



The International Development Association's Sustainable Development Finance Policy

An Early-Stage Evaluation



IEG
INDEPENDENT
EVALUATION GROUP

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ATTRIBUTION

Please cite the report as: World Bank. 2021. *The International Development Association's Sustainable Development Finance Policy. An Early-Stage Evaluation*. Independent Evaluation Group. Washington, DC: World Bank.

COVER PHOTO

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November 10, 2021

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Abbreviations

COVID-19	coronavirus
DeMPA	Debt Management Performance Assessment
DPO	development policy operation
DSA	debt sustainability analysis
DSEP	Debt Sustainability Enhancement Program
DSSI	Debt Service Suspension Initiative
FY	fiscal year
G-20	Group of Twenty
GDP	gross domestic product
IDA	International Development Association
IDA19	19th Replenishment of the International Development Association
IEG	Independent Evaluation Group
IMF	International Monetary Fund
LIC	low-income country
LIC DSF	Debt Sustainability Framework for Low-Income Countries
MAC DSA	Debt Sustainability Framework for Market Access Countries
MDRI	Multilateral Debt Relief Initiative
NCBP	Non-Concessional Borrowing Policy
PCO	Program of Creditor Outreach
PIM	public investment management
PPA	performance and policy action
SDFP	Sustainable Development Finance Policy

SOE state-owned enterprise

All dollar amounts are US dollars unless otherwise indicated.

Acknowledgments

This report was prepared by an Independent Evaluation Group team led by Jennifer Keller (senior economist) and including Daniel Nogueira-Budny (public sector specialist), Yumeka Hirano (economist), Malvina Pollack (consultant), and Christopher Towe (consultant). Research support was provided by Anna Amato and Ying Li (consultants). Patricia Acevedo, Carla Coles, and Dung Thi Kim Chu provided administrative support. The report was carried out under the direction of Jeffrey Allen Chelsky (manager) and Oscar Calvo-Gonzalez (director), and the overall guidance of Alison Evans (vice president and Director-General, Evaluation).

The report was peer reviewed by Sudhir Shetty (nonresident fellow at the Center for Global Development and former chief economist for the East Asia and Pacific Region of the World Bank), Pamella McLaren (head of debt management, Commonwealth Secretariat), and Mark Lewis (assistant director, Institute for Capacity Development at the International Monetary Fund). The team appreciates the support received from the International Development Association team in the Development Finance Vice Presidency; the Global Macro and Debt Unit in the Equitable Growth, Finance, and Institutions Vice Presidency; country economists and practice managers in the Macroeconomics, Trade, and Investment Global Practice; and International Monetary Fund mission chiefs and desk economists during the preparation of the report, as well as helpful comments from Independent Evaluation Group colleagues.

Key Findings and Recommendations

The World Bank's Sustainable Development Finance Policy (SDFP) was conceived as part of 19th Replenishment of the International Development Association (IDA) to help IDA-eligible countries achieve and maintain debt sustainability by incentivizing their move toward transparent, sustainable financing and by promoting coordination between IDA and other creditors in support of countries' efforts (World Bank 2020a). In the context of rising debt distress, which could jeopardize IDA-eligible countries' ability to meet their development goals, the 19th Replenishment of IDA's deputies asked for options for expanding and adapting IDA's allocation and financing policies to support countries' development agendas while minimizing risks of debt distress.

The SDFP responds to recommendations from reviews of its predecessor policy, the Non-Concessional Borrowing Policy, by expanding country coverage to include all IDA-eligible countries. It broadens the coverage of public debt to include domestic borrowing, which played a significant role in the rapid rise in debt stress over the past decade. It provides a mechanism for articulating performance and policy actions (PPAs) and incentives to address country-specific drivers of debt stress.

It is too early to evaluate several aspects of the SDFP and its implementation, not least because of challenges associated with rolling it out under adverse conditions due to the coronavirus (COVID-19) pandemic. The extent to which the set-aside incentives will influence country actions has not yet been tested, although questions about the design can be posed legitimately at this early stage. Similarly, there is little if any experience with the enhanced Program of Creditor Outreach. However, previous experience with creditor coordination, including in the context of the Non-Concessional Borrowing Policy, points to a need to clarify the Program of Creditor Outreach's mandate and ambition.

Drawing on early experience with the implementation of the new policy provides an opportunity to improve both the design and the implementation of the SDFP. The Independent Evaluation Group identified several areas that may strengthen the SDFP in its objectives of promoting transparent, sustainable financing and improved coordination with creditors in IDA-eligible countries. The screening of IDA-eligible countries to determine which countries should implement PPAs needs to better reflect the speed at which many of these countries have moved to higher levels of debt distress and therefore help avoid the risks of excluding potentially vulnerable countries. The experience so far also shows that PPAs could target the most important country-specific drivers of debt stress more systematically and that the frequent use of one-time actions in PPAs may have bypassed opportunities to promote institutional changes that could have more enduring impact.

Recommendations

This evaluation has identified several opportunities to strengthen SDFP effectiveness:

1. Consideration should be given to expanding the countries covered by the Debt Sustainability Enhancement Program beyond those at moderate or high levels of debt distress or in debt distress. Countries at low risk of debt distress, which are currently not required to implement PPAs, can shift into higher levels of risk in a relatively short time. In fact, one-third of the countries that experienced an elevation in their risk of debt distress over the past decade experienced a two-level deterioration in less than three years. A low level of debt distress alone should not be sufficient for exclusion from the Debt Sustainability Enhancement Program, and the Independent Evaluation Group recommends applying an additional filter.
2. PPAs should emanate from an up-to-date assessment of country-specific debt stress and be set explicitly within a longer-term reform agenda. PPAs should target the main country-specific drivers of debt stress and risk. Standard PPAs applied across countries (including nonconcessional borrowing ceilings and requirements that PPAs be spread across multiple topics) should be avoided because they run counter to ensuring that actions target country-specific priorities and could crowd out more impact-

ful actions. PPA notes should situate PPAs within a longer results chain and articulate complementary and subsequent actions needed to ensure impact. This should be done even when the World Bank does not provide support for next steps because the articulation of a results chain linking actions needed for impact can provide important signals to development partners and help build domestic support for future actions.

3. Where PPAs support actions that need to be taken regularly (for example, debt reporting to parliament), they should aim for long-lasting institutional reforms rather than relying on one-time actions. PPAs should seek to institutionalize good practice in fiscal and debt management by supporting the establishment of statutory requirements, the existence of which can help depoliticize future decisions. Inclusion of one-time measures that need to be repeated yearly should be avoided (even if supported by subsequent PPAs) unless they clearly bridge to more permanent solutions.

Management Response

Overall

Management notes with satisfaction the overall finding of the report which is that the Sustainable Development Finance Policy (SDFP) is an improvement over its predecessor, the Non-Concessional Borrowing Policy, on several fronts. This includes the expanded country coverage, broadened treatment of public debt, a mechanism for articulating Performance and Policy Actions (PPAs), and incentives to address country-specific drivers of debt distress. Management acknowledges the report's assertion that it is too early to evaluate the impact of the SDFP and its key aspects, such as the Program of Creditor Outreach and the set-aside incentives of the Debt Sustainability Enhancement Program (DSEP). Management also appreciates the report's recognition that staff and management have already recognized areas for improvement in design and implementation raised in this evaluation and are in the process of addressing them. Management has indeed prioritized learning and adaptation during the first year of implementation of the policy, and important lessons have been addressed in the updated SDFP Implementation Guidelines, issued in May 2021. Due to the compressed timeline of this evaluation, these guidelines were not used to inform the findings and recommendations of this report. Following this evaluation, detailed guidance, templates, and other staff resources are being updated as needed in the intranet portal dedicated to the SDFP.

Context

Management underscores the extraordinary circumstances during the SDFP's first year of implementation and finds that the analysis could have been more context sensitive. The first year of implementation took place amid the coronavirus pandemic (COVID-19), which resulted in lockdowns and restricted mission travel that significantly affected the rollout of the policy. Eligible countries focused primarily on establishing crisis response plans and were affected by one of the largest exogenous economic shocks in decades.

This context created a particularly difficult environment for policy dialogue and capacity building, making consultation, formulation, implementation, and verification of PPAs even more challenging. Although the report emphasizes the need to prepare PPAs on fiscal consolidation, many countries had to provide fiscal stimuli to cope with increased gross financing needs due to falling revenues and rising expenditures. Given the situation, management applied country-tailored approaches that balanced ambition with realism and accounted for institutional capacities. Some PPAs have an immediate impact on reducing debt distress, whereas many others will have medium- to long-term effects on the country's debt sustainability. PPAs aiming at debt transparency potentially play a role in creating an enabling environment for future debt distress reduction.

Management emphasizes that PPAs should be understood in the context of other debt-related initiatives and instruments addressing debt vulnerabilities. The evaluation's goal was to assess the effectiveness of the SDFP's PPAs in addressing debt vulnerabilities and the rise in debt-related risks in countries eligible for International Development Association (IDA) assistance. It is important to remember, though, that the SDFP is only one aspect of a range of global initiatives designed to deal with debt vulnerabilities. IDA plays a key role in the international effort to address debt vulnerabilities in IDA countries, together with the Group of Twenty's Debt Service Suspension Initiative (DSSI) and Common Framework, and in close collaboration with the International Monetary Fund (IMF). The DSSI, extended until end-2021, has provided 43 IDA countries with \$5.7 billion in debt service suspension during 2020, creating liquidity and fiscal space to address the coronavirus crisis. Beyond the DSSI, the Group of Twenty endorsed the Common Framework at the end of 2020 to provide debt treatment, including net present value reductions if necessary. These initiatives complement IDA's ongoing support to countries to confront their debt vulnerabilities through a comprehensive policy tool kit comprising the World Bank–IMF Multi-Pronged Approach, the interrelated policy commitments covering debt transparency from the 19th Replenishment of IDA (IDA19), domestic revenue mobilization and infrastructure governance, and the PPAs being implemented through the SDFP—often in synergy with the World Bank's development policy financing (DPF). During its first year of implementation, the SDFP supported the im-

plementation of the DSSI, aiming at monitoring spending, enhancing public debt transparency, and ensuring prudent borrowing, as well as proactively contributing to efforts in the context of the ongoing Common Framework for debt treatment. In addition, for greater transparency, the World Bank launched the DSSI web page, which offers a country-by-country accounting of DSSI participants and the amounts they owe to creditors based on information from the World Bank's International Debt Statistics (IDS) database.

Sustainable Development Finance Policy Review

Management recognizes the potential tensions between PPA adherence and increased IDA commitments, and has, therefore, put a robust governance structure in place. Since implementation has just commenced and the tension exists, the World Bank has put in place a robust governance structure, combining technical and operational expertise on debt issues. The PPA review process includes collaboration with client countries and several thorough reviews during the formulation of PPAs to ensure the proposed actions are robust and realistic, given the countries' implementation capacities. The review process also aims to ensure equity of treatment, taking into consideration the countries' most pressing debt vulnerabilities. A multilayered approach was adopted systematically to enhance the relevance of the PPAs in addressing the countries' key debt vulnerabilities over a medium- to long-term horizon. The annual assessment verification mechanism put in place by IDA ensures that countries are monitored for effective implementation of actions, within the agreed timeline.

Moving Forward

The suggested IDA20 debt policy commitments further increase support to countries to address debt vulnerabilities and rebuild from the economic crisis caused by the coronavirus pandemic to achieve sustainable outcomes.¹ Enhancing debt transparency and improving fiscal risk assessments requires recurring and programmatic assistance to ensure that capacity is built gradually, but sustainably, and that institutional and legal setups provide effec-

tive frameworks for progress. IDA19 built the foundation for transparency and fiscal risk assessments, focusing on supporting countries to build solid foundations. IDA20's policy commitments advance the quality of expected outcomes, shifting the focus away from enhancing transparency through the publication of debt reports to strengthening their comprehensiveness by including additional subsectors of the public sector, including state-owned enterprises, and by focusing on comprehensive fiscal risk statements that help identify, assess and mitigate key risks and vulnerabilities.

Management will intensify activities under the Program of Creditor Outreach to support implementation of the SDFP, advancing dialogue on sustainable financing and facilitating coordination with traditional and nontraditional creditors. The Program of Creditor Outreach will reach out to development partners to establish shared principles in three main areas: (i) transparency and information sharing; (ii) sustainable financing policies; and (iii) creditor coordination. Outreach initiatives with the IMF, multilateral development banks, and international finance institutions (IFIs) on debt and financing policies will continue in the context of annual multilateral development bank meetings. Similar outreach initiatives are being planned with traditional and nontraditional creditors. As an example, IDA facilitated a High-Level Roundtable on Sustainable Development Finance at the end of September 2021, which included Paris Club and non-Paris Club creditors, multilateral development banks, and the private sector. Furthermore, country- and regional-level outreach will aim to promote dialogue on sustainable financing with development partners.

Management believes that the DSEP offers sufficient flexibility to expand country coverage when appropriate, and therefore, considers it to be premature to adjust parameters for the countries' obligation to implement PPAs (recommendation 1). The DSEP is a dynamic program, illustrated by the fact that the number of countries preparing PPAs increased from 55 in fiscal year (FY)21 to 60 in FY22. Management, therefore, does not find sufficient justification for the conclusion that the screening process for the DSEP coverage did not fully reflect the speed at which IDA-eligible countries have moved from lower to higher risk of debt distress. Although there have indeed been several examples of countries that experienced a rapid deterioration in debt distress, changes to the SDFP are not seen as warranted, since the annual

Debt Sustainability Analysis of all eligible IDA countries already encompasses measures for a wide array of financial, fiscal, and economic vulnerabilities. Furthermore, large debt accumulation could trigger PPAs in all IDA countries under the SDFP, even in countries currently at low risk of debt distress. A key principle of the SDFP is that criteria for countries to prepare PPAs should be clear and consistent. Including additional criteria for inclusion may increase unpredictability and risk unnecessarily complicating the process.

In line with its efforts toward greater outcome orientation, management fully adheres to the principle of placing PPAs explicitly within a longer-term reform agenda built on an up-to-date assessment of country-specific debt stress (recommendation 2). Given that this principle is foundational to the SDFP, FY21 PPAs were carefully calibrated to countries' implementation capacity across the spectrum of client countries, including small states and fragile and conflict-affected states. Given the significant fiscal constraints faced by governments to cope with the coronavirus pandemic, many PPAs were focused on debt management (mainly debt ceilings) and debt transparency,² both of which are critical to reduce debt vulnerabilities. Management finds non-concessional borrowing ceiling PPAs for red-light countries (particularly those without significant market access) particularly warranted in the current context. Even if these countries have debt limit requirements (for example, through IMF programs), having a nonconcessional borrowing ceiling PPA is important to advocate with creditors for more concessional terms, by highlighting the incentive of the set-aside mechanism. Management also clarifies that there is no requirement or incentive for countries to establish PPAs in more than one DSEP area and thus many did not. In forthcoming PPA cycles management will continue to target countries' most important sources of debt vulnerability and will strive to set PPAs as programmatic engagements in relation with other World Bank support, for example DPFs, over a medium-term horizon, all in close collaboration with country authorities and with due consideration to the context in individual countries.

Management agrees that, whenever possible, PPAs should aim for long-lasting institutional reforms rather than relying on one-time actions (recommendation 3). Management fully shares the view that PPAs formulated as one-time actions underuse synergies for larger institutional changes, yet the unprecedented global context of FY21 made the promotion of institutional

change untimely in many countries. Notwithstanding this constraint, about 80 percent of DSEP countries examined by the SDFP committee had at least one PPA with programmatic actions, often with a view to ensuring sustainability of ongoing reforms, that are most often also supported by DPFs or other World Bank instruments. The programmatic PPAs facilitate engagement with government authorities by laying out a medium-term agenda progressively to tackle debt vulnerabilities. Compared with the past, policy discussions on debt and on actions needed to mitigate long-standing vulnerabilities are now a core component of country dialogue and of annual country programming. In the ongoing and forthcoming PPA cycles, management aims to deepen the reforms supported by PPAs and other World Bank interventions in the previous years so that, over time, countries achieve lasting improvements in their outlooks toward fiscal and debt sustainability.

¹ This includes supporting more comprehensive reporting of public and publicly guaranteed debt and publication of fiscal risk statements.

² Specifically, 82 percent of countries agreed to implement at least one Performance and Policy Action on debt management, and 76 percent of countries at least one Performance and Policy Action on debt transparency.

Report to the Board from the Committee on Development Effectiveness

The Committee on Development Effectiveness met to consider the Independent Evaluation Group (IEG) evaluation entitled *The International Development Association's Sustainable Development Finance Policy: An Early-Stage Evaluation* and the draft management response.

The committee welcomed the report and noted that, although it was too early to evaluate the outcomes of the Sustainable Development Finance Policy (SDFP), the early assessment provided a strong and timely narrative and helpful inputs to strengthen the policy's effectiveness and inform the upcoming discussions for the 20th Replenishment of the International Development Association (IDA). Members commended management for the effective rollout of the policy, especially given the extraordinary circumstances under which the policy has been implemented.

Members noted management's full agreement with the principle of placing Performance and Policy Actions (PPAs) explicitly within a longer-term reform agenda built on an up-to-date assessment of country-specific debt stress (recommendation 2) and for PPAs, whenever possible, to aim for long-lasting institutional reforms rather than relying on one-time actions (recommendation 3). They appreciated management's commitment to work closely with country authorities and take into account individual country capacity to ensure that PPAs address country-specific vulnerabilities, are set explicitly within a longer-term reform agenda, and aim for long-lasting institutional reforms.

Many members expressed their agreement with IEG's recommendation for management to consider augmenting Debt Sustainability Analysis results with other filters that focus on prevention of debt risks in the case of countries considered to be at low risk of debt distress (recommendation 1), given the rapidity with which countries may jump several levels in terms of their debt risk. Although this need not necessarily include all IDA-eligible

countries, members agreed that the requirement for PPA implementation should not rely solely on the Debt Sustainability Analysis, given potentially optimistic bias. Management highlighted its disagreement with the recommendation and cautioned that prematurely applying additional filters to expand countries covered by the Debt Sustainability Enhancement Program could contradict the key SDFP principle that the criteria should be clear and consistent, noting that the policy’s criteria were already clear and comprehensive, and the program was dynamic with robust governance arrangements on the process for approving PPAs and implementation. Furthermore, management considered that the increase in the number of countries with PPAs from 55 in fiscal year 2021 to 60 in fiscal year 2022 illustrated the comprehensiveness of the tool and underscored that it did not find it necessary or appropriate to change the criteria at this time. However, seeing merit for management to consider expanding the criteria for excluding countries from the Debt Sustainability Enhancement Program—provided carefully drafted criteria is used to ensure that only countries at risk of moving to higher categories of risk are additionally captured—members encouraged management and IEG to further discuss the intent of the recommendation.

