44. For the purpose of the debt limits policy, public sector debt:

- i. **should normally cover public and publicly guaranteed debt.** However, institutional constraints and lack of data availability could justify the use of narrower sectoral coverage (e.g., central government), or focusing on specific public debt instruments (e.g., short term external debt, issuance of central government guarantees).<sup>26 27</sup>
- ii. **would typically refer to debt of the nonfinancial public sector.** This comprises debt of the consolidated central government, state governments, local governments, social security funds, as well as nonfinancial public enterprises and other nonfinancial official sector entities.<sup>28</sup> In any case, the definition of public sector debt should be made clear in program documents (e.g., in the TMUs) with any exclusions explicitly documented.

#### Treatment of Central Bank Debt and other Public Financial Institutions

**45. The inclusion of liabilities of the central bank or other public financial institutions in public debt would depend on country circumstances.** Central bank debt issued solely for monetary purposes is excluded from the definition of public sector debt. The inclusion of other liabilities of the central bank or other public financial institutions could be justified when they pose significant fiscal risks, and excluding them would undermine the effectiveness of debt limits in addressing debt vulnerabilities. Similarly, the external debt of the central bank should be included under public external debt limits if such debt contributes to external debt vulnerabilities and associated fiscal risks. In countries where the central banks also act as the agent of the government and issue treasury bonds on behalf of the government, such issuance would constitute public debt. Similarly, government borrowings from the central bank should normally be included in public debt. In general, the decision to include any financial instrument (including swaps or repo agreements) for the purposes of public debt conditionality should be based on whether they present a fiscal risk, and should be spelled out clearly in the program (TMU).

<sup>26</sup>For example, when sub-national governments have full fiscal autonomy.

<sup>27</sup>A comprehensive range of public debt instruments is provided in *Government Finance Statistics Manual 2014* (GFSM 2014) and the *Public Sector Debt Statistics: Guide for Users and Compilers* (IMF 2011).

<sup>28</sup>For the purpose of this paper, the terms “public enterprises” and “state-owned enterprises” are used interchangeably and refer to enterprises and agencies that are **owned or controlled** by the government, but are not necessarily consolidated in the budget, of the central or general government, as relevant. While ownership by the government of at least 50 percent of the shares guarantees its control over the enterprise, such control may exist even when it owns a smaller proportion (see GFSM 2014, Chapter 2 for guidance on establishing control by a government unit).

## Treatment of State-Owned Enterprises

**46. State-owned enterprises (SOEs) and other official sector entities should be covered by debt limits established under Fund arrangements.** A case for selective exclusion can be made for public enterprises and other official sector entities that may borrow without a guarantee of the government and whose operations pose limited fiscal risk to the government. The rationale is that including them in debt limits may constrain inappropriately their operations and potentially hamper investment.

**47. The decision to exclude a particular SOE should be guided by the extent of fiscal risks they pose.** Earlier Fund staff work pointed out two criteria that should be binding in the determination of fiscal risks; an enterprise should be judged to have a high fiscal risk if (i) it carries out uncompensated quasi-fiscal activities, and (ii) it has negative operating balances. Additional relevant indicators should be considered as well: SOEs' managerial independence; relations with the government; the periodicity of audits; publication of comprehensive annual reports and protection of shareholders' rights; financial indices and sustainability; and other risk factors.

## B. Defining External Public Debt

**48. The appropriate criterion to define external debt (whether residency or currency) will depend on country circumstances.** For countries that are not significantly integrated into international financial markets, the choice of currency or residency criterion for measuring external debt is not a major issue, as the two approaches are likely equivalent. However, high nonresident participation in the primary and/or secondary domestic debt markets (in both local- and foreign-currency) can challenge this equivalence. This opens the possibility that external debt defined on residency basis may not be satisfactorily monitorable under the program, or sufficiently under the control of the authorities.