The committee appreciated learning that management had begun addressing many areas for improvement regarding the SDFP design and implementation, including updating staff guidance and templates to ensure a more consistent understanding of critical tools for sustainability, even-handedness, and transparency. Members were also pleased to hear that, overall, the SDFP is an improvement over its predecessor, the Non-Concessional Borrowing Policy; that it provides a mechanism for articulating PPAs and incentives to address country-specific drivers of debt stress; and that in the first year of its implementation, the majority of adopted PPAs responded to key drivers of debt vulnerabilities and were likely to make positive contributions.

While acknowledging that it was too early to evaluate the Program of Creditor Outreach (PCO) and that the SDFP might not be the right tool to bring all creditors to the table, members emphasized the importance of the PCO and expressed concern regarding the PCO’s achieved progress. They encouraged management to more clearly define the PCO ambition and objective and asked management to explain how it assesses the capacity of low-income countries to report on debt data accurately in the environment of the grow-

ing borrowings from nontraditional creditors. Because it is one of the two pillars of the SDFP, they also stressed that the PCO should be given higher importance and urged management to be more proactive and, together with the International Monetary Fund, use their role as mediators to facilitate progress in this field.

1 | Introduction

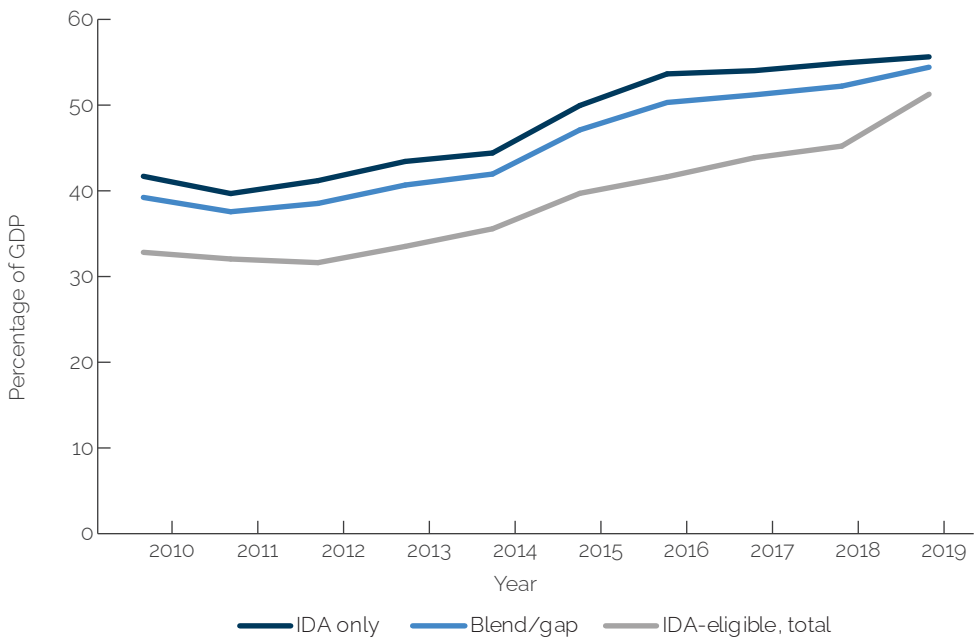
This report is an early-stage evaluation of the International Development Association (IDA) Sustainable Development Finance Policy (SDFP). The Independent Evaluation Group (IEG) prepared the report at the request of the Committee for Development Effectiveness of the World Bank Group's Board of Executive Directors to provide timely input to strengthen the SDFP's effectiveness. The urgency of ensuring an effective SDFP rollout is heightened by the compounding effect on debt stress that many IDA-eligible countries face because of the coronavirus (COVID-19) pandemic's economic impact. Its findings will also help inform discussions in the context of the 20th Replenishment of IDA.

The evaluation provides an assessment of the SDFP's design, early rollout, and initial country-level application, with the aim of identifying opportunities to strengthen the policy and its implementation. Given its early stage, process and guidance are often being devised in real time, and World Bank staff and management are learning from experience. Staff and management have already acknowledged many of the shortcomings in design and implementation raised in this evaluation and are in the process of addressing them. This evaluation recognizes these efforts where possible.

The World Bank conceived the SDFP in response to a rapid increase in debt levels and debt stress over the past decade in many IDA-eligible countries. The financing needs of IDA-eligible countries are substantial because they seek to achieve the Sustainable Development Goals, and borrowing has been an important source of financing. Public sector borrowing can enable countries to finance investments that are essential for economic growth and poverty alleviation and can enable fiscal policy to play a countercyclical role during economic downturns. However, when debt levels become unsustainable, debt service on public sector borrowing can crowd out critical development spending, choke off access to affordable finance, and derail the development agenda.

An upsurge in borrowing took place across countries at every level of development in the wake of the global financial crisis and in the context of historically low global interest rates. The resulting increase in debt was particularly burdensome for lower-income countries, many of which had low domestic revenue mobilization and weak public investment management (PIM). Between 2010 and 2019, before the COVID-19 pandemic, general government gross debt in IDA-eligible countries had climbed from 38 to 54 percent of gross domestic product (GDP; figure 1.1),^{1, 2} and the number of IDA-eligible countries at high risk of or in debt distress more than doubled from 19 to 40. More than half of IDA-eligible countries experienced an increase in their assessed risk of debt distress over the period, with the majority falling into high risk of debt distress (figure 1.2).

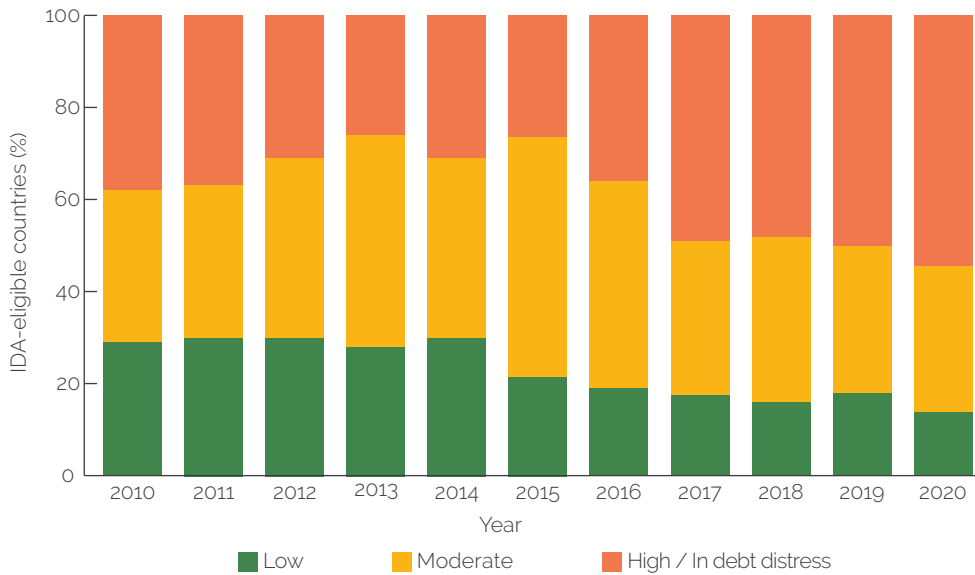
Figure 1.1. Public Debt as a Share of GDP in International Development Association-Eligible Countries, 2010–19



Source: World Development Indicators database (July 2021).

Note: GDP = gross domestic product.

Figure 1.2. Evolution of Debt Distress Ratings in International Development Association–Eligible Countries, 2010–20

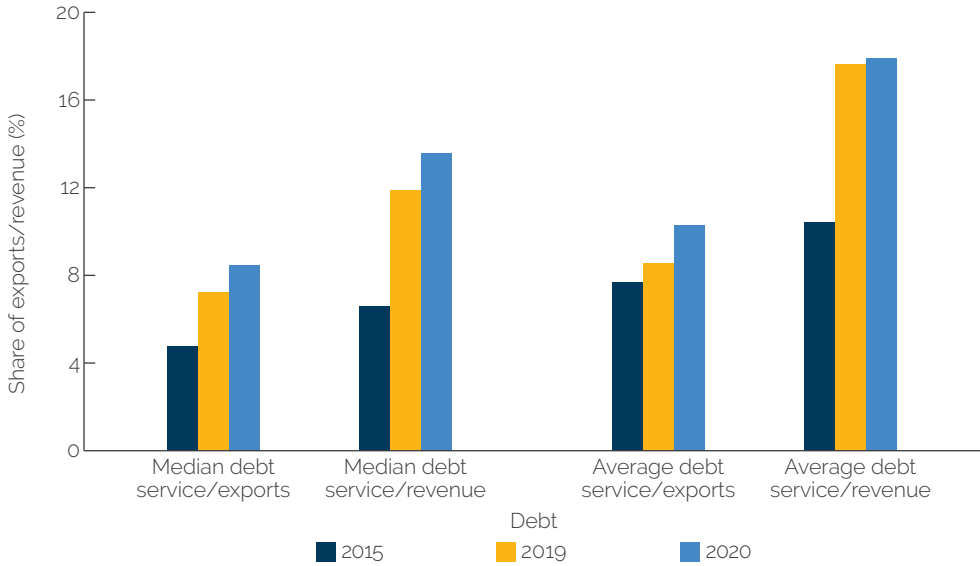


Source: World Bank 2020b; International Monetary Fund Debt Sustainability Analysis (database), International Monetary Fund, Washington, DC (accessed April 2021), <https://www.worldbank.org/en/programs/debt-toolkit/dsa>.

Note: These are the latest estimates (depending on the date of the debt sustainability analysis update). IDA = International Development Association.

The rise in public debt has been accompanied by a rise in public debt service as a share of revenues. This increase in debt service has crowded out spending on core public services such as education, health, and basic infrastructure. Consolidated government debt service exceeded 25 percent of revenue and grants in 40 percent of IDA-eligible countries for which data were available in 2020.³ Median public debt service payments as a share of revenue doubled from 6.7 to 13.7 percent (figure 1.3). High and rising indebtedness, often on shorter maturities, has also exposed already vulnerable countries to rollover, exchange rate, and interest rate risks that have increased fiscal, external, and financial sector vulnerabilities.

Figure 1.3. Public Debt Service Burdens in International Development Association–Eligible Countries, 2015–20

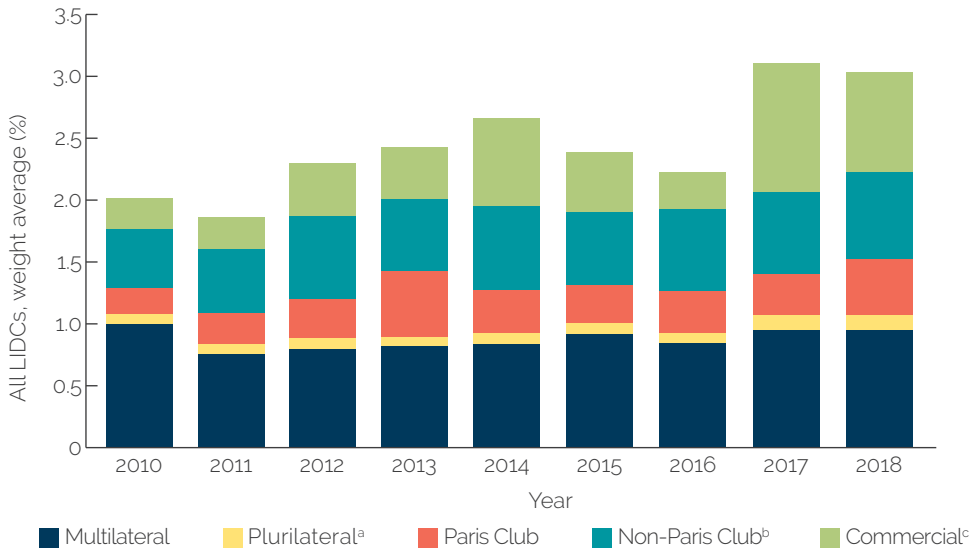


Source: Staff estimates from the World Bank and International Monetary Fund Debt Sustainability Analysis (database).

Note: IDA = International Development Association.

The increased availability of financing, particularly from commercial and non–Paris Club bilateral creditors, contributed to the buildup of debt. In 2010, multilateral institutions accounted for about half of lending to low-income countries (LICs). Within a decade, that share had declined to less than one-third as commercial and bilateral creditors grew to dominate lending flows (figure 1.4). Bilateral credit has also shifted from traditional creditors to nontraditional lenders, most importantly China.⁴ There has also been a pronounced increase in commercial financing (for example, Eurobonds and commercial bank lending), with its share in total lending to IDA-eligible countries more than doubling over the past decade and now accounting for more than one-quarter of disbursed and outstanding external debt.⁵

Figure 1.4. Disbursed Lending to Low-Income Economies by Creditor Type, 2010–18



Source: World Bank and IMF 2020.

Note: Calculated as the sum of disbursements divided by gross domestic product. This highlights the supply of credit to low-income developing countries. LIDC = low-income developing countries.

a. See appendix III of IMF 2018.

b. Includes disbursements from China.

c. Includes disbursements from bonds and other instruments.

Purpose and Scope of the Early-Stage Evaluation

In the context of rising debt, debt service, and debt distress, the SDFP was conceived during the 19th Replenishment of IDA (IDA19) to support IDA-eligible countries in their efforts to achieve and maintain debt sustainability. Noting that “rising debt vulnerabilities in IDA-eligible countries could jeopardize their development goals,” IDA19 deputies asked for options from the World Bank to expand and adapt IDA’s allocation and financial policies to support financial sustainability and help IDA achieve country development goals while minimizing risks of debt distress (World Bank 2019a). The SDFP became effective on July 1, 2020, and replaced the Non-Concessional Borrowing Policy (NCBP), which had sought to support debt policies and long-term external debt sustainability in IDA-eligible nongap countries by focusing on external, nonconcessional financing flows.

The SDFP's objective is to incentivize IDA-eligible countries to borrow sustainably and to promote coordination among IDA and other creditors. It consists of two pillars: the Debt Sustainability Enhancement Program (DSEP) and the Program of Creditor Outreach (PCO). The DSEP encourages country-level actions to enhance debt transparency, promote fiscal sustainability, and strengthen debt management by requiring countries at moderate and elevated risk of debt distress to adopt concrete performance and policy actions (PPAs) to address the drivers of their country-specific debt vulnerabilities. The PCO aims to use the World Bank's potential as a convener to promote information sharing, dialogue, and collective action among creditors of IDA-eligible countries, including traditional and nontraditional creditors.

This evaluation examines the SDFP's design and early implementation, while acknowledging the difficult context (owing to the COVID-19 pandemic) in which the policy was introduced. The design was assessed regarding its relevance to the drivers of debt stress in IDA-eligible countries over the past decade and lessons learned from experiences in dealing with threats to debt sustainability in LICs. Reflecting its early-stage nature, the evaluation examines the SDFP implementation during its first year (fiscal year [FY]21). In addition to reviewing the use of PPAs across all DSEP countries, the evaluation conducted case studies for eight countries to assess the agreed-on PPAs' relevance in relation to country-specific debt challenges and to the SDFP's objectives.⁶

Given the evaluation's early-stage nature, outcomes of the SDFP as a whole or of individual PPAs are not assessed because clear impacts on debt sustainability and debt stress will take time to materialize. Additionally, the IEG team did not consider it possible to evaluate the impact of SDFP-related set-asides of IDA allocations on country incentives because set-asides would take effect only in the second year of SDFP implementation (although there are questions about the set-aside framework's design that can be posed legitimately at this early stage). Similarly, because the objectives, form, and function of the PCO are not yet elaborated fully, assessment of the PCO is limited. But previous experience with creditor coordination, including in the context of the NCBP, points to a need to clarify the program's mandate and ambition. Appendix A provides more details on the scope and methodology

used in this evaluation and how the team addressed the questions posed in the evaluation’s Approach Paper (World Bank 2021b).

This report is structured as follows: Section 2 discusses the drivers of the increase in debt stress in IDA-eligible countries over the past decade. Section 3 assesses the extent to which the SDFP, as designed, responds to the debt sustainability challenges faced by IDA-eligible countries and lessons learned from past efforts at managing debt stress. Section 4 presents an assessment of PPA relevance and design based on a review of all PPAs and eight country case studies, and section 5 presents conclusions and recommendations.

¹ General government gross debt consists of all liabilities that require payment or payments of interest, principal, or both by the government.

² Staff estimates from the International Monetary Fund World Economic Outlook database, April 2021, unweighted average of general government gross debt to gross domestic product.

³ According to staff estimates from International Development Association Debt Sustainability Analysis data.

⁴ China has become the dominant non-Paris Club bilateral creditor, but confidentiality clauses in many of its loans make it difficult to estimate the size of lending precisely (see Morris 2020).

⁵ Access to international capital markets remains concentrated—10 International Development Association countries account for 90 percent of outstanding international debt security issuance as of the third quarter of 2020. Staff estimates are from the Bank for International Settlements database at <https://www.bis.org/statistics/secstats.htm>.

⁶ The Independent Evaluation Group team undertook country case studies for Dominica, Ghana, Kenya, Mozambique, Nigeria, Pakistan, Papua New Guinea, and Zambia. Cases were purposefully selected to ensure representation across countries that demonstrated increased debt risks over the past decade, either regarding debt-to-gross domestic product or debt service to revenue (or both). See appendix A for a description of the evaluation methodology, including case study selection.

2 | Origins of the Sustainable Development Finance Policy

Public debt burdens in IDA-eligible countries have risen substantially over the past decade. Between 2010 and 2019, general government gross debt as a share of GDP for IDA-eligible countries rose, on average, from 39 to 54 percent.¹ Factors behind the debt built up in individual countries varied. They include (i) the availability of lending at the low interest rates prevailing after the global financial crisis coupled with new financial instruments and major changes in financial markets;² (ii) encouragement of developing economy governments to increase spending to finance growth-enhancing investments; (iii) inefficient spending (including for many public investments), resulting in a lower rate of return than anticipated; and (iv) weak domestic revenue mobilization.

There were a variety of drivers of increased debt burdens. In an environment characterized by relatively inexpensive credit, many IDA-eligible countries expanded public investment, particularly in infrastructure, often with disappointing returns. The International Monetary Fund (IMF) estimates that approximately 40 percent of the potential gains from public investment in LICs was lost because of inefficiencies in the public investment process (IMF 2015). Many IDA-eligible countries spent heavily on inefficient energy subsidies or faced stagnant tax revenues (often caused by high tax exemptions and deductions, narrow tax bases, and inefficient revenue mobilization; Fatás et al. 2019). Spending to respond to natural disasters, particularly in small island states, was also a factor for the buildup in debt.

The shift to less-concessional financing reflected changes in creditor composition, which has increased borrowing costs significantly. Between 2010 and 2019, the share of nonconcessional borrowing in the total external debt of IDA-eligible countries increased from 43 to 60 percent. Although the share of nonconcessional debt among IDA-only borrowers has seen only a modest increase (from 44 to 48 percent of total external debt), the share of nonconcessional finance in IDA gap and blend countries has risen from 42 percent of total

external debt to 66 percent.³ The increase in nonconcessional borrowing from bilateral and private creditors has exposed countries to shorter maturities and greater rollover risks and has crowded out other public spending. During the 2010–19 period, variable rate debt as a share of total external debt for IDA-eligible countries increased, on average, from 11 to 16 percent.

The rapid increase in borrowing over the past decade has drawn attention to weaknesses in debt transparency that hindered full awareness of and accountability for exposure to fiscal risk. Comprehensive debt reporting and debt transparency have featured strongly in recent discussions of debt sustainability. The World Bank has clear reporting standards for debt transparency in place for its borrowers (box 2.1). Specifically, World Bank borrowers are required to provide regular, detailed reports on long-term external debt owed by a public agency or by a private agency with a public guarantee. However, these standards have not led to full disclosure of external debt, particularly debt contracted by public entities that does not benefit from a sovereign guarantee. Information on terms and conditions of some debt instruments, such as bilateral debt restructuring by nontraditional creditors, is also limited. The World Bank's debtor reporting requirements do not apply to domestic debt, which has been an important factor in rising debt stress for several IDA countries.

Box 2.1. The World Bank's Debtor Reporting System

The World Bank's Debtor Reporting System (DRS) is the most important single source of verifiable information on the external indebtedness of low- and middle-income countries. World Bank borrowers are required to provide regular, detailed reports on long-term external debt owed by a public agency or by a private agency with a public guarantee. Borrowers are also required to report in aggregate on long-term external debt owed by the private sector with no public guarantee. Currently, approximately 120 countries are reporting to the DRS, including all International Development Association–eligible countries.

Information the DRS required on new loan commitments is readily available from loan agreements. As such, complying with DRS reporting requirements should not place an undue burden on national debt offices. Most reports are now submitted electronically, and borrowers that use the debt management software provided by the Commonwealth Secretariat and the United Nations Conference on Trade and Development have access to an automated link that derives DRS reports from the national debt

(continued)

Box 2.1. The World Bank's Debtor Reporting System (cont.)

database. The quality of reporting to the DRS has improved significantly in recent years in parallel with enhanced debt management capacity for measurement and monitoring of external public debt in many low- and middle-income countries. Countries that have difficulty complying with the DRS requirements tend to be poorer International Development Association borrowers, typically fragile states or those in conflict.

The most significant gap in reporting to the DRS is the omission of borrowing by state-owned enterprises (SOEs), particularly SOE borrowing without a government guarantee. Although a few countries might underreport the extent of public debt liabilities deliberately, most SOE-related omissions reflect shortcomings in legal frameworks whereby the authority of the national debt office does not extend to collecting information on SOEs' nonstate guaranteed debts, which are nevertheless implicit contingent liabilities of the government (this practice is not limited to developing countries). The World Bank's Development Economics Vice Presidency, which manages the DRS, is actively pursuing avenues to close this information gap, including (i) collaborating closely with World Bank and International Monetary Fund country teams and staff on suspected underreporting, (ii) communicating directly with central banks and agencies responsible for compiling Balance of Payments and International Investment Position statistics that routinely collect information on borrowing by SOEs and private sector entities, (iii) reaching out to bilateral creditors for information on their lending activities, and (iv) maximizing the use of information from market sources and in creditors' annual reports.

The DRS gives the World Bank both the tools and the leverage to improve debt transparency. Bank Procedure 14.10 clearly states, "As a condition of Board presentation of loans and financings, each Member Country must submit a complete report (or an acceptable plan of action for such reporting) on its foreign debt." However, the World Bank has been reluctant to withhold lending for failure to meet debt reporting requirements, but it could do so. The Independent Evaluation Group was unable to find any instance of loans or financing being withheld because of incomplete reporting under the DRS. Data gaps that are linked directly to institutional lending imperatives have overridden strict enforcement of the World Bank's policy. This has resulted in acceptance of aggregate reporting of public and publicly guaranteed debt by some large borrowers or deferral of the reporting requirement because of specific country circumstances.

Source: Independent Evaluation Group.

Note: International Development Association countries that receive only grants and with no outstanding debt obligations to the World Bank are not required to report to the DRS. These are typically small island economies—for example, Kiribati, the Marshall Islands, and Tuvalu.

Lessons from Review of the International Development Association's Non-Concessional Borrowing Policy

The rise in debt vulnerabilities over the past decade underscored deficiencies in IDA's NCBP. The NCBP came into effect in 2006 as part of IDA's tool kit to support debt policies and long-term external debt sustainability after the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative (MDRI). The policy was pursued through a two-pronged strategy designed to encourage appropriate borrowing behavior through disincentives to external nonconcessional borrowing by grant-eligible and post-MDRI countries and to enhance creditor coordination. By limiting nonconcessional borrowing, the NCBP also addressed institutional and IDA donor concerns with “free riding” by lenders offering nonconcessional terms (such as private bondholders and official lenders from countries that are not members of the Organisation for Economic Co-operation and Development) to grant-eligible countries because of cross-subsidization through IDA grants (World Bank 2006).

Earlier reviews of the NCBP noted shortcomings in achieving its objectives (World Bank 2015, 2019b). The NCBP lacked the capacity to stem the rise in IDA-eligible countries' nonconcessional external borrowing over the past decade, partly because of its limited country and debt coverage. The NCBP covered only grant-eligible and nongap MDRI recipient countries, and it applied only to external nonconcessional borrowing, allowing for a subsequent rise in domestic debt (World Bank 2019b). The 2019 review concluded that the NCBP's impact on creditor coordination had been “effective but limited in scope”—the NCBP was unable to meaningfully affect the lending decisions of non-Paris Club bilateral and private creditors. Regarding influencing creditors' behavior, the NCBP review found that multilateral and bilateral creditors that formed the core of the global coalition for the Heavily Indebted Poor Countries Initiative and MDRI were already engaging with the World Bank on sustainable lending practices. These creditors were often found to have allocation mechanisms and lending procedures like IDA's and were open to taking the lead from the World Bank and the IMF regarding assessment of debt sustainability. By contrast, engagement with non-Paris Club bilateral creditors and private creditors was sporadic, with most interactions limited to requests to IDA for information through IDA's Lending to LICs mailbox.

World Bank Response to Emerging Debt Stress in International Development Association–Eligible Countries

In response to rising debt distress, the IMF and the World Bank implemented a joint strategy for addressing debt vulnerabilities in LICs. The Multipronged Approach to Addressing Emerging Debt Vulnerabilities came into effect in 2018 and comprised actions to (i) strengthen debt transparency by working with borrowing countries and creditors to compile and make better public sector debt data available, (ii) support capacity development in public debt management to mitigate debt vulnerabilities, (iii) provide suitable tools to analyze debt developments and risks, and (iv) adapt the IMF and World Bank surveillance and lending policies to better address debt risks and promote efficient resolution of debt crises (World Bank 2019c).

The multipronged approach encompasses many of the existing instruments and tools the World Bank uses to support IDA-eligible countries in creating fiscal space for growth-enhancing investments and to enhance debt management. These instruments include channels to (i) improve the efficiency, effectiveness, and equity of revenue collection; (ii) establish and strengthen systems for budget preparation and management (including public expenditure management, public sector accounting, PIM, and internal and external accountability); and (iii) build capacity to manage government assets and liabilities efficiently, including for macroeconomic policy and fiscal risk management purposes. The support takes varying forms, including through investment projects, advisory services and analytics, development policy operations (DPOs), and technical assistance.

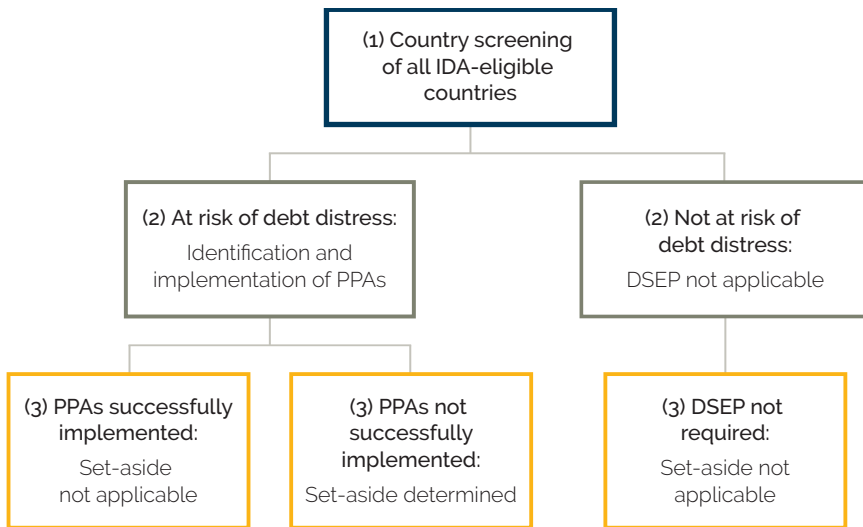
IDA19 deputies and borrower representatives asked IDA to present options for adapting its allocation and financial policies to minimize risks of debt distress. These options were expected to ensure continuation of IDA's focus on financial sustainability while supporting the achievement of country-specific development goals. An Options Paper was presented to IDA deputies, in which World Bank management proposed replacing IDA's existing NCBP with the SDFP (World Bank 2019a).

The SDFP is composed of the DSEP and the PCO. The DSEP seeks to create country-level incentives to enhance debt transparency and fiscal

sustainability and to strengthen debt management. It does so by screening countries by levels of risk of debt distress and requiring countries at heightened levels of risk to undertake actions that would move the country toward more sustainable borrowing practices. Countries that do not undertake such actions successfully would be penalized through set-asides of their core IDA allocations. The key elements of the DSEP are as follows:

- » **Country screening:** An initial screening of IDA-eligible countries to identify those at heightened risk of debt distress (using the World Bank–IMF Debt Sustainability Framework).⁴ Those at moderate risk of debt distress, high risk of debt distress, or in debt distress are required to implement PPAs.⁵
- » **PPAs:** Countries subject to the DSEP define PPAs to address critical drivers to debt vulnerabilities. PPAs are implemented through lending instruments, technical assistance, and analytical work.
- » **Set-asides:** Countries that fail to implement agreed-on PPAs have a share of their IDA allocation set aside (10 percent and 20 percent for countries at moderate and high risk of debt distress, respectively) and released only on satisfactory implementation of the agreed-on PPAs (figure 2.1).

Figure 2.1. Debt Sustainability Enhancement Program Implementation Framework



Source: Independent Evaluation Group.

Note: The DSEP includes some countries without risk ratings of debt stress (that is, countries with Debt Sustainability Analysis for Market Access Countries). DSEP = Debt Sustainability Enhancement Program; IDA = International Development Association; PPA = performance and policy action.

The PCO seeks to promote collective action at the creditor level to reduce debt-related risks to IDA-eligible countries. The program operates through promotion of greater information sharing, dialogue, and collective action among IDA-eligible country creditors, including traditional and nontraditional creditors (figure 2.2).

Figure 2.2. Program of Creditor Outreach Implementation Framework

-  **Advance dialogue among a broader range of development partners** towards putting in place a set of principles on transparent and sustainable financing.
-  **Facilitate coordination at the country level among different creditors,** including traditional and non-traditional creditors and the International Monetary Fund, on actions to promote sound economic policies, prudent debt management, and sustainable lending practices.
-  **Enhance transparency and communications on sustainable financing** through new information sharing initiatives and dialogue on the SDFP.

Source: World Bank 2020b.

Note: SDFP = Sustainable Development Finance Policy.

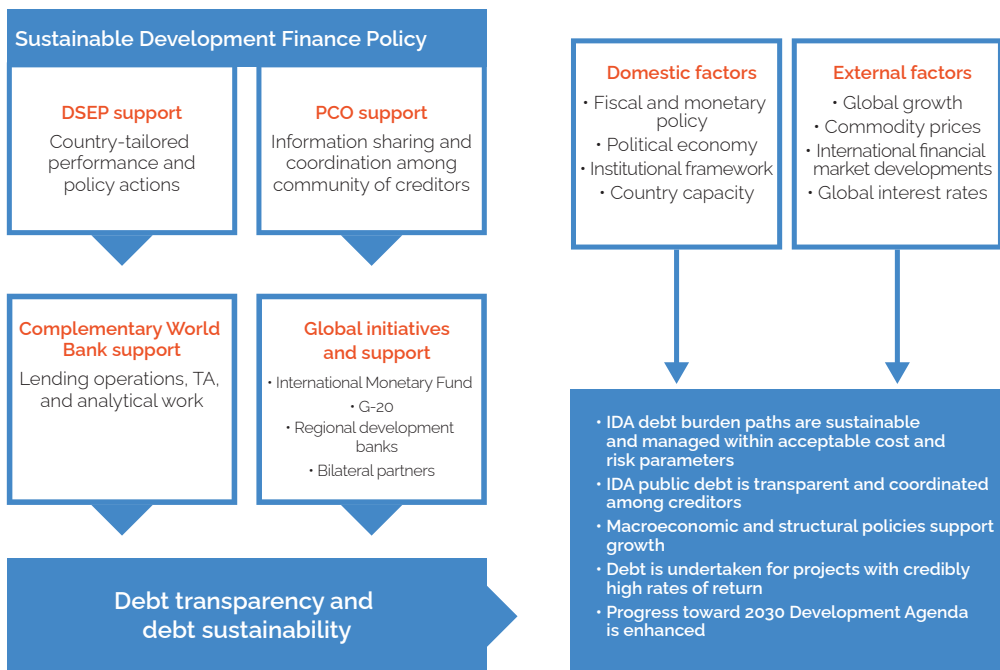
The Group of Twenty (G-20) countries announced a Debt Service Suspension Initiative (DSSI) when it became clear early in 2020 that the COVID-19 pandemic would have significant and negative implications for debt sustainability in many LICs. The DSSI offered a suspension of debt service repayments to G-20 bilateral creditors due from May 1 to December 31, 2020, for 73 countries that the United Nations classified as IDA-eligible or as “least-developed.” By late 2020, 43 countries had asked for support under DSSI, deferring just more than an estimated \$5 billion in debt. The DSSI was subsequently extended to debt service due in 2021. The IMF also offered debt service relief to 29 of the poorest countries through the Catastrophe Containment and Relief Trust (IMF 2020c). The recently adopted G-20 Common Framework for Debt Treatments beyond the DSSI coordinates a sovereign debt solution that brings together Paris Club and other G-20 bilateral creditors and requires participating debtor countries to seek treatment at least as favorable from other bilateral and private creditors as that agreed to under the framework.

A secretariat in the Development Finance Vice Presidency manages the SDFP implementation and has compiled guidance for country teams for both

the selection of PPAs and for drafting the PPA note. It also manages the PPA database and tracks their implementation. Technical staff in the Equitable Growth, Finance, and Institutions Global Practice’s debt unit provide guidance to country teams in developing PPAs, which an SDFP committee reviews. Final decisions on the PPAs and set-asides are taken by the managing director, on the recommendation of the regional vice presidents and the concurrence of the respective vice presidents of the Development Finance Vice Presidency; Operations Policy and Country Services; and Equitable Growth, Finance, and Institutions, with the advice of the SDFP Committee (see appendix B for discussion of SDFP governance arrangements). Together, these mechanisms seek to ensure that PPAs are based on sound diagnostics of the drivers of debt stress, reflect policy dialogue with and approval by country authorities, and support an ambitious but realistic pathway toward debt sustainability (World Bank 2020d).

Figure 2.3 sets out the framework through which the SDFP is expected to contribute to improvement of debt sustainability in IDA-eligible countries.

Figure 2.3. Sustainable Development Finance Policy and Its Role in Promoting Debt Sustainability



Source: Independent Evaluation Group.

Note: DSEP = Debt Sustainability Enhancement Program; G-20 = Group of Twenty; IDA = International Development Association; PCO = Program of Creditor Outreach; TA = technical assistance.

¹ Weighting by gross domestic product, the share of gross government debt rose from 32 to 49 percent over the period.

² This includes the rise of regional banks, a growing appetite for local currency bonds, the availability of concessional and nonconcessional lending from non-Paris Club creditors, and increased demand for emerging market and developing economy debt from the nonbank financial sector (Kose et al. 2021).

³ International Development Association (IDA) gap countries are those above the operational cutoff for IDA but lacking the creditworthiness to borrow from the International Bank for Reconstruction and Development. IDA blend countries are countries eligible for IDA based on per capita income but also creditworthy for some International Bank for Reconstruction and Development borrowing.

⁴ The Debt Sustainability Framework uses a set of indicative policy-dependent thresholds against which baseline scenario projections of external debt burden indicators over the next 20 years are compared to assess the risk of debt distress. Vulnerability to external and policy shocks are explored in alternative scenarios and standardized stress tests. The indicative threshold for each debt burden indicator is adjusted to reflect each country's policy and institutional capacity as measured by three-year moving averages of the World Bank's Country Policy and Institutional Assessment scores.

⁵ Exceptions include countries with loans and credits in nonaccrual status and countries that are eligible for funding from IDA's Remaining Engaged during Conflict Allocation.

3 | Assessing Sustainable Development Finance Policy Design

The evaluation of SDFP's design focuses on the extent to which the SDFP as designed and implemented to date addresses the origins of the rise in debt stress in IDA-eligible countries over the past decade. The assessment is undertaken with respect to four dimensions:

- » Country coverage
- » Debt coverage
- » Incentive structure for actions by borrowers and creditors
- » Relevance of country-specific PPA

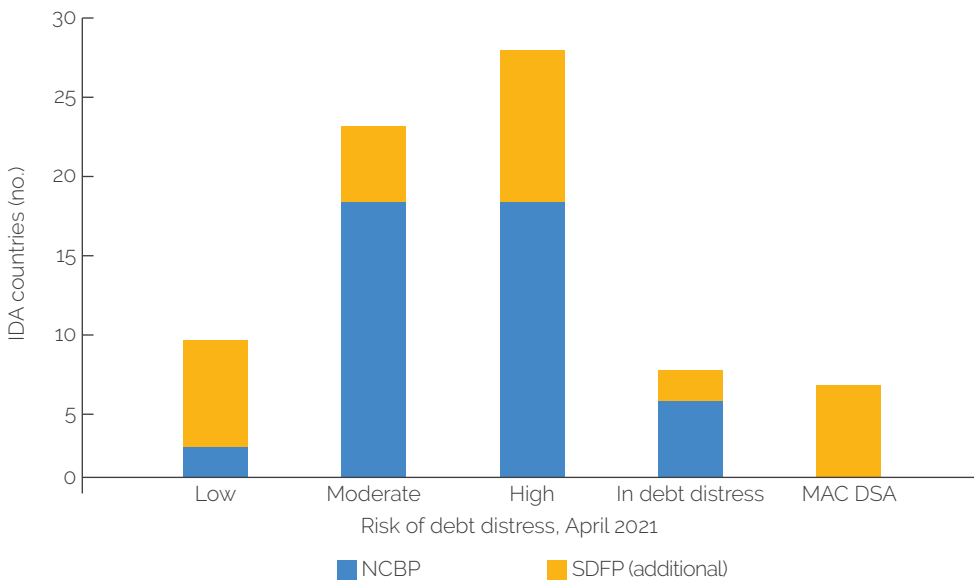
The assessment also considers the monitoring and evaluation framework in place by which to assess progress toward the policy's objectives.