**49. For countries with relatively closed financial accounts or very limited financial integration with the rest of the world, the use of the residency criterion would remain appropriate.** Nonresident acquisition of domestically-issued debt in the secondary market is expected to be very limited in this case, and it may be reasonable to exclude such debt from the definition of external debt for the purpose of the debt limits policy. In such cases, vulnerabilities associated with the excluded debt instruments would need to be addressed in the program, including, through the following safeguards (tailored to country circumstances as appropriate):

- i. The program relies on an appropriately broad concept for the fiscal deficit performance criterion, to close any definitional loopholes;
- ii. All new borrowing on the domestic market is normally in local currency;
- iii. Relevant changes are made in the program's design (e.g., higher NIR targets), if needed to mitigate vulnerabilities associated with significant nonresident holdings of domestically-issued debt;

- iv. Any secondary market transaction by nonresidents is fully reflected, to the extent possible, in the external DSA, including with an explicit assessment of the vulnerabilities potentially associated with them (e.g., higher rollover risk in the case of short-term borrowing, a potential threat to the exchange rate and/or reserves in the event of sudden withdrawals);
- v. The authorities report to the Fund the terms of new domestically-issued debt, including the currency composition, and take steps over time to improve their monitoring of secondary market transactions; and
- vi. The authorities are not signatories in transactions that involve the immediate repackaging of domestically-issued debt instruments for the sole purpose of reselling the repackaged instruments to nonresidents.

**50. For countries with an intermediate degree of integration and where the use of residency criterion becomes problematic, a currency of denomination criterion could be used.**

These are typically countries that have seen increasing nonresident ownership of their domestically-issued debt, but do not yet have regular access to international capital markets or open financial accounts. For these countries, a definition of external debt based on the residency criterion encompassing all debt held by nonresidents could be difficult for the authorities to monitor and control. In such cases, the definition of external public debt and concessionality requirements (where needed) could be applied to foreign-currency denominated public debt. However, risks from local currency debt held by nonresidents should be actively tracked and reported in the DSA. Country teams should also be mindful of the possibility that domestically-issued debt could be foreign currency indexed or that the repayment currency may not be the same as the currency of issuance.

## Annex I. Borrowing Plan and Interaction with Debt Limits

### A. What is a Borrowing Plan?

1. **A borrowing (or financing) plan is an integral component of a country's fiscal program, and hence of the planned macroeconomic policy framework.** Regardless of a country's financing mix, a borrowing plan underlying the financing of a planned fiscal deficit is usually prepared. Its design is determined by several factors, including: the appropriateness of the underlying fiscal deficit from a demand management perspective; the compatibility of the borrowing plan with maintaining debt sustainability over the medium-term; the consistency of the projected trajectory of public investment and savings; and the feasibility of implementing envisaged investment programs given capacity constraints. A description of the key features of a country's borrowing plan is expected to be included in program documentation.<sup>1</sup>
2. **The key features of a borrowing plan depend on a country's financing circumstances,** including the degree of financial market integration and the extent to which the borrowing plan covers typical budgetary financing or financing of public investments deemed critical for growth. Key features include the breakdown of the sources of new borrowings across different characteristics: financing terms (including concessionality mix); maturities and currency composition; and uses of financing (relevant where a significant share of financing is destined to investment projects). Information related to the design of debt conditionality, e.g., indicators of PV of debt or indicators of currency composition (where debt limits are used to address vulnerabilities from exposure to currency risks) would also be relevant in assessing the implementation of the borrowing plan.
3. **The borrowing plan to be disclosed in program documentation would need to preserve the confidentiality nature of some information.** Adequate flexibility and discretion should be provided to avoid unduly limiting the country's ability to secure the most favorable terms on current and future debt negotiations. While disclosure of specific financing terms is not required, some sensitive information could be derived in cases where disclosure of concessionality requirements (e.g., the PV of debt) is a key element in the borrowing plan and where the borrowing plan only includes a small number of loans. In this case, the level of disaggregation of the information should be carefully tailored to avoid unintentional disclosure of sensitive information.

<sup>1</sup>As indicated in the [Reform of the Policy on Public Debt Limits in Fund-Supported Programs](#), program documentation refers to authorities' Letter of Intent (LOI) and Memorandum of economic and financial policies (MEFP) or the accompanying staff report.

## B. Role in Setting Debt Limits

4. **As discussed in Section II, a borrowing plan is a key component in deriving quantitative debt limits.** It plays an important role in the process of assessing and deriving the appropriate level of borrowing underlying a debt limit in any country.