Country Coverage

The SDFP expands the NCBP's country coverage to a larger number of IDA-eligible countries facing risks of debt distress. Although the NCBP applied only to post-MDRI and grant-eligible IDA-only countries, the SDFP applies to *all* IDA-eligible countries. This expands the scope of the policy from 44 countries (under the NCBP) to 74 countries.¹ Regarding the composition of countries covered, of the 40 (of 74) IDA-eligible countries determined to be at high risk of debt distress (or in debt distress) in FY21, the SDFP covers almost half (17) that the NCBP would not have covered. However, only a subset of SDFP countries implement policy actions under the DSEP. Fifty-five countries are required to implement PPAs under the SDFP, 11 more than were covered under the NCBP (figure 3.1).

The policy guidelines identify three categories of countries that are not required to agree to and implement PPAs: (i) countries at low risk of debt distress according to the Debt Sustainability Framework for LICs (LIC DSF) and countries under the Debt Sustainability Analysis for Market Access Countries (MAC DSA) for which management determines that debt vulnerabilities are limited;² (ii) countries in nonaccrual status with the International Bank for Reconstruction and Development and IDA;³ and (iii) countries that are eligible for IDA’s Remaining Engaged during Conflict Allocation.⁴

Figure 3.1. Sustainable Development Finance Policy versus Non-Concessional Borrowing Policy by Country’s Risk of Debt Distress, FY21



Source: Independent Evaluation Group compilation based on International Development Association performance and policy action database.

Note: FY = fiscal year; MAC DSA = Debt Sustainability Analysis for Market Access Countries; NCBP = Non-Concessional Borrowing Policy; SDFP = Sustainable Development Finance Policy.

Screening countries for risk of debt stress relies on the World Bank–IMF debt sustainability analysis (DSA). The SDFP screens all IDA-eligible countries. IDA-only countries assessed to be at medium or high risk of debt distress or in debt distress, according to the LIC DSF, fall under the DSEP and are required to undertake PPA. IDA blend countries are evaluated using the MAC DSA. Countries found to breach the vulnerability thresholds for debt, gross financing needs, or debt profile indicators are subject to implementing PPAs

under the DSEP. The LIC DSF (box 3.1) and MAC DSA draw heavily on the country's past performance and projected outlook for real growth, international reserves coverage, remittance inflows, the state of the global environment, and the World Bank's Country Policy and Institutional Assessment index. Different indicative thresholds for debt burdens are used depending on the country's assessed debt-carrying capacity.

Box 3.1. Debt Sustainability Framework for Low-Income Countries

The Debt Sustainability Framework for Low-Income Countries (LIC DSF) applies to low-income countries that have substantially long-maturity debt with terms that are below market terms rates (concessional debt) or to countries that are eligible for the World Bank's International Development Association grants.

The LIC DSF is the main tool to assess risks to debt sustainability in low-income countries. The framework classifies countries based on their assessed debt-carrying capacity, estimates threshold levels for selected debt burden indicators, evaluates baseline projections and stress test scenarios relative to these thresholds, and then combines indicative rules and staff judgment to assign risk ratings of debt distress.

First introduced in 2005, the LIC DSF has been subject to a comprehensive review every five years. The most recently revised LIC DSF became operational in 2018.

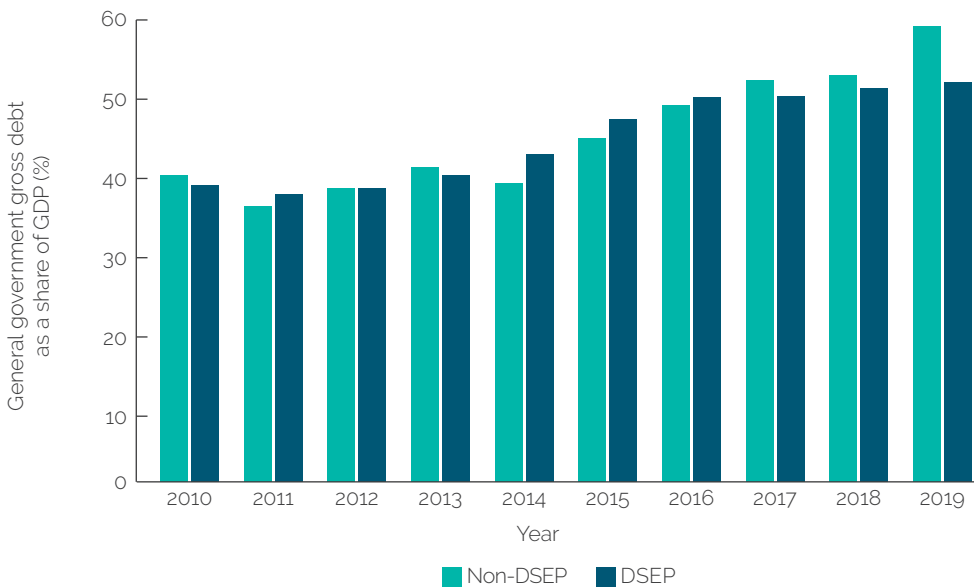
Source: World Bank Debt and Fiscal Risks Toolkit (<https://www.worldbank.org/en/programs/debt-toolkit/dsf>).

The pattern of debt accumulation is largely the same for IDA-eligible countries covered and not covered by the DSEP. The trajectory of debt-to-GDP across DSEP versus non-DSEP countries is nearly identical, and since 2017, debt as a share of GDP was, on average, higher in non-DSEP economies (figure 3.2). The DSA that underpins the LIC DSF is driven to a significant extent by assumptions about the future, many of which can change quickly because of unanticipated shocks or policy shifts (for example, growth outlook). Moreover, DSA growth assumptions have tended to have an optimistic bias, with downside risks often underestimated, particularly regarding contingent liabilities of state-owned enterprises (SOEs) or in assessing the potential im-

part of a compounding of vulnerabilities (World Bank, forthcoming). World Bank management has recognized this and is in the process of improving DSAs' governance and contestability.

The underlying logic of not applying the DSEP to countries at low risk of debt distress rests on an implicit assumption that low risk equates to sustainable development financing practices. However, experience over the past decade shows that countries at low risk of debt distress can shift into higher levels of risk in a relatively short time. In fact, one-third of the countries that experienced an elevation in their risk of debt distress over the past decade experienced a two-level deterioration in less than three years.⁵ Countries can experience rapid deteriorations in risk ratings because of exogenous factors, such as global commodity price declines or natural disasters. Experience since 2016 and evaluative evidence suggest that the assigned probabilities have often been overoptimistic.

Figure 3.2. Public Sector Debt/GDP for Debt Sustainability Enhancement Program versus Non-Debt Sustainability Enhancement Program IDA-Eligible Countries, 2010–19



Source: Staff estimates from World Development Indicators data.

Note: DSEP = Debt Sustainability Enhancement Program; GDP = gross domestic product; IDA = International Development Association.

Exempting countries at low risk of debt distress from the DSEP is not without risk. Exempting countries at low risk of debt distress from the DSEP's requirement to implement PPAs is not without risk. It may incentivize IDA-eligible countries to pursue sustainable financing practices, but the strength of this incentive is unproven. The SDFP guidelines state that a change in risk rating during the FY will not change a country's PPA eligibility status for that FY, as in Rwanda, where the assessed risk of debt distress moved from low in FY20 to moderate in FY21. However, the guidelines also indicate that exceptions could be considered and cite as criteria (i) a marked deterioration in the country's debt sustainability outlook, coupled with a sharp increase in debt burden indicators, or a reassessment of the debt as unsustainable; or (ii) a deterioration driven by endogenous factors, including insufficient debt transparency.

Debt Coverage

The SDFP expanded coverage of public debt beyond that in the NCBP. The NCBP applied only to external nonconcessional borrowing to reflect that, at the time of its introduction, nonconcessional external borrowing was perceived as the predominant risk to debt sustainability. The SDFP expands coverage to all external and domestic public sector borrowing. This reflects more accurately the debt accumulation over the past decade that has led to higher debt risks in IDA-eligible countries. For some countries, domestic public sector borrowing played a significant role in the rapid rise in debt stress. The focus on public external debt under the NCBP occasionally resulted in large "debt surprises" when contingent liabilities (such as SOE debt) were realized or when guarantees had to be honored.

Incentive Structure for Borrowers and Creditors

IDA Allocation Set-Asides

The SDFP relies on potential set-asides of IDA allocations to incentivize DSEP countries to implement agreed-on PPAs. Countries that fail to implement agreed-on PPAs have a portion of their IDA allocation set aside

(10 percent for countries at moderate risk of debt distress and 20 percent for those at high risk or in debt distress). Originally, set-asides were designed for a three-year IDA cycle. Over the first two years of an IDA Replenishment, those set-asides would remain within the country's multiyear IDA allocation. However, if the country had not implemented agreed-on PPAs by the start of the third year of an IDA cycle, the set-aside for the third year and accumulated set-asides would be released to be reallocated across other IDA-eligible countries through the Performance-Based Allocation formula.

With the shortening of the IDA19 cycle in the face of unanticipated COVID-19 needs, the system for set-asides has been adjusted. Now, the SDFP set-aside and discount mechanism is Replenishment neutral, running continuously across IDA cycles while maintaining the incentive structure that underpins the PPAs' implementation. A Replenishment cycle-neutral set-aside implies that unsatisfactory implementation of PPAs in any particular FY would generate a set-aside, which can be recovered in the next year if the PPA is implemented satisfactorily, regardless of when in the IDA cycle the set-aside happens.

Although there is no direct and concrete experience yet with the use of set-asides for failure to implement PPAs, experience with the NCBP provides some insight into the credibility and efficacy of underlying incentives. The NCBP, like the SDFP, allowed for sanctions in response to a failure to adhere to the policy in the form of reductions in IDA allocations and hardening of IDA terms. Since 2015, there have been 17 cases of NCBP breach in six countries. As noted in the 2019 NCBP review (World Bank 2019b, 8), waivers for most breaches were granted ex post, which does not provide confidence in the strength of the incentive to adhere to the NCBP. IDA financing terms were hardened for three countries (Ethiopia, Maldives, and Mozambique). Hardening of terms usually involved converting some portion of the grant element of IDA financing into regular IDA credits. IDA allocation was reduced in only one country (Mozambique).

Although hardening of terms remains an option, SDFP incentives are expected to rely primarily on set-asides of future IDA allocations. Hardening of terms remains an option but is not expected to be used as the primary mechanism. This may reflect concern (articulated by World Bank management in the context of the 2006 NCBP policy paper) that a hardening of terms could

make IDA financing relatively less attractive to countries with continued access to alternative sources of financing. Nevertheless, most of the cases of sanctions have involved a hardening of terms (World Bank 2019b, table 1). In light of the limited experience with using volume reductions, the credibility of a set-aside cannot be taken for granted amid a global economic crisis triggered by a pandemic, particularly given the importance that IDA has assigned to rapidly increasing commitments to affected countries. Therefore, there is a risk that weak PPAs could be adopted to try to reconcile the trade-off between PPA adherence and increased IDA commitment. At this point, there is little if any experience on which to base an assessment of PPA efficacy and the credibility of set-aside incentives.

The fact that IDA resources generally represent a declining share of IDA-eligible country finance might also make the credibility of a set-aside questionable. IDA has provided extraordinary support in response to the COVID-19 pandemic, but generally, IDA represents an increasingly small share of total net financial flows (debt and equity), particularly for market access countries. Among DSSI-eligible countries, IDA and International Bank for Reconstruction and Development lending represents only about 10 percent of net financial flows.

Program of Creditor Outreach

The PCO's primary objective is "leveraging the World Bank's potential as a convener to promote stronger collective action, greater debt transparency, and closer coordination among borrowers and creditors to mitigate debt-related risks." This objective is similar to the NCBP's, though with more ambitious aspirations for the range of creditors and countries with which to engage. There have been a number of workshops and meetings to date with other multilateral creditors and borrowing countries but modest engagement with non-Paris Club creditors, with the first major event planned for October 2021 (World Bank 2020c).

Review of the NCBP found that its PCO has had a positive but limited impact on creditors' lending decisions. Multilateral and bilateral creditors, which formed the core of the global coalition for the Heavily Indebted Poor Countries Initiative and MDRI, were found to have engaged with the World Bank

on sustainable lending practices. These creditors often have allocation mechanisms and lending procedures like IDA's and were open to taking their lead from the World Bank and the IMF regarding assessment of debt sustainability. This coordination continues to be effective. The extent to which the new PCO represents significant additionality with respect to this group of creditors is therefore unclear.

Previous efforts at coordination with non-Paris Club and private creditors, including under the NCBP, produced little in concrete results. Engagement between IDA and non-Paris Club and private creditors was sporadic and generally limited to responding to requests for information through the Lending to LICs mailbox. The 2019 review of the NCBP did not offer findings on which to base improvements in collective action with non-Paris Club and private creditors.⁶ Given the significant role these two groups of creditors played in the rise in debt stress among IDA-eligible countries over the past decade (see figure 1.4), a successful PCO would need to lead to more effective collaboration with these groups of creditors. But it is not obvious that the World Bank *on its own* has sufficient leverage as a convener and enabler to promote substantive collective action and closer coordination among non-Paris Club and private sector creditors.

To date, there is little evidence of inroads made to strengthen collective action with non-Paris Club and private creditor groups. Given that these are the groups most implicated in the rise in debt distress over the past decade, the PCO's success will hinge on performance in this area. Although the SDFP offers a general framework for outreach, and despite stakeholder events over FY21, the modalities and strategy for achieving PCO objectives with respect to non-Paris Club and private creditor groups have yet to be articulated. Experience to date, including with the NCBP, suggests that past practices are unlikely to be sufficient for success.

¹ The determination of countries under Non-Concessional Borrowing Policy eligibility reflects countries that would have been classified as International Development Association–only for fiscal year 2021. The determination of countries under Sustainable Development Finance Policy and Debt Sustainability Enhancement Program eligibility is based on the information provided in World Bank (2021c).

² A low-income country may eventually graduate from the Debt Sustainability Framework for Low-Income Countries and migrate to the Debt Sustainability Analysis for Market Access Countries when its per capita income level exceeds a certain threshold for a specified period or when it has the capacity to access international markets on a durable and substantial basis.

³ Countries currently in nonaccrual status with the International Bank for Reconstruction and Development or the International Development Association are Eritrea, the Syrian Arab Republic, and Zimbabwe.

⁴ Countries currently in this category are South Sudan and the Republic of Yemen.

⁵ Twenty-four (of 75) International Development Association–eligible countries for which data were available over the 2012–19 period experienced an increase in their risk of debt distress. Of these, nine rose in debt distress risk from low to high (or from moderate to in debt distress), and the average time for the two-level increase was 2.7 years.

⁶ The 2019 Non-Concessional Borrowing Policy review suggests expanding dissemination to creditors through a Lending to LICs (low-income countries) mailbox (World Bank 2019b), but there is no significant evidence that the mailbox has had an impact on creditor behavior.

4 | Insights from Sustainable Development Finance Policy Implementation in FY21

Sustainable Development Finance Policy Performance and Policy Action Portfolio

Implementation of PPAs under the DSEP is a central aspect of the SDFP’s theory of change. PPAs are determined through direct discussions with country authorities and World Bank country economists and country directors; MTI Global provides advice, knowledge, and support to ensure PPAs are realistic. To a significant extent, it is through the articulation and implementation of PPAs that address the drivers of country-specific debt vulnerabilities that IDA-eligible countries would be expected to move toward more transparent, sustainable financing, which is SDFP’s main objective.¹ Of the 74 IDA-eligible countries, 55 countries were required to prepare PPAs under the DSEP (see appendix C for a list of countries). These countries were required to implement 130 PPAs in FY21. Of the 55 countries required to implement PPAs, 26 were at high risk of debt distress, 5 were in debt distress, and another 19 countries were at moderate risk of debt distress. The remaining 5 countries were MAC DSA countries, for which there were breaches of vulnerability thresholds for debt, gross financing needs, or debt profile indicators.

The SDFP secretariat classifies PPAs into three categories: debt management, debt transparency, and fiscal sustainability. The classification is not entirely informative because the categories overlap partially. For example, good debt management practices require transparency about borrowing decisions; similarly, fiscal sustainability is difficult to assess without clarity on debt stocks, borrowing, and debt service. Because of this conceptual overlap, similar PPAs are occasionally categorized differently, and there have been revisions to some PPAs’ classifications. For example, nonconcessional borrowing ceilings were originally classified under “fiscal sustainability” but

have since been recategorized as “debt management” (table 4.1).² The fiscal sustainability classification was broadly conceptualized to cover all aspects related to debt sustainability, including domestic resource mobilization.³

PPAs for most countries were spread across all three categories. PPAs were concentrated in a single category in just 4 of 55 countries (the Marshall Islands, Samoa, Tonga, and Vanuatu), and only for countries implementing only two PPAs.

More than half of the debt management PPAs (almost one-quarter of all FY21 PPAs) called for the adoption of a single-year ceiling on nonconcessional external borrowing. All IDA-only countries in debt distress or at high risk of debt distress (20) agreed to a PPA for the adoption of such a ceiling. Among blend and gap countries, about half (6 of 11) in debt distress or at high risk of debt distress agreed to PPAs requiring adoption of a nonconcessional borrowing ceiling. Among countries at moderate risk of debt distress, 4 IDA-only countries (out of 11) and 1 blend or gap country (out of 3) implemented nonconcessional borrowing ceilings.

The majority of PPAs categorized as fiscal sustainability focused mostly on fiscal transparency rather than fiscal policy. For example, audit reports on the use of COVID-19 funds (though potentially an important step toward fiscal sustainability) enhance transparency; they do not change fiscal parameters. Few PPAs have had a direct impact on spending or revenue, but there are a few examples of such measures, including an excise tax proclamation in Ethiopia and a decree to eliminate payment of ghost workers in Lesotho. The timing of the SDFP rollout with the extraordinary circumstances of COVID-19 made the implementation of fiscal policy-oriented PPAs related to fiscal consolidation (that is, procyclical fiscal policy) more difficult. At the same time, not all fiscal reforms are procyclical, and the circumstances of COVID-19 have heightened the urgency of prioritizing public expenditure and investment management and domestic revenue mobilization.

Table 4.1. SDFP Categorization of Performance and Policy Action under Debt Sustainability Enhancement Program, FY21

Countries	Countries (no.)	Agreed-on PPAs (no.)	Distribution of PPAs (%)		
			Debt management	Debt transparency	Fiscal sustainability
All DSEP	55	130	39	32	29
FCV	18	40	40	35	25
Small state	14	29	41	28	31
Lending category					
IDA-only	34	81	47	27	26
Blend-gap	21	49	27	39	35
Risk of debt distress					
Moderate risk of debt distress	19	46	33	37	30
High risk of debt distress	26	59	42	27	31
In debt distress	5	13	46	31	23
MAC DSA countries	5	12	42	33	25
IMF program	30	72	40	28	32
No IMF program	25	58	38	36	26

Source: World Bank 2021d.

Note: DSEP = Debt Sustainability Enhancement Program; FCV = fragility, conflict, and violence; FY = fiscal year; IDA = International Development Association; IMF = International Monetary Fund; MAC DSA = Debt Sustainability Analysis for Market Access Countries; PPA = performance and policy action; SDFP = Sustainable Development Finance Policy.

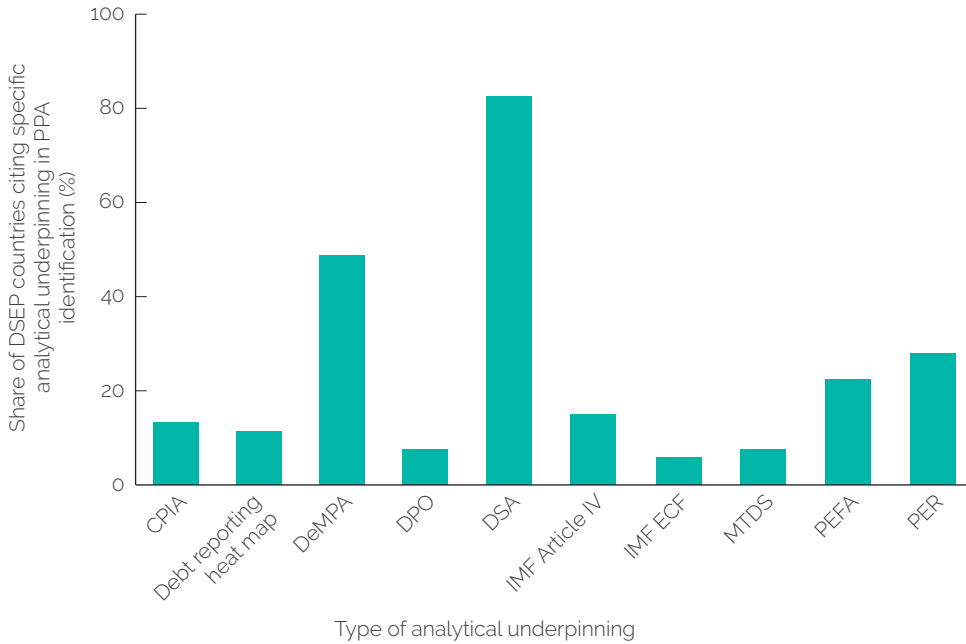
Few PPAs were devoted to PIM. Although the suboptimal use of past borrowed funds has contributed to debt stress in many IDA-eligible countries,⁴ only 4 of 130 PPAs were targeted to improving PIM.⁵ This falls short of the Board-endorsed recommendation in the recent IEG evaluation *World Bank Support for Public Financial and Debt Management in IDA-Eligible Countries* calling for regular updates of key diagnostics of public financial and debt management to inform the design of budget support operations, investment projects, and country-specific PPAs under the newly adopted SDFP (for example, by considering improvements in PIM together with measures to improve debt transparency and debt management). In its report to the Board on this evaluation's findings (World Bank 2021e, xxi), the Committee on Development Effectiveness suggested that "the implementation of the SDFP could pay greater attention to public investment management (PIM)."

World Bank documentation on PPA recommendations and design referenced a range of analytical underpinnings. As part of the internal PPA approval process, country teams were required to indicate the main diagnostics and analysis underpinning recommendations for and design of individual PPAs (figure 4.1). A database that the SDFP secretariat maintains shows that PPA recommendations and design over FY21 drew on a range of advisory services and analytics and technical assistance, including DSAs, Debt Management Performance Assessments (DeMPAs), Public Expenditure Reviews, Public Expenditure and Financial Accountability assessments, and Country Policy and Institutional Assessments.

A key diagnostic instrument underpinning many PPAs—the DeMPA—was often either outdated or not publicly available. For the majority of countries citing the DeMPA as a key analytical underpinning, no DeMPA was publicly available, complicating assessment of the relevance of some PPAs.⁶ IEG's recent evaluation, *World Bank Support for Public Financial and Debt Management in IDA-Eligible Countries*, noted that greater public awareness of DeMPA findings would help guide donor support and better inform public debate on country-specific reform priorities. That evaluation "acknowledged the World Bank's active encouragement" of country authorities to publish DeMPAs and suggested that DeMPA policy shift to a "presumption" of publication, with clients needing to explicitly request nonpublication (World Bank 2021e). This evaluation likewise recognizes the World Bank's recent

efforts to actively encourage governments to publish existing DeMPAs and points to the benefits of shifting to a presumption of DeMPA publication unless governments explicitly object.

Figure 4.1. Analytical Underpinnings Cited for FY21 Agreed-on Performance and Policy Actions



Source: Independent Evaluation Group staff estimates from World Bank (2021c).

Note: CPIA = Country Policy and Institutional Assessment; DeMPA = Debt Management Performance Assessment; DPO = development policy operation; DSA = debt sustainability analysis; DSEP = Debt Sustainability Enhancement Program; ECF = Extended Credit Facility; FY = fiscal year; IMF = International Monetary Fund; MTDS = Medium-Term Debt Management Strategy; PEFA = Public Expenditure and Financial Accountability; PER = Public Expenditure Review; PPA = performance and policy action.

The process for verifying implementation of PPAs is yet to be developed fully. The SDFP FY21 Board Update lists PPAs approved over FY21, but it does not report on their implementation, the deadline for which has been extended from May 2021 to July 2021 (World Bank 2021d). The SDFP secretariat maintains a database of PPAs that does not include information on the modality and responsibility for tracking PPA implementation. In some cases, PPAs are included in DPOs either as prior actions or, on occasion, as a results indicator.⁷ However, although the World Bank’s legal department confirms implementation of PPAs as prior actions as part of the DPO approval process, achievement of targets for results indicators is not subject to the same standard of verification.

Limited attention has been paid to putting a framework in place to monitor PPA impact. If PPAs are implemented as prior actions in DPOs, there is a requirement for results indicators and targets with which to assess outcomes. Otherwise, PPA notes have no explicit guidance or requirement to specify indicators with which to monitor impact. The lack of a monitoring and evaluation framework significantly weakens the ability to monitor the SDFP's overall success and to learn from implementation experience. The guidelines mention the results only once, related to the information that should be presented to the SDFP committee when implementation is under a DPO. Elsewhere, the focus is exclusively on how to identify PPAs.

About one-quarter of PPAs are prior actions in DPOs. However, this can present challenges when agreement on or approval of the DPO (that contains the PPA) is delayed or the DPO is canceled.⁸ Other PPAs have relied on verification outside of World Bank operations, including policy dialogue checkpoints, check-ins with country teams, and self-reporting by the country (through various mechanisms). In these cases, responsibility for confirming compliance has been unclear. The SDFP secretariat is aware of this and is working closely with teams to ensure an adequate and consistent standard of verification for all PPAs.

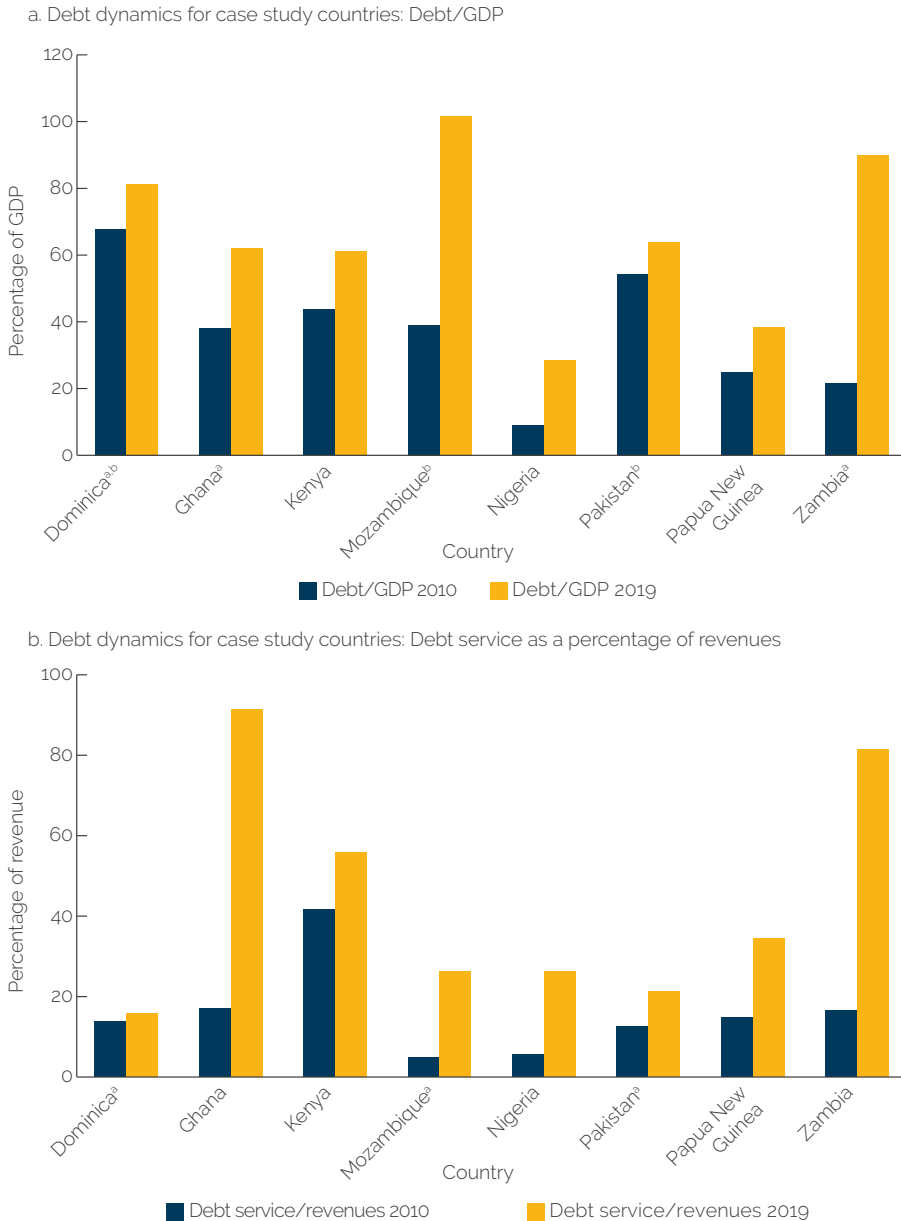
Insights from Country Case Studies

IEG conducted eight case studies for countries under the DSEP to learn from the SDFP implementation over FY21. The case studies were also an opportunity to evaluate the relevance of PPAs at the country level to drivers of debt stress, drawing on existing diagnostics and interviews with country teams and IMF staff. Appendix A describes the methodology for country selection and for evaluating the relevance of the PPAs of each country. Reflecting the early-stage nature of this evaluation, the assessment of relevance was undertaken in the spirit of identifying good practice and highlighting ways in which the use of PPAs could be made more impactful.

Of the eight countries selected, five were assessed to be at high risk of debt distress and one was assessed to be in debt distress. Two countries, Nigeria and Pakistan, are market access countries that breached vulnerability thresholds for debt, gross financing needs, debt profile indicators, or all

three. All the countries but one (Mozambique) are IDA blend or gap. All the countries showed significant deteriorations in debt or debt service indicators between 2010 and 2019 and experienced elevations in their assessed risks, gross financing needs, or debt profile indicators (figure 4.2).

Figure 4.2. Changes in Debt and Debt Service among Case Study Countries, 2010–19



Source: Staff estimates from the International Monetary Fund World Economic Outlook database.

Note: GDP = gross domestic product.
 Panel a: a. Central government debt. b. 2017 figures.
 Panel b: a. 2017 latest available.

Drivers of rising debt distress are country specific. In Dominica, spending for natural disasters and recurrent fiscal deficits contributed to a steadily rising debt burden, pushing the country into high risk of debt distress. In Mozambique, hidden nonconcessional borrowing by SOEs led to a recategorization of debt risk, and now the country is considered in debt distress. Extremely low revenue mobilization and rising costs of debt service (partly because of expensive central bank financing of budget deficits) resulted in a fivefold rise in Nigeria's debt service to revenue ratio. Debt service now accounts for nearly 100 percent of federal revenue (the level of government that is responsible for servicing the debt) and one-quarter of consolidated government revenue. A drop in commodity prices, an overvalued exchange rate, and realization of a large stock of contingent liabilities from SOEs all contributed to Papua New Guinea's increase in debt-to-GDP. In Zambia, expansionary and procyclical fiscal policies and a large number of capital projects—many of which have failed to yield expected growth—resulted in debt-to-GDP almost quadrupling over the past decade.

All eight case study countries were required to implement PPAs in FY21 (see appendix D, table D.2). All but two were required to implement three PPAs each. Dominica and Papua New Guinea were the exceptions, required to implement two PPAs each (Dominica as a small state and Papua New Guinea as a country affected by fragility, conflict, and violence). Only two countries (Ghana and Kenya) implemented two PPAs in the same category (fiscal sustainability), and the rest had PPAs spread across the SDFP categories. Three countries (Mozambique, Papua New Guinea, and Zambia) had PPAs requiring nonconcessional borrowing ceilings.

IEG confirmed the implementation of 19 of the 22 agreed-on PPAs as of July 20, 2021. PPAs not implemented as of August 2021 include Dominica PPA2 (adoption of a fiscal rules and responsibility framework), Pakistan PPA2 (issuance of implementing regulations after approval of the common goods and services tax law), and Pakistan PPA3 (publication of debt bulletins and a report on COVID-19 spending). In Pakistan, both actions are pending legislative actions. The SDFP committee has formally granted a waiver to Dominica, given that the administration had made a good faith effort to pass the aforementioned fiscal rules act, which parliamentary procedure was delaying. However, the act is expected to pass within the next several months.

Relevance of Country Case Study Performance and Policy Actions

IEG evaluated PPAs for each of the case study countries for their relevance to the underlying country-specific drivers of debt stress.⁹ Key criteria for determining relevance included the following:

- » The extent to which a PPA addressed an identified driver of country debt distress;
- » The degree to which a PPA was articulated within a clear and credible results chain, linking the PPA to an eventual reduction in risk of debt distress, including through identification of other measures that may be needed to have an impact;
- » The degree to which a PPA addressed a systemic weakness in an enduring manner (rather than a one-off or ad hoc manner); and
- » The degree to which a PPA is expected to make a substantive contribution to reducing the risk of debt distress (see appendix D, table D.3).¹⁰

Do Case Study Countries' Performance and Policy Actions Address Drivers of Rising Debt Stress?

Almost two-thirds of PPAs, both overall and at the country level, responded to areas of country-specific debt stress. A PPA that was well targeted to identified areas of debt risk is the cancellation of \$1 billion in contracted but undisbursed debt in Zambia, which addressed (at least partly) the escalation in debt from poorly managed capital projects with questionable returns. The action was expected to have an impact on Zambia's debt sustainability and assist in the reduction in accumulated external arrears of \$5 billion. Another example is Ghana, where the amendment to the Revenue Administration Act addressed a key driver of the country's debt stress (low domestic revenue mobilization) and is expected to expand the tax base and strengthen compliance. In Pakistan, harmonization of the sales tax addressed a recognized area of deteriorating fiscal space, and its implementation is expected to significantly reduce tax compliance costs (thereby increasing compliance). In Nigeria, the country's amended budget, which permits access to cheaper and more transparent

financing by raising domestic and external borrowing limits, was a short-term response to an immediate source of escalating debt servicing costs. In total, 14 of the 22 PPAs were well aligned to identified sources of debt stress.

Although most of the PPAs addressed identified areas contributing to debt stress, a few PPAs addressed issues that did not feature prominently in diagnostics of debt stress. For example, Nigeria's publication of signed but undisbursed federal government loans might contribute to better debt management, but no evidence is presented to suggest that undisbursed loans are a main factor underlying the recent rise in debt stress (which is manifested in debt service). Similarly, the Kenyan National Treasury's online publication of the latest audited statement of public debt improves the availability of timely, granular public debt data, but no evidence is presented that the lack of debt transparency was a major driver of debt stress.

Although many of the PPAs promote general good practice, major country-specific drivers of debt stress were sometimes unaddressed. For example, Zambia's debt stress was affected heavily through borrowing to finance inefficient public investments. This would suggest the need, alongside a reduction in the stock of debt, for improvements in PIM, particularly in the selection of projects, including a requirement to undertake higher-quality ex ante appraisals of new public investment projects. According to Zambia's 2017 Public Investment Management Assessment, public investment suffered from an estimated efficiency loss of 45 percent. Zambia's FY21 PPAs seek to address the problem of borrowing for projects through the cancellation of undisbursed debt, focusing on projects thought to have lower expected returns. Although critical to addressing the country's debt distress by reducing the *existing* debt stock, the PPAs do not tackle the shortcoming that led to the borrowing in the first place (that is, weak PIM).

Nonconcessional borrowing ceilings were included in PPAs for three case study countries, even when their absence was not a main driver of rising debt stress. For example, in Papua New Guinea, the increase in debt stress from moderate to high risk related primarily to a decline in export revenues and the government taking over the servicing of three SOE project loans as central government debt (and implicit government-guaranteed debts of SOEs and unfunded superannuation liabilities related to pensions). It is not

obvious that the nonconcessional borrowing ceiling will affect the trajectory of nonconcessional borrowing in practice because the new (PPA-based) nonconcessional borrowing ceiling was set about 30 percent higher than average yearly external borrowing over the previous four years.

Most PPAs drew on current, relevant, and credible analytical underpinnings. PPAs drew on a wide body of analytical work, including DSAs, DeMPAs, Public Expenditure Reviews, and Public Expenditure and Financial Accountability assessments, along with other technical assistance analyses, Systematic Country Diagnostics, and IMF documents (particularly Article IV consultation reports). This highlights the importance of having available and up-to-date core diagnostics of a country's public debt and financial management, institutions, and performance, which is a key recommendation of IEG's evaluation, *World Bank Support for Public Financial and Debt Management in IDA-Eligible Countries* (World Bank 2021e). In the evaluation, IEG recommends that the World Bank ensure the existence and availability of such country-level diagnostics and regular monitoring of their indicators to help country teams better prioritize and sequence World Bank support, including through PPAs.