5. **Borrowing plans would also have a role in the assessment of implementation of debt conditionality in program reviews.** A nonobservance of debt conditionality would require an assessment of the circumstances leading to it (e.g., whether there was a change in the projected financing mix or the level of new borrowing accommodated under the debt limit). To this end, depending on the specific circumstances, the assessment of the implementation of the components of the borrowing plan would help in determining the cause of the nonobservance and point to modifications needed to the program.

## C. Presentation of Borrowing Plans in Program Documents: Illustrative Examples

6. **The examples below provide an illustration of the most general cases that can be identified depending on the financing characteristics:** countries with limited or no access to concessional financing and countries relying primarily on concessional financing. These are not meant to be exhaustive.

### Countries that do not Normally Rely on Official Concessional Financing

7. **Example A illustrates the borrowing plan of a country in which** (i) there is no project financing and all borrowing is untied for budgetary purposes only; (ii) has no access to concessional financing; and (iii) public debt vulnerabilities are primarily related to large rollover needs. Hence, the debt conditionality is designed to address rollover risks by constraining the issuance of short-term debt. Consistent with the characteristics of the country the borrowing plan and debt limits are presented in nominal terms.

<b>(US\$million)</b>	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
<b>Financing Needs</b>	100	80	60
<b>Uses of debt financing</b>			
Budget financing	100	80	60
<b>Financing Sources</b>			
Short Term	10	5	3
Medium-Long Term	90	75	57

8. Based on this borrowing plan staff can assess whether the realized pattern of debt accumulation was consistent with program expectations regarding constraining rollover risks and ascertain the implications for the program if there were any deviations. Similarly, where public debt vulnerabilities are related, e.g., to foreign currency borrowing, a breakdown between FX and local currency issuance would be shown in the summary table.

### Countries that Normally Rely on Concessional Official External Financing

9. Example B below provides an illustrative borrowing plan of a country: i) relying primarily on concessional external financing with some non-concessional loans foreseen, and where ii) the bulk of financing is used for financing infrastructure projects with only a small portion going directly to budget financing (in this case representing a sovereign bond issuance); and iii) no domestic financing is envisioned. In this case, the external borrowing plan of the country gives a fairly detailed breakdown of the sources of external financing and its main uses, key features for the design and assessment of debt conditionality in this country. As discussed in paragraph 3, when the borrowing plan entails only one loan under one specific category, sensitive information about financing terms could be unintentionally disclosed. To avoid this risk, the presentation of the borrowing plan in program documents could remove the creditor by creditor details of the PV of debt and present only the aggregate PV values.

Avoid disclosing details of PV

<b>Example B. Summary Table on External Borrowing Program</b>		
<b>PPG external debt contracted or guaranteed</b>	Volume of new debt, US million 1/	Present value of new debt, US million 1/
<b>Sources of debt financing</b>	<b>100</b>	<b>62</b>
Concessional debt, of which 2/	65	33
Multilateral debt	35	14
Bilateral debt	30	19
Non-concessional debt, of which 2/	35	29
Semi-concessional debt 3/	20	14
Commercial terms 4/	15	15
<b>Uses of debt financing</b>	<b>100</b>	<b>62</b>
Infrastructure	75	44
Budget financing	25	18
<i>Memorandum items</i>		
Indicative projections		
Year 2	100	60–65
Year 3	120	72–78
1/ Contracting and guaranteeing of new debt. The present value of debt is calculated using the terms of individual loans and applying the 5 percent program discount rate.		
2/ Debt with a grant element that exceeds a minimum threshold. This minimum is typically 35 percent, but could be established at a higher level.		
3/ Debt with a positive grant element which does not meet the minimum grant element.		
4/ Debt without a positive grant element. For commercial debt, the present value would be defined as the nominal/face value.		