Occasionally, it was not possible to verify the links between analytical underpinnings and PPAs. The ability to evaluate the relevance of approved PPAs was constrained when underlying diagnostics were not publicly available (such as the Papua New Guinea 2020 DeMPA) or when PPAs were based on country dialogue (and no specific diagnostic document). In other cases—even when referenced analytical underpinnings were recent, credible, and available—verifiability was complicated by the fact that PPA notes did not always clearly explain why certain PPAs were chosen.

Do Case Study Countries' Performance and Policy Actions Clearly and Credibly Articulate the Results Chain Linking the Performance and Policy Actions to Reduced Debt Stress?

Many PPAs represent single steps within a longer results chain to reduce debt stress, but subsequent actions are often needed to ensure impact. Where this is the case, PPA efficacy requires clarity on next steps. Although situating PPAs in the context of a longer-term theory of change is not re-

quired as part of the SDFP, having such clarity can signal to development partners and the public the concrete actions required to address the underlying causes of high and rising debt stress. It can also provide a clear basis from which the World Bank can draw in articulating future PPAs or prior actions in DPOs.

Half the case study PPAs are situated explicitly within the results chain required for impact (sometimes with subsequent actions identified to take reforms further along the results chain). For example, Kenya's PPA notes clearly articulate how PPA1, on approval of PIM regulations and inventory of public investment projects, fits into the broader results chain. It explains subsequent steps necessary for impact after passage of the regulations, including support for full implementation of PIM and project monitoring and evaluation guidelines. Additionally, it explains how the inventory exercise will be used to help determine which projects could be terminated through submission to the cabinet of recommendations on how to streamline Kenya's project portfolio. Conversely, other PPAs were presented in isolation, with little clarity on how the supported actions would be taken forward. Ghana's three FY21 PPAs, for example, do not explain how the proposed actions will lead to longer-term outcomes, and it is necessary to refer to the Project Appraisal Document of the Ghana Economic Management Strengthening Project (from which the PPAs were derived) to find out.

Do Case Study Countries' Performance and Policy Actions Support Lasting Solutions to Drivers of Debt Stress?

In several cases, PPAs involved changes in institutional requirements or arrangements that would have a more enduring impact. Of the 22 PPAs in the eight case studies, 13 institutionalized actions (through legal amendments, regulatory changes, or well-disseminated public commitments to particular actions). Pakistan's PPA2, for example, requires legislation to harmonize the goods and services tax at the federal and provincial levels and publication of implementing regulations. These measures are aimed at streamlining and improving revenue collection and directly address the issue of low tax revenues, which is one of the key drivers of debt distress in Pakistan.

However, some PPAs were one-off actions, requiring repeated action to have enduring impact. For example, the expansion of coverage of Dominica’s debt reporting to parliament to include all active loan guarantees was a valuable measure, but PPA1 called for the submission of the more inclusive debt report to parliament in FY21 only. A stronger measure might have required submitting the debt report to parliament annually, which would have depoliticized the decision to report comprehensive debt information and not required subsequent decisions on publication. Although the country team has indicated the intention to have a subsequent PPA on submission of the FY22 debt report to parliament next year, this approach misses the opportunity to depoliticize publication by making it a statutory requirement. Therefore, subsequent PPAs could be used to address other drivers of debt stress.

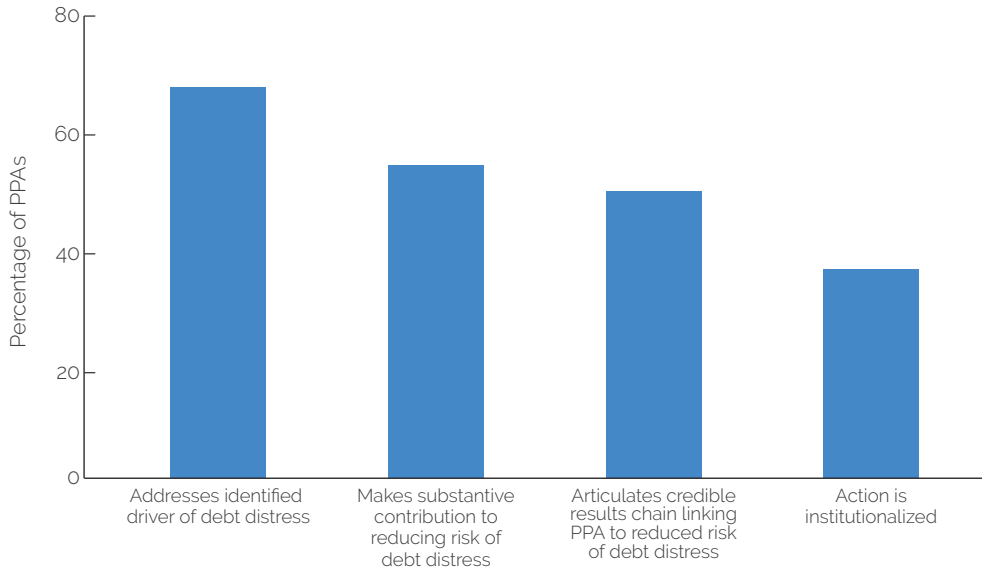
In a few cases, institutionalization was achieved through efforts parallel to PPAs. Mozambique’s PPAs were one-off actions (that is, publication of the annual debt report, adoption of a zero nonconcessional borrowing limit on external public and publicly guaranteed debt for the current FY, and production of credit risk reports for seven SOEs using a new credit risk assessment framework). But ongoing dialogue between the World Bank country team and the client has led to ongoing compliance with the integration of debt reporting and the credit risk assessment framework into the regulations of the country’s new Public Financial Management Act. The act’s regulations now mandate the publication of annual debt reports that cover the SOE sector and fiscal risk statements that contain SOE credit risk reports. The PPAs were used as a bridge to the enactment of the Public Financial Management Act.

Do Case Study Performance and Policy Actions Make a Substantive Contribution to Reducing Debt Stress?

For more than half of the PPAs, the action is expected to make a substantive contribution to reducing debt stress. In Nigeria, for example, the average interest rate on the central bank overdraft is 3–5 percentage points higher than federal government bonds and treasury bills, and revisions to borrowing limits should yield immediate and substantial savings in debt service (a key driver of debt stress in Nigeria). Creating the borrowing headroom to allow Nigeria to borrow at lower rates is expected to yield annualized cost savings of about \$500 million, or about 10 percent of total interest payments in 2019.

Similarly, Ghana's narrow tax base, low tax compliance, and overgenerous exemptions dampen domestic resource mobilization. Amending the Revenue Administration Act of 2016 to reduce tax exemptions and strengthen voluntary disclosure is expected to offset the government's severe decline in revenue over the medium term.

Figure 4.3. Proportion of Country Case Study Performance and Policy Actions Meeting Specific Relevance Criteria



Source: Independent Evaluation Group.

Note: PPA = performance and policy action.

In some cases, however, the contribution to addressing the drivers of debt stress is expected to be modest. For example, in Zambia, PPA1 required adoption of a zero nonconcessional borrowing ceiling on contracting new external public and public guaranteed debt in 2021 (such ceilings were adopted for all countries at high risk of debt distress or already in distress). However, the *additionality* of this action was likely modest because the government of Zambia had already postponed the contracting of all new nonconcessional loans indefinitely: In May 2019, a cabinet decision effectively put a nonconcessional borrowing ceiling in place. This same cabinet directive also included a measure to cancel some committed but undisbursed loans to free up at least \$6 billion in contracted but undisbursed loans (out of \$9.7 billion of such debt), which questions the additionality of Zambia's

PPA2 on cancellation of at least \$1 billion of debt by May 2021. Although it is clear that a zero ceiling would help prevent the buildup in debt, and that cancellation of undisbursed debt can reduce the debt stock, the value added of duplicating preexisting and credible commitments to zero ceilings is minimal. Figure 4.3 summarizes the findings of an analysis of the relevance of PPAs for the country case studies.

Country Teams' Implementation Issues

Country teams' ability to conceptualize the appropriate PPAs relies on a range of guidance mechanisms. Several country teams described the guidance they received from the SDFP secretariat (for general information on the policy); from Operations Policy and Country Services; and from the Equitable Growth, Finance, and Institutions's debt unit (for technical guidance on PPAs) as "instrumental" for articulating relevant PPAs. These channels of support were particularly helpful because the SDFP implementation guidelines were in development and further clarification was needed.

Country teams mentioned several areas where clarity could be strengthened. One area was debt risk screening for MAC DSA countries. Although the process for screening LICs was clear, there was less clarity about how MAC DSA countries would be assessed for debt risk, who would make that decision, and when the decision would be made. In Nigeria, this lack of clarity reduced the time the country team had to identify and consult on PPAs. There was also lack of clarity on the necessity of including a nonconcessional borrowing ceiling among PPAs for countries at high risk of debt distress (particularly for blend countries). In two countries (Ghana and Zambia), staff were under the impression that a nonconcessional borrowing ceiling needed to be included among the PPAs, even though nonconcessional borrowing ceilings were already in place.

Several country teams saw a need for additional resourcing for the SDFP. These teams argued that developing PPAs and implementing them requires significant support, particularly for countries with very low capacity. In Dominica, for example, it was relatively easy to identify a PPA related to improving the debt management report (drawing on recommendations from the DeMPA), but the government needed significant support to draft the re-

port. A PPA related to a fiscal rules framework also required significant technical assistance (which the country team resourced from a Global Tax Trust Fund). Although the Debt Management Facility is the likely source of financing for technical assistance related to some aspects of SDFP implementation, the number of countries expecting to undertake actions could imply efforts to ensure that technical assistance demand matches supply.

The limited time between internal PPA approval and the PPA implementation deadline affected some PPAs' ambition. Short timelines sometimes made it difficult to implement more ambitious PPAs. For example, Nigeria's PPA note was approved in February 2021 after seven revisions.

¹ Creditor coordination under the Program of Creditor Outreach is the other dimension to encourage sustainable borrowing.

² The Sustainable Development Finance Policy secretariat maintains a database charting policy implementation, which is updated continually. As of the end of April 2021, the implementation database categorized nonconcessional borrowing ceilings as actions toward fiscal sustainability. Nonconcessional borrowing ceilings were subsequently reclassified as debt management actions.

³ In fiscal year 2021, 7 of 55 countries implementing performance and policy actions (PPAs) had domestic resource mobilization–related PPAs.

⁴ World Bank (2021e) found that relatively few International Development Association–eligible countries that are currently at risk of or in debt distress received development policy operation support to strengthen public investment management. During the evaluation period, only 7 of 30 International Development Association–eligible countries at high risk of or in debt distress (as at 2017) had development policy operations with prior actions related to public investment management.

⁵ Countries implementing PPAs related to public investment management include The Gambia, Grenada, Kenya, and Maldives.

⁶ Debt Management Performance Assessments are confidential and require government approval for publication.

⁷ For example, Fiji’s PPA2, in which the Ministry of Economy includes the risk profiles of publicly guaranteed liabilities in the government debt status report, is a results indicator on the approval of a government guarantee policy for granting guarantees to government entities (Fiji Second Fiscal Sustainability and Climate Resilience development policy operation).

⁸ This was the case for two of Zambia’s three fiscal year 2021 PPAs.

⁹ See appendix D for a full list of PPAs for case study countries.

¹⁰ Although criterion 1 is directed to the sources of debt stress (for example, revenue or expenditure challenges), criterion 4 assesses the degree to which the PPA makes a meaningful contribution toward reducing debt stress risks. It is possible that a PPA addresses a driver of debt stress but that the contribution toward lowering the associated risk is modest.

5 | Findings and Recommendations

Findings

IEG's early-stage evaluation of IDA's SDFP focuses on the extent to which the SDFP, as designed and implemented to date, addresses the drivers of the rise in debt vulnerabilities in IDA-eligible countries over the past decade by incentivizing a move toward transparent, sustainable financing. The evaluation examined four critical dimensions of the policy: (i) country coverage, (ii) debt coverage, (iii) the incentive structure for actions by borrowers and creditors, and (iv) the relevance of the country-specific PPAs to the key drivers of debt stress.

The SDFP marks an important improvement over the NCBP in several ways. These include broadening of country coverage to more countries at risk of debt distress, inclusion of domestic and external debt, and closer attention to a wider range of risks from nonconcessional borrowing such as contingent liabilities and collateralization. The SDFP introduced a requirement for country-specific policy performance actions to address drivers of debt distress and the use of set-asides to incentivize implementation (the NCBP allowed for outright reductions in IDA allocations).

It is premature to assess several aspects of the SDFP, particularly given the adverse conditions under which the policy was rolled out. For example, it is too soon to assess the strength of the SDFP incentive of using IDA allocation set-asides to ensure implementation of PPAs; to date, no set-asides have been applied. It is also too early to assess whether the PCO will succeed in incentivizing creditor coordination. A fundamental question is whether the World Bank has sufficient leverage or persuasive power over the creditor community when IDA is not the dominant creditor in many IDA-eligible countries. The PCO represents a well-intentioned objective to engage the broader community of creditors, but objectives are only vaguely articulated and may lack realism regarding what can be achieved through dialogue and education. The review

of the NCBP found that previous efforts at creditor coordination had a positive but limited impact on lending decisions; little was achieved with respect to coordination with non-Paris Club and private creditors. It highlights a need for the SDFP to function on two fronts: (i) to maximize coordination with like-minded multilateral and bilateral creditors with the capacity to lend on concessional terms, and (ii) to move the focus away from loan terms and on to building consensus with commercial creditors about the need to finance only viable projects with positive rates of return.

Drawing on the early experience with the implementation of the new policy and the insights from reviews of NCBP performance is an opportunity to improve the SDFP. IEG identified several aspects of the policy that could be adjusted to enhance its impact in support of IDA-eligible countries, as follows:

- » The SDFP screening process for DSEP coverage did not fully reflect the speed at which IDA-eligible countries have moved from lower to higher risk of debt stress. The current SDFP exempts IDA-eligible countries at low risk of debt distress from implementing PPAs. But one-third of IDA-eligible countries that experienced an elevation in their risk of debt distress over the past decade experienced a two-level deterioration within three years. This suggests some modification in the DSEP application. Although this does not have to require that all IDA-eligible countries participate in the DSEP, additional criteria for exclusion (reflecting a broader range of underlying fiscal or economic vulnerabilities) may be warranted.
- » PPAs did not always address the main country-specific drivers of debt stress, even though the SDFP provides a flexible mechanism for targeting country actions to the diverse sources of debt risks in IDA countries. About one-third of PPAs had limited additionality or value added. Analysis of eight case study countries suggests that although most PPAs focused on areas that were relevant for reducing debt stress, PPAs were not always grounded in a country-specific assessment of the main drivers of debt distress. In some cases, “standard” PPAs (for example, nonconcessional borrowing ceiling) or good practice reforms were included among PPAs, even when countries already had their own similar policies in place. In other cases, a desire to cover more than one category of PPA (for example, debt transparency, debt management, or fiscal sustainability) led to the selection of PPAs of secondary importance. These practices resulted in crowding out more critical reforms.

- » Only half of the PPAs were explicitly set in the context of a clearly articulated results chain linking the action to a reduction in debt stress. Moreover, clarity was often lacking on the subsequent or complementary actions required for the PPA to have impact. Although situating PPAs in the context of a longer-term theory of change is not required as part of the SDFP, having such clarity can signal to development partners and the public the concrete actions that are required to address the underlying causes of high and rising debt stress. Clarity can also provide a clear basis from which the World Bank can draw in articulating future PPAs or prior actions in DPOs.
- » Several PPAs were crafted as one-off actions (for example, publication of debt reports or submission of them to parliament). A majority of the PPAs from the country case studies are not institutionalized, meaning the actions are not embedded in legislation or in an institutional authority that could ensure the action's continuation. Such a year-by-year approach does not create the institutional framework needed to depoliticize transparency. It also relies on using future external leverage to achieve the transparency objective on a longer-term basis.
- » SDFP's first year of implementation revealed opportunities to strengthen the guidance and review processes. Clarity was lacking on several occasions, including regarding screening and the application of nonconcessional borrowing ceilings; the availability of guidance from core SDFP teams was instrumental for country teams to articulate appropriate PPAs. Except for PPAs that are prior actions in DPOs, there is no requirement for World Bank staff to identify indicators to monitor PPA impact, weakening the ability to assess the SDFP's effectiveness at the global or country level. The SDFP secretariat initiated a seminar series in July 2021 to provide regular guidance to country teams on the policy. That and other efforts could help resolve remaining uncertainties.¹ There were also challenges with the timeline for implementation, intensified by a time-consuming review process. Simplifying the process of presenting PPAs for review could help alleviate a potential risk to implementation.
- » The ability of the SDFP's second pillar—the PCO—to make a meaningful contribution to the SDFP's goals remains uncertain. Despite several outreach events during FY21, PCO strategies and modalities remain vague more than a year after the SDFP's approval. The PCO's success hinges on its ability to

improve coordination and foster collective actions with non-Paris Club and private creditors, something that the World Bank was unable to achieve in a meaningful way under the NCBP. It remains unclear whether the World Bank has the prospect of any greater traction with creditors under the PCO.

Recommendations

1. Consideration should be given to expanding the countries covered by the DSEP beyond those at moderate or high levels of debt distress or in debt distress. Countries at low risk of debt distress, which are currently not required to implement PPAs, can shift into higher levels of risk in a relatively short time. In fact, one-third of the countries that experienced an elevation in their risk of debt distress over the past decade experienced a two-level deterioration in less than three years. A low level of debt distress alone should not be sufficient for exclusion from the DSEP, and IEG recommends applying an additional filter.
2. PPAs should emanate from an up-to-date assessment of country-specific debt stress and be set explicitly within a longer-term reform agenda. PPAs should target the main country-specific drivers of debt stress and risk. Standard PPAs applied across countries (including nonconcessional borrowing ceilings and requirements that PPAs be spread across multiple topics) should be avoided because they run counter to ensuring that actions target country-specific priorities and could crowd out more impactful actions. PPA notes should situate PPAs within a longer results chain and articulate complementary and subsequent actions needed to ensure impact. This should be done even when the World Bank does not provide support for next steps because the articulation of a results chain linking actions needed for impact can provide important signals to development partners and help build domestic support for future actions.
3. Where PPAs support actions that need to be taken regularly (for example, debt reporting to parliament), they should aim for long-lasting institutional reforms rather than relying on one-time actions. PPAs should seek to institutionalize good practice in fiscal and debt management by supporting the establishment of statutory requirements, the

existence of which can help depoliticize future decisions. Inclusion of one-time measures that need to be repeated yearly should be avoided (even if supported by subsequent PPAs) unless they clearly bridge to more permanent solutions.

¹ Updated Sustainable Development Finance Policy Implementation Guidelines were adopted in May 2021.

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APPENDIXES

Independent Evaluation Group

*The International Development Association's
Sustainable Development Finance Policy:
An Early-Stage Evaluation*

Appendix A. Approach and Methodology

Methodology for Evaluating Overall Design and Governance of the Sustainable Development Finance Policy

The Approach Paper for this evaluation sought to answer four key questions on the early experience of the Sustainable Development Finance Policy (SDFP).

Country Case Studies and Evaluation of Sustainable Development Finance Policy Implementation

The assessment of the SDFP at the practice level was undertaken through an analysis of approved performance and policy actions (PPAs) for a set of eight countries for which the evaluation assessed the relevance of approved PPAs to meaningfully addressing the main drivers of debt stress. Using a theory-based approach, the evaluation assessed the clarity of the country-specific results chain linking each PPA to a reduction in country-specific debt stress and vulnerabilities.

The evaluation team conducted interviews with staff responsible for the design and implementation of the SDFP—including the Development Finance Vice Presidency (which heads the SDFP secretariat) and the debt unit of the Macroeconomics, Trade, and Investment Global Practice—to obtain information regarding the development of the policy. In addition to providing further insights into the articulation of PPAs, the interviews helped assess the clarity and coherence of internal guidance on the policy.

The eight countries selected for case studies represent countries that demonstrated particularly significant increases in debt risks over the past decade, either regarding debt to gross domestic product or debt service to revenue, or both. These countries fall into the top-right quadrant of figure A.1. They are not intended to be representative of the 55 countries participating in the Debt Sustainability Enhancement Program. From countries experiencing increases in debt and debt service burdens, the sample was refined further to ensure representation of characteristics considered relevant to efforts to address debt stress, including debt sustainability analysis risk of debt distress ratings; fragility, conflict, and violence status; country size; lending category; and the presence of an International Monetary Fund (IMF) program (see table A.1).

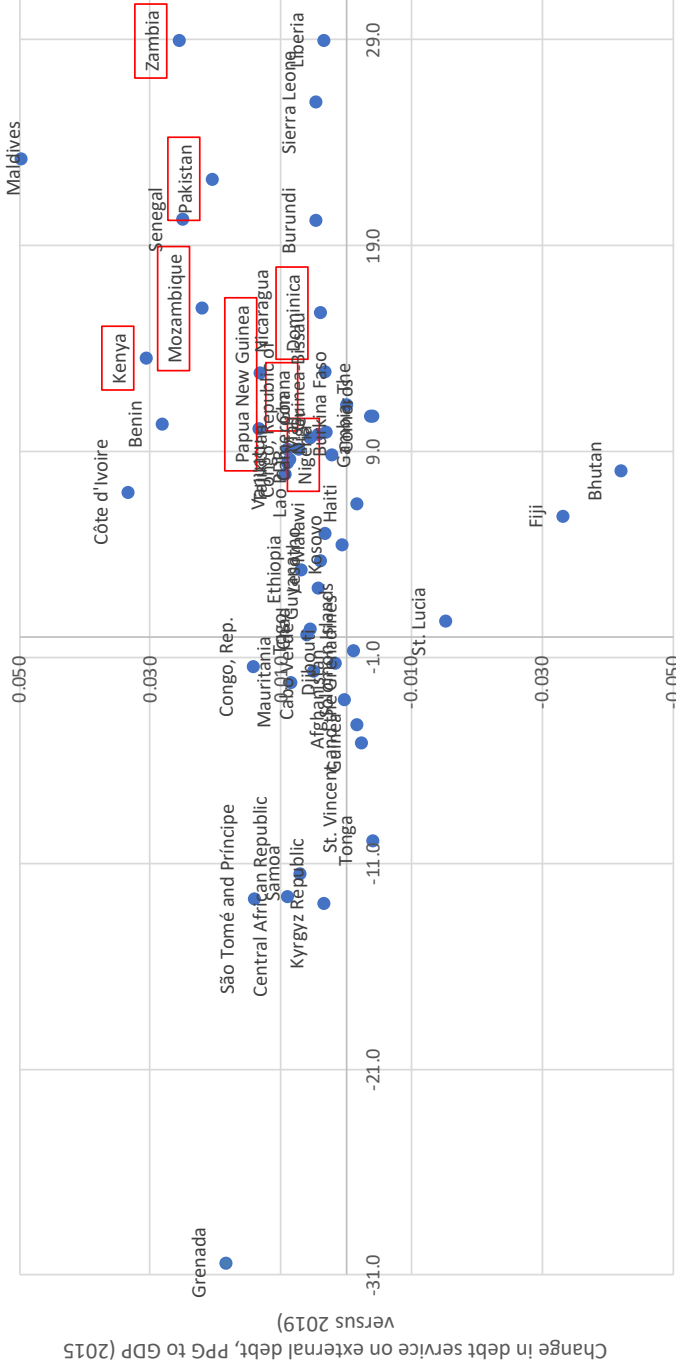
Table A.1. Country Case Studies Descriptive Statistics

Case Study	Region	DSA in 2015	DSA in 2020	FCV	Lending Category	IMF Program
Dominica	LAC	High	High	No	Blend	No
Ghana	AFR	High	High	No	Gap	No
Kenya	AFR	Low	High	No	Blend	No
Mozambique	AFR	Moderate	In distress	FCV	IDA only	No
Nigeria	AFR	MAC DSA	MAC DSA	FCV	Blend	No
Pakistan	SAR	MAC DSA	MAC DSA	No	Blend	Yes
Papua New Guinea	EAP	n.a.	Moderate	FCV	Blend	Yes
Zambia	AFR	Moderate	High	No	Gap	No

Source: World Bank 2021b; World Bank World Development Indicators database (accessed June 2021); IMF Government Finance Statistics (database), International Monetary Fund, Washington, DC (accessed June 2021), <https://data.imf.org/?sk=a0867067-d23c-4ebc-ad23-d3b015045405>; World Bank and International Monetary Fund Debt Sustainability Analysis (various years).

Note: AFR = Africa; DSA = debt sustainability analysis; EAP = East Asia and Pacific; FCV = fragility, conflict, and violence; IDA = International Development Association; IMF = International Monetary Fund; LAC = Latin America and the Caribbean; MAC DSA = Debt Sustainability Analysis for Market Access Countries; n.a. = not applicable; SAR = South Asia.

Figure A.1. Changes in Debt-to-GDP Ratio and Debt Service on External Debt, Public, and Publicly Guaranteed to GDP (2015 versus 2019)



Change in debt-to-GDP ratio (2015 versus 2019)

Source: World Bank World Development Indicators database, June 2021; International Monetary Fund World Economic Outlook database, April 2021; International Monetary Fund Government Finance Statistics database, June 2021. Note: GDP = gross domestic product; PPG = public and publicly guaranteed debt.

Approved PPAs were assessed for relevance at the country level. Through both a review of key diagnostic analysis of debt vulnerabilities (including debt sustainability analyses, Article IV consultation reports, Country Economic Memorandums, Systematic Country Diagnostics, Macro Poverty Outlooks, Debt Management Performance Assessment reports, Public Expenditure Reviews, and PPA notes) and interviews with country teams, the evaluation team assessed the relevance of approved PPAs in the eight country cases for the fiscal year 2021. The assessment drew on a methodology similar to one that the Independent Evaluation Group used to evaluate the relevance of prior actions in the development policy operations, which looks at:

- » Extent to which PPA addressed an area identified as a major driver of their debt distress;
- » Degree to which PPA was articulated within a clear and credible results chain, linking PPA to an eventual reduction in risk of debt distress, including through the articulation of subsequent actions needed to have impact;
- » Degree to which PPA sustainably addressed a systemic weakness; and
- » Degree to which PPA is expected to make a substantive contribution to reducing the risk of debt distress.

Semistructured interviews with country teams and IMF staff provided information on the rationale for PPA selection and SDFP implementation in the first year. Country teams responsible for identifying PPAs were interviewed to obtain their views on the main drivers behind the buildup of debt, related reform priorities, the process whereby the country team identified and articulated PPAs (both within the World Bank and with client governments and the IMF), and the process for verifying PPA implementation. Information from these interviews was triangulated with data from the analysis of PPAs to inform findings on the extent to which the SDFP's rollout in its first year of implementation supported achievement of its stated objective of addressing the drivers of the rise in debt distress over the past decade.

The Independent Evaluation Group also conducted interviews with IMF mission chiefs and desk economists for case study countries to solicit their views on the key drivers of debt stress and their experience working with World Bank staff during the SDFP implementation.

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Appendix B. Governance Arrangements for the Sustainable Development Finance Policy

The performance and policy action (PPA) approval process is governed by a World Bank–wide Sustainable Development Finance Policy (SDFP) committee. The SDFP committee consists of the Development Finance Vice Presidency, the Operations Policy and Country Services vice president, and the Equitable Growth, Finance, and Institutions vice president, with the managing director, Operations, reviewing and approving PPAs. The implementation guidelines for the SDFP state that the governance arrangements underpinning the identification of PPAs are meant to ensure that they are (i) based on the policy dialogue with the country authorities, (ii) informed by sound diagnostics, and (iii) aimed at supporting an ambitious but realistic pathway toward debt sustainability and addressing related challenges (World Bank 2020).

The process by which PPAs are conceived and approved (table B.1) is described in the SDFP implementation guidelines (June 22, 2020). PPA implementation is verified through a variety of methods, including a letter from the client, publications, and posting on official websites, all of which are confirmed by the relevant World Bank staff.

Table B.1. Process for Performance and Policy Action Formulation and Submission

Processing Steps	Roles and			
	Actions	Distribution	Timing	Remarks
The country economist prepares the PPA note (both formulation of PPAs for next fiscal year and progress on PPAs of previous year or years)	TTL: recommends PM: concurs CD: concurs SDFP committee members: advise RVP: Concurs	From: TTL To: PM, CD, SDFP committee, RVP Cc: decided by the Region	A calendar determining the deadline for each Region will be provided yearly.	
Region submits the final PPA note for corporate review and approval	RVP: recommends SDFP committee: advises DFi, OPCS, EFI VPs: concur MDO: decides	From: RVP To: SDFP committee, DFi, OPCS, EFI VPs, MDO Cc: decided by the Region	Submission by May 1 Decision by June 20	The RVP may delegate to DSO MDO may delegate to DFi VP

Source: World Bank 2020.

Note: Cc = carbon copy; CD = country director; DFi = Development Finance Vice Presidency; DSO = director, strategy and operations; EFI = Equitable Growth, Finance, and Institutions; MDO = managing director, Operations; OPCS = Operations Policy and Country Services; PM = practice manager; PPA = performance and policy action; RVP = regional vice president; SDFP = Sustainable Development Finance Policy; TTL = task team leader; VP = vice president.

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Appendix C. International Development Association–Eligible Countries Subject to the Debt Sustainability Enhancement Program

Table C.1. International Development Association–Eligible Countries Subject to the Debt Sustainability Enhancement Program

Country Name	Lending Eligibility	DSA Rating	Year of DSA Rating	Joint World Bank–IMF DSA Overall Risk of Debt Distress
Afghanistan	IDA-only	High	2020	High
Benin	IDA-only	Moderate	2020	Moderate
Bhutan	Gap	Moderate	2020	
Burkina Faso	IDA-only	Moderate	2020	Medium-intensity conflict
Burundi	IDA-only	High	FY20 latest ^a	High institutional and social fragility
Cabo Verde	Blend	High	2020	
Cameroon	Blend	High	2020	Medium-intensity conflict
Central African Republic	IDA-only	High	2020	Medium-intensity conflict
Chad	IDA-only	High	2020	Medium-intensity conflict
Comoros	IDA-only	Moderate	2020	Moderate institutional and social fragility, small state
Congo, Dem. Rep.	IDA-only	Moderate	2020	Moderate, medium-intensity conflict

(continued)

Country Name	Lending Eligibility	DSA Rating	Year of DSA Rating	Joint World Bank–IMF DSA Overall Risk of Debt Distress
Congo, Rep.	Blend	In distress	FY20 latest ^a	High institutional and social fragility
Côte d'Ivoire	Gap	Moderate	2020	
Djibouti	Gap	High	2020	
Dominica	Blend	High	FY20 latest ^a	
Ethiopia	IDA-only	High	2020	High
Fiji	Blend	MAC DSA		
Gambia, The	IDA-only	High	2020	High institutional and social fragility
Ghana	Gap	High	2020	
Grenada	Blend	In distress	FY20 latest ^a	
Guinea	IDA-only	Moderate	2020	
Guinea-Bissau	IDA-only	Moderate	2020	High institutional and social fragility
Guyana	Gap	Moderate	2020	
Haiti	IDA-only	High	2020	High institutional and social fragility
Kenya	Blend	High	2020	High
Kiribati	IDA-only	High	2020	High institutional and social fragility, small state
Kosovo	Gap	MAC DSA		High institutional and social fragility
Kyrgyz Republic	IDA-only	Moderate	2020	
Lao PDR	Gap	High	2020	Moderate
Lesotho	Gap	Moderate	2020	High institutional and social fragility
Liberia	IDA-only	Moderate	2020	Moderate
Malawi	IDA-only	Moderate	2020	
Maldives	IDA-only	High	2020	High institutional and social fragility, small state
Marshall Islands	IDA-only	High	2020	

(continued)

Country Name	Lending Eligibility	DSA Rating	Year of DSA Rating	Joint World Bank-IMF DSA Overall Risk of Debt Distress
Mauritania	IDA-only	High	2020	High institutional and social fragility, small state
Micronesia, Fed. Sts.	IDA-only	High	FY20 latest ^a	Medium-intensity conflict
Mozambique	IDA-only	In distress	FY20 latest ^a	Medium-intensity conflict
Niger	IDA-only	Moderate		Medium-intensity conflict
Nigeria	Blend	MAC DSA	FY20 latest ^a	Subnational regions: Khyber Pakhtunkhwa, Federally Administered Tribal Areas, Balochistan
Pakistan	Blend	MAC DSA		High institutional and social fragility
Papua New Guinea	Blend	High	FY20 latest ^a	
Samoa	IDA-only	High	2020	
São Tomé and Príncipe	IDA-only	In distress	FY20 latest ^a	
Senegal	IDA-only	Moderate	2020	
Sierra Leone	IDA-only	High	2020	High institutional and social fragility, small state
Solomon Islands	IDA-only	Moderate	2020	High-intensity conflict
Somalia	IDA-only	In distress	FY20 latest ^a	
St. Lucia	Blend	MAC DSA		
St. Vincent and the Grenadines	Blend	High	2020	
Tajikistan	IDA-only	High	2020	
Togo	IDA-only	Moderate	2020	
Tonga	IDA-only	High	FY20 latest ^a	High institutional and social fragility, small state

(continued)

Country Name	Lending Eligibility	DSA Rating	Year of DSA Rating	Joint World Bank–
				IMF DSA Overall Risk of Debt Distress
Tuvalu	IDA-only	High	2020	
Vanuatu	IDA-only	Moderate	2020	

Source: World Bank 2021; Debt Sustainability Analysis database.

Note: Fiscal year 2020 is the latest debt sustainability analysis (end of May 2020) reported in the performance and policy action. AFE = Africa East; AFW = Africa West; DSA = debt sustainability analysis; EAP = East Asia and Pacific; ECA = Europe and Central Asia; FY = fiscal year; IDA = International Development Association; IMF = International Monetary Fund; LAC = Latin America and the Caribbean; MAC DSA = Debt Sustainability Analysis for Market Access Countries; MENA = Middle East and North Africa; SAR = South Asia.

Reference

World Bank. 2021. *Global Economic Prospects: January 2021*. Washington, DC: World Bank.

Appendix D. Performance and Policy Action Descriptive Statistics

Table D.1. Selected Statistics of Sustainable Development Finance Policy Case Study Countries

Country	Debt Distress Risk ^a	IDA Category	PPAs (no.)	Key Drivers of Debt Stress	PPA Categories
Dominica	High	Blend	2	Natural disasters Social expenditure and costs associated with small state status	Debt transparency, fiscal sustainability
Ghana	High	Gap	3	Contingent liabilities, primarily from the energy sector Low tax and nontax revenues (including oil related)	Debt transparency, fiscal sustainability (2)
Kenya	High	Blend	3	Weak public investment management Steady erosion in tax and nontax revenue collection Increasing debt service due to high borrowing costs	Debt transparency, fiscal sustainability (2)
Mozambique	In debt distress	IDA-only	3	Nontransparent sovereign guarantees and other contingent liabilities Natural disasters	Debt management, debt transparency, fiscal sustainability
Nigeria	MAC DSA	Blend	3	Debt service costs due to high cost of deficit financing Low domestic revenue mobilization	Debt management, debt transparency, fiscal sustainability

(continued)

Country	Debt Distress Risk ^a	IDA Category	PPAs (no.)	Key Drivers of Debt Stress	PPA Categories
Pakistan	MAC DSA	Blend	3	Weak debt management Low tax revenue collection Circular debt from energy sector	Debt management, debt transparency, fiscal sustainability
Papua New Guinea	High	Blend	2	Implicit guaranteed debts of SOE sector, unfunded liabilities related to pensions Weak domestic resource mobilization Overreliance on undiversified and volatile revenue	Debt management, fiscal sustainability
Zambia	High	Gap	3	External borrowing (increasingly nonconcessional) to fund public investments Weak public investment management with non-growth-enhancing investments Overreliance on undiversified and volatile revenue from commodities	Debt transparency, fiscal sustainability (2)

Source: World Bank 2021; staff summary of analytical underpinnings.

Note: IDA = International Development Association; MAC DSA = Debt Sustainability Analysis for Market Access Countries; PPA = performance and policy action; SOE = state-owned enterprise.

a. As of May 2020.