35 % minimum threshold

## Annex II. Technical Considerations in Setting and Monitoring Debt Limits

### A. Relevant Issues for Countries that Normally Rely on Official External Concessional Financing

#### Calculating the Present Value (PV) and Grant Element of (GE) External Debt<sup>1</sup>

**1. For the purpose of setting and monitoring debt limits, the following will apply:**

- **The calculation of the PV and GE** will be based on the [Fund’s concessionality calculator](#).
- **A single discount rate is used and set at 5 percent.** The level of the discount rate will be reviewed during next review of the LIC DSF by the Executive Boards of the Bank and the Fund.<sup>2</sup>
- **The calculation of the PV and GE will be based on the loan amount contracted** in a given year. Specifically, it will be assumed that all new loans contracted are fully disbursed at the time when they are contracted. A loan, therefore, will contribute to an annual PV target on debt accumulation only in the year during which it is contracted.
- **For loans with a grant element equal or below zero,** the PV will be set equal to the nominal value of the loan.
- **For loans carrying a variable interest rate,** a “program reference rate” will be specified in the program documents (e.g., the TMU). This rate would be based on staff’s “average projected rate” for the six-month USD LIBOR over the following 10 years. The average projected rate will be updated annually on the Fund’s concessionality calculator, based on the fall vintage of the World Economic Outlook (WEO). The program reference rate would be set equal to the most recently available average projected rate and will be fixed for the duration of the program. The PV of the loan would be calculated using the program reference rate, plus the fixed spread (in basis points) specified in the loan contract. Where the variable rate is linked to a benchmark interest rate other than the six-month USD LIBOR, a spread reflecting the difference between the benchmark rate and the six-month USD LIBOR (rounded to the nearest 50 bps) will be added.

#### Assessing the Concessionalities of Financing Packages

**2. In the context of program monitoring, Fund staff may assess on a case-specific basis whether an envisaged combination of financing instruments can be treated as a package for**

<sup>1</sup>The present value (PV) of public external debt is equal to the sum of all future debt service payments (principal and interest), discounted to the present using a set discount rate. The grant element (GE) measures the concessionality of a loan and is the difference between the nominal and the present value, expressed as a percentage of the nominal value.

<sup>2</sup>IMF (2013), [“Unification of the Discount Rates Used in External Debt Analysis for Low-Income Countries.”](#)

**purposes of meeting conditionality under Fund-supported programs.** A number of elements are taken into consideration to determine whether a financing package in any particular case can be regarded as an integrated incurrence debt for the purposes of the debt ceilings. The list below illustrates several of the most important taken into consideration to support the determination:

- Identical intended use or purposes for the financing;
- Inter-related schedules for disbursement;
- Cross-conditions for:
  - entry into legal effect (for example, whether the contracting or guaranteeing of the debt is conditional upon the provision of the grant);
  - availability of funds (for example, whether the availability of loan disbursements is contingent on release of scheduled grant disbursements); and
  - default (for example, whether default in one of the contracts is considered default on other contracts); and
- Identical parties to the financing.

**3. Once the components have been determined to constitute an integrated package of debt, the overall concessionality of the package is calculated using the weighted average of the grant elements of its various components.** If, however, the financing package is not found to be integrated, the concessionality of each element of the package will be assessed individually.

### **Treatment of Grants in Setting Debt Conditionality**

**4. The inclusion of grants in a PV target would not affect the PV limits given that the present value of grants is zero.** In theory, the change of an envisaged concessional loan into grants could create some space to contract more non-concessional loans, but grants tend not to be substitutes for concessional loans in terms of size and targeting sector.

## Addressing Uncertainties in the Projection of Present Value of Debt

**5. Uncertainty about financing terms of loans could introduce uncertainty on the projected present value of new debt to be contracted. In many instances,** the precise financing terms of loans assumed in a borrowing program may still be under negotiation at the time program conditionality is being set. This creates uncertainty about the actual PV of a particular loan that, even without any change in the total nominal loan amount, could generate deviations from the originally-envisaged PV debt target. Given this uncertainty, the use of an adjustor on debt conditionality set in PV terms may be warranted. Recognizing that deviations may come from one large loan or a few number of small/medium loans, program conditionality could accommodate moderate changes to the debt limit set on PV terms and use an adjustor of up to 5 percent of the new borrowing in PV terms (i.e., the envisioned debt limit) only when deviations are prompted by an unexpected change in the financing terms of a loan or loans.

## B. Relevant Issues for All Countries

### Effectives of a Loan

**6. For the purposes of setting and monitoring debt conditionality, the assessment of when a loan becomes effective will be based on country-specific definitions,** reflecting the application of the national decision-making processes (e.g., in some countries, the relevant date is when a loan is approved by the highest relevant decision-making unit in the government, while in other it is when a parliament approves the loan). Since country practices differ on the procedures to be followed in regard to the contracting of public external debt, program documentation (e.g., TMUs) should make every effort to include a specific definition as to the precise stage in these processes at which, for program purposes, the debt is viewed as having been contracted. If no specific definition is included in the program documents, a debt will be deemed contracted in accordance with the terms of the contract and as determined by the law applicable to such contracts.

### Treatment of Credit Lines

**7. Credit lines with uncertain disbursement schedules or allowing for multiple disbursements should be included in debt conditionality on a contracting basis.** Credit lines usually make available funds that can be disbursed at any time upon the borrower's demands. As such, the disbursement schedule is not determinable at the time debt conditionality is set. In such cases, staff is expected to discuss with the authorities the expenditures to be financed by the credit lines up to its expiration date. When disbursements can take place over multiple years, annual sub-limits on maximum disbursements under the credit line could be established based on the most likely disbursement schedule.

## Annex III. Use of Program Conditionality for Countries Using the MAC DSA: Recent Practice

### General Resource Accounts

**1. Analysis of the recent GRA cases suggests that the current practice in general fits well with the proposed framework (Table AIII 1).<sup>1</sup>** In line with the interpretations of the heat map indicators provided in section III, about one half of the sample could be qualified as having significant debt vulnerabilities. To address these vulnerabilities, the programs included some form of conditionality controlling for debt accumulation. Overall public debt limits combined with a target on public guarantees have been in place in Greece, Cyprus, and Jamaica, where all three heat map rows were flashing red. In other cases (Jordan, Albania Ukraine, Pakistan) debt accumulation was captured by the fiscal conditionality defined 'below-the-line'. Program conditionality with Seychelles and Armenia included targeted limits to address specific vulnerabilities. Debt conditionality on sub-components of debt were also included in Romania and Bosnia and Herzegovina (these countries were classified as lower scrutiny for the purpose of the MAC DSA, and therefore no heat maps were required) to address targeted debt vulnerabilities not covered by the fiscal conditionality (the composition of debt and issuance of public guarantees).

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<sup>1</sup>The table presents a summary of GRA program countries active as of end-2014.

Table AIII 1. Debt Vulnerabilities and Program Conditionality in Recent GRA Arrangements

Country (Staff Report Issuance Date)	Did the MAC DSA suggest presence of significant debt vulnerabilities?					Elements of program conditionality capturing debt accumulation			
	Assessment based on the heat map indicators	Selected MAC DSA results				Limit on overall public debt	Limit on subcomponent of public debt	Limit on public guarantees	Fiscal conditionality measured from "below the line"
		Debt level above the benchmark? (1st row is red)	GFN are above the benchmark? (2nd row is red)	Any of the debt profile indicators is red?	Spread between the peak debt level and the benchmark				
<b>Greece</b> (May -14)	Yes	√	√	√	89	√		√	
<b>Cyprus</b> (Dec-13)	Yes	√	√	√	41	√		√	
<b>Jamaica</b> (June-14)	Yes	√	√	√	77	√		√	
<b>Jordan</b> (Apr-14)	Yes	√	√		21				√
<b>Albania</b> <b>(Feb-14)</b>	Yes	√	√		2				√
<b>Ukraine</b> (Dec-13)	Yes		√	√	-10			√	√
<b>Pakistan</b> (Dec-13)	Yes		√		-4		√		√
<b>Seychelles</b> (May-14)	Yes		√	√	-5		√	√	
<b>Armenia</b> (Feb-14)	No			√	-24				√
<b>Morocco</b> (Jan-14)	No				-7				
<b>Georgia 1/</b> (Aug-14)	No								√
<b>Romania 1/</b> (Mar-14)	No							√	
<b>Tunisia 1/</b> (Sep-14)	No								√
<b>Bosnia and Herzegovina 1/</b> (Apr-14)	No						√		√

1/ Countries classified as lower scrutiny for the purpose of the MAC DSA are not required to report a heat map.