Table D.2. Performance and Policy Actions and Implementation Mechanisms for Case Studies

Country	PPA Description	Implementation Vehicle
Dominica	PPA1: The government, through its Cabinet, has required (i) inclusion of all records of active loan guarantees in the DPR, (ii) annual submission of the DPR to parliament, (iii) public disclosure of DPRs on the Ministry of Finance website.	Prior action: Dominica First COVID-19 Response and Recovery DPC (P174927)
Dominica	PPA2: The Recipient, through its parliament, has adopted a Fiscal Rules and Responsibility Framework that outlines fiscal responsibility principles, sets targets for spending, fiscal balances, and public debt levels, and establishes a Fiscal Council.	Prior action: Dominica First COVID-19 Response and Recovery DPC (P174927)
Ghana	PPA1: The Recipient's parliament has amended the Revenue Administration Act 2016 (Act 915), to (i) strengthen the volunteer disclosure program to promote self-declarations and correction of omissions and misstatements in returns, thereby increasing the number of registered taxpayers and consequently expanding the tax base; and (ii) establish a tax appeals board to enhance confidence in the tax system and thus improve compliance and collection.	None identified
Ghana	PPA2: The Recipient's Ministry of Finance has published its Annual Debt Report for 2020, which includes information on the debt of the energy sector SOEs and discloses the SOEs and statutory bodies that have undergone a centralized credit risk assessment by the end of 2020.	None identified
Ghana	PPA3: A draft State Ownership Policy has been submitted to the Recipient's Cabinet to provide the framework for (i) the rationalization of government SOE investments (including the principles for divestment and privatization of SOEs when warranted) and (ii) improvement of SOE corporate governance (including ensuring that audits are done and submitted in the mandated time frame).	None identified

(continued)

Country	PPA Description	Implementation Vehicle
Kenya	<p>PPA1: (i) The National Treasury has approved the public investment management regulations, covering all phases of the public investment project cycle, including the provisions relating to the identification, economic appraisal, selection, implementation, and monitoring and evaluation of all proposed, active, and completed projects; and</p> <p>(ii) To rationalize the portfolio, the National Treasury has completed an inventory of all the public investment projects in the education, health, and infrastructure sectors that are currently active in the capital budget, including financial and nonfinancial information regarding the status of each project.</p>	<p>(i) Prior Action: Kenya Accelerating Reforms for an Inclusive and Resilient Recovery DPF (P175251)</p> <p>(ii) None identified</p>
Kenya	PPA2: The National Treasury has published on the National Treasury website the latest audited statement of public debt, including the external debt register.	None identified
Kenya	PPA3: The National Treasury completes a financial evaluation of the nine SOEs with largest fiscal risk to the FY20/21 budget and uses this as the basis for any extraordinary support to these SOEs (the supplementary budget limits this to 0.3 percent of gross domestic product).	None identified
Mozambique	PPA1: The government of Mozambique publishes the 2020 annual debt report with coverage of SOE and liquid natural gas debt.	None identified
Mozambique	PPA2: The government of Mozambique uses the newly published credit risk assessment framework to produce credit risk reports for seven SOEs.	None identified
Mozambique	PPA3: Zero nonconcessional borrowing limit on external public and publicly guaranteed debt.	None identified
Nigeria	PPA1: To reduce the cost of domestic borrowing by curtailing recourse to the CBN (financing through the overdraft facility), the government will enact an Amended Budget for 2020 that raises domestic and external borrowing limits, which allows issuance of cheaper and more transparent marketable (or concessional) debt instruments.	None identified

(continued)

Country	PPA Description	Implementation Vehicle
Nigeria	PPA2: To enhance the monitoring of tax incentives to inform tax-expenditure rationalization efforts, the government, through the Federal Ministry of Finance, Budget, and National Planning, will, for the first time, prepare and present to the National Assembly along with the annual Federal Budget 2021 an annual tax-expenditure statement with the estimated cost (in 2019) of tax exemptions, incentives and rebates provided under Nigeria's corporate income tax, value-added tax, and customs laws.	None identified
Nigeria	PPA3: To enhance the transparency and management of public debt and contingent liabilities, the government will publish by January 31, 2021, on its website information on contracted federal government loans that have been signed but not yet disbursed as of the end of June 2020.	None identified
Pakistan	PPA1: The Finance Division issues administrative rules assigning all debt management functions to the Debt Management Office after amendments to the 2005 Fiscal Responsibility and Debt Limitation Action—by the end of April 2021.	None identified
Pakistan	PPA2: The Finance Division and provincial finance departments issue implementing regulations after the approval of common goods and services tax laws passed by the federal and provincial assemblies to harmonize the sales tax—by May 2021.	None identified
Pakistan	PPA3: The Finance Division publishes (i) semiannual debt bulletins, (ii) an annual report comparing debt management strategy implementation with targets for end FY21, and (iii) a report on federal COVID-19-specific expenditure for FY21 by March 2021.	None identified
Papua New Guinea	PPA1: The government may enter into contractual obligations for new long-term external public and publicly guaranteed nonconcessional debt in a total amount not exceeding \$1,200 million in FY21. For the period through June 2021, the nonconcessional debt limit may be adjusted as determined by the World Bank (i) to reflect any material change of circumstances or, (ii) coordination with the IMF, in particular in line with adjustment in the IMF Debt Limit Policy.	None identified

(continued)

Country	PPA Description	Implementation Vehicle
Papua New Guinea	PPA2: The government has approved amendments to the State Guarantee Policy, which incorporates policies and procedures relating to (i) monitoring of outstanding loan guarantees, (ii) loan guarantee payments and recovery, and (iii) recording and reporting of loan guarantees.	None identified
Zambia	PPA1: Zero nonconcessional borrowing ceiling on contracting new external public and publicly guaranteed debt in FY21.	None identified
Zambia	PPA2: Government cancels at least \$1.0 billion in contracted but undisbursed external debt by May 2021.	None identified
Zambia	PPA3: Government publishes the 2020 Annual Public Debt Report, including coverage of debt, guarantees, and contingent liabilities for SOEs.	None identified

Source: Independent Evaluation Group.

Note: CBN = Central Bank of Nigeria; CIT = corporate income tax; COVID-19 = coronavirus; DPC = development policy credit; DPF = development policy financing; DPR = Debt Portfolio Review; FY = fiscal year; IMF = International Monetary Fund; PPA = performance and policy action; SOE = state-owned enterprise.

Table D.3. Relevance of Performance and Policy Actions to Underlying Drivers of Debt Stress for Case Study Countries

Country PPA	Addresses Identified Driver of Debt Distress	Clearly and Credibly Articulates the Results Chain Linking the PPA to Reduced Risk of Debt Distress	Action is Institutionalized	Action Makes Substantive Contribution to Reducing Risk of Debt Stress
Dominica PPA1	No	No	No	No
Dominica PPA2	Yes	No	Yes	Yes
Ghana PPA1	Yes	No	Yes	Yes
Ghana PPA2	Yes	No	No	No
Ghana PPA3	Yes	No	Yes	Yes
Kenya PPA1	Yes	Yes	Yes	Yes
Kenya PPA2	No	No	No	No
Kenya PPA3	Yes	Yes	No	Yes
Mozambique PPA1	Yes	Yes	No	No
Mozambique PPA2	Yes	Yes	No	No
Mozambique PPA3	No	No	No	Yes
Nigeria PPA1	Yes	Yes	Yes	Yes
Nigeria PPA2	Yes	Yes	No	Yes
Nigeria PPA3	No	No	No	No
Pakistan PPA1	Yes	Yes	Yes	Yes
Pakistan PPA2	Yes	Yes	Yes	Yes
Pakistan PPA3	No	Yes	No	No
Papua New Guinea PPA1	No	No	No	No
Papua New Guinea PPA2	Yes	Yes	Yes	No
Zambia PPA1	No	No	No	Yes
Zambia PPA2	Yes	Yes	No	Yes
Zambia PPA3	No	No	No	No

Source: Independent Evaluation Group staff assessments.

Note: PPA = performance and policy action.

Reference

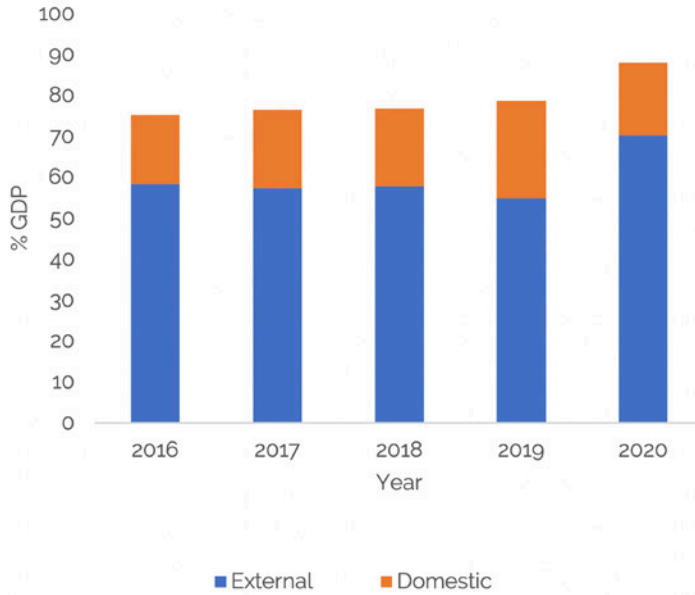
World Bank. 2021. *Global Economic Prospects: January 2021*. Washington, DC: World Bank.

Appendix E. Case Studies

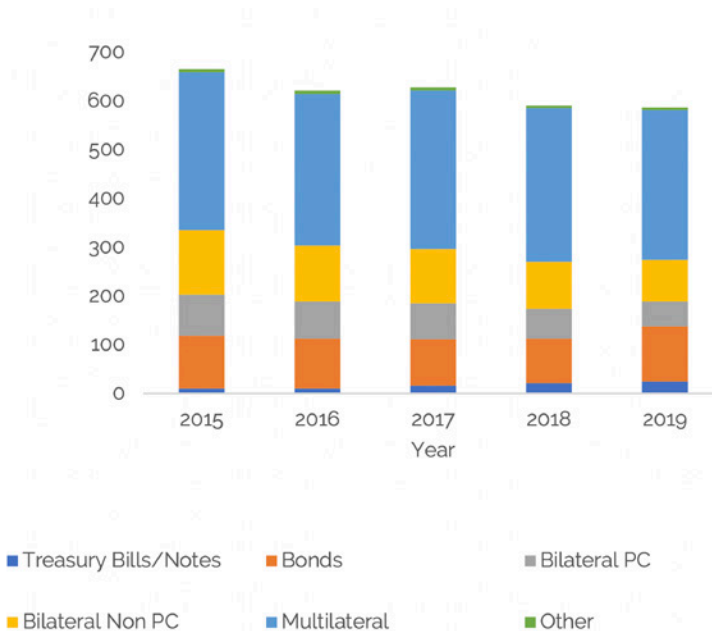
Dominica

Figure E.1. Dominica

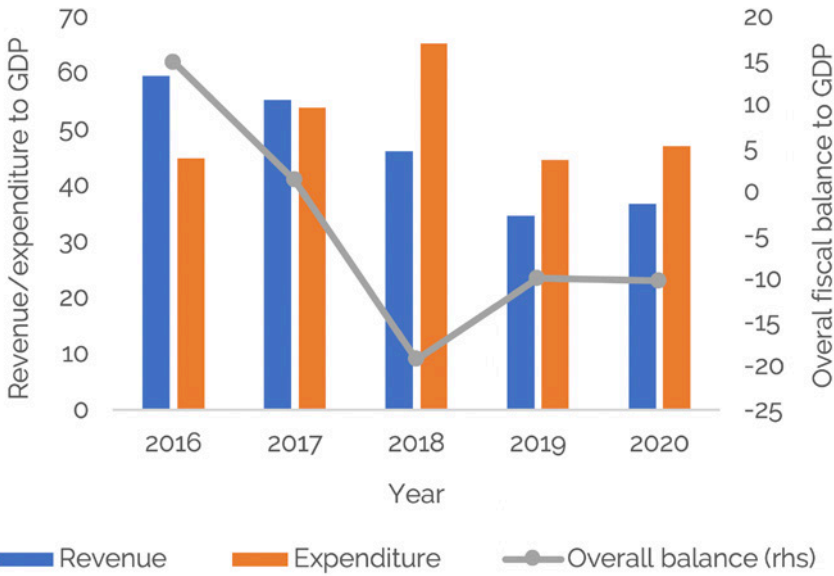
a. Public debt-to-GDP, 2016–20



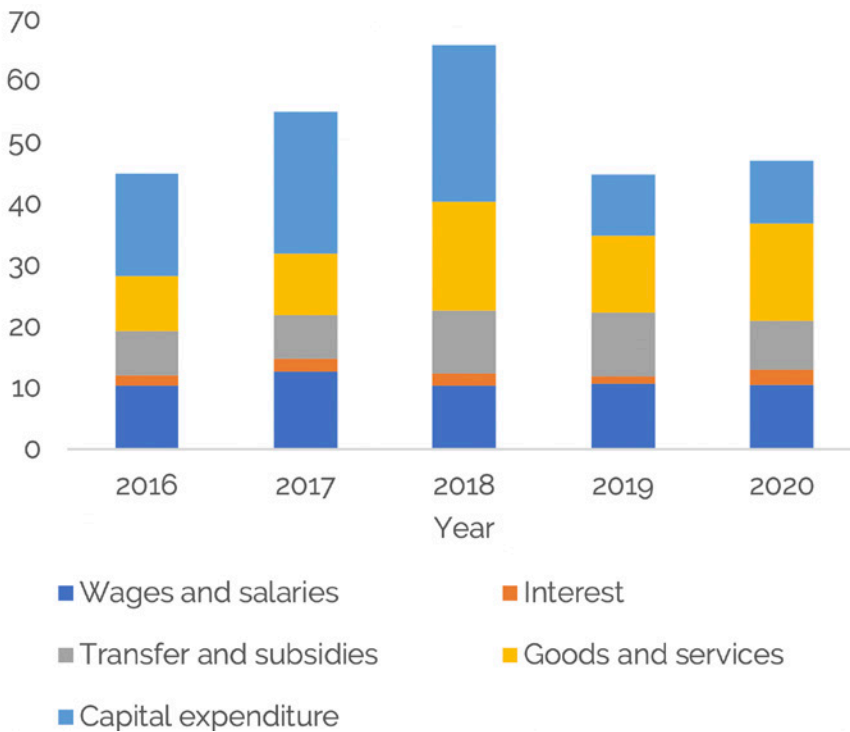
b. External government debt by creditor group (EC\$, millions)



c. Fiscal aggregates (percent of GDP)



d. Central government expenditure (percent of GDP)



Source: Panel a: Ministry of Finance, International Monetary Fund, and World Bank estimates; panel b: Ministry of Finance, Debt Portfolio Review 2019; panel c: Ministry of Finance, International Monetary Fund, and World Bank staff estimates; panel d: Ministry of Finance, International Monetary Fund, and World Bank staff estimates.

Note: In panel b, \$1.00 = EC\$2.70. EC\$ = East Caribbean dollar; GDP = gross domestic product; PC = Paris Club; rhs = right-hand scale.

Debt Situation

Dominica's debt situation has deteriorated over the past several years. Dominica is a small island state with an economy dependent largely on tourism and agriculture and is highly vulnerable to natural disasters and economic shocks. Dominica's debt to gross domestic product (GDP) ratio increased from 68.9 percent in 2010 to 75.3 percent in 2016 and to 88.1 percent in 2020 (figure E.1, panel a), with spending for natural disasters and the coronavirus (COVID-19) response driving large fiscal deficits that reached more than 20 percent of GDP in 2018, averaging about 10 percent of GDP in 2019 and 2020 (figure E.1, panel c). About three-quarters of public debt is external, owed largely to official creditors (including the Caribbean Development Bank, the World Bank, and the International Monetary Fund [IMF]) and to bilateral creditors (figure E.1, panel b).^{1,2} The government of Dominica is expected to benefit from bilateral debt payment deferrals of approximately 0.5 percent of GDP as part of the Debt Service Suspension Initiative.

With persistent vulnerability to natural disasters, Dominica's debt risk rating has remained high since 2015.³ The April 2020 debt sustainability analysis (DSA) noted that the risk of debt distress assigned to public and publicly guaranteed external debt was high, indicating that public debt becomes unsustainable under the low-growth, natural disaster, and historical scenarios. Debt sustainability was highly dependent on access to grants and concessional financing and the continued success of its Citizenship by Investment program (IMF 2018).⁴

Government expenditure for posthurricane reconstruction and recovery efforts has been a major driver of rising debt stress in Dominica. Hurricane Maria caused losses equivalent to 226 percent of GDP, damaging large swaths of agricultural land, critical infrastructure, and an estimated 90 percent of buildings (World Bank 2021b). As a result of the damage, annual capital expenditure increased from 16.6 percent of GDP in 2016 to 25.6 percent of GDP in 2018 (figure E.1, panel d). Recurrent fiscal deficits, driven both by sharp revenue declines from the Citizenship by Investment program and the tourism industry after the hurricane, also contributed to a steadily rising debt burden.

Key Debt Priorities

Significant fiscal consolidation (on both the revenue and expenditure sides) is necessary to return the debt trajectory to a sustainable path. With the worsening fiscal deficit over the past five years, the government has committed to a fiscal path targeting fiscal savings of 6 percent of GDP cumulatively, phased over six years (World Bank 2020, 2021). With high expenses associated with the pandemic response and weak revenue performance, contraction in public investment will be unavoidable in the short term. Over the medium term, key fiscal consolidation measures include strengthening fiscal policies and budget planning. Building a more robust fiscal framework with specific targets is necessary to generate savings, reduce debt loads, and create fiscal space to provide resources for resilient infrastructure investment and increase flexibility when natural disasters, pandemics, or other shocks materialize (World Bank 2021b). Other important measures include revenue mobilization, creation and resourcing of a contingencies fund, public investment management (PIM; planning, prioritization, and reporting),⁵ and procurement reform.

The country also needs to improve the coverage and dissemination of public debt data. Before the Sustainable Development Finance Policy (SDFP) was implemented, the Debt Portfolio Review (DPR) did not fully include government-guaranteed loans, was not presented to parliament regularly, and had not been made publicly available.⁶ The 2018 Debt Management Performance Assessment noted that the DPRs (2016 and 2017) were never submitted to cabinet and published (World Bank 2018, 14). The World Bank's Debt Reporting Heat Map shows that Dominica scores poorly on "information on last loans contracted," because debt information is not published regularly and updated; and on "sectoral coverage" and "contingent liabilities," because loan guarantees and state-owned enterprise (SOE) debt were not reported to parliament.⁷ The government has recognized the necessity of expanding the coverage of the DPR, submitting it to parliament, and publishing it in public to make informed decisions and enhance accountability and transparency (World Bank 2021b).

Relevance of Performance and Policy Actions to Drivers of Debt Stress

Dominica was required to implement two performance and policy actions (PPAs). The PPAs agreed among the authorities and the World Bank for fiscal year (FY)21 are the following:

- » **PPA1 (debt transparency):** The government, through its Cabinet, has required: (i) inclusion of all records of active loan guarantees in the DPR; (ii) annual submission of the DPR to parliament; and (iii) public disclosure of DPRs on the Ministry of Finance website.
- » **PPA2 (fiscal sustainability):** The Recipient, through its parliament, has adopted a Fiscal Rules and Responsibility Framework (FRRF) that outlines fiscal responsibility principles, sets targets for spending, fiscal balances, and public debt levels, and establishes a Fiscal Council.

PPA1 aims at improving debt transparency through improved debt reporting. The selection of this PPA was informed by the Debt Management Performance Assessment and the Debt Reporting Heat Map. This PPA supports measures required to improve the coverage and timeliness of public debt data reporting, and thus provide greater debt transparency.⁸ PPAs for FY22 and FY23 were planned just to repeat actions.⁹

PPA1 will not have any direct or immediate impact on improving Dominica's debt sustainability, but indirectly it may contribute to reducing or limiting future public borrowing. Absence of debt transparency was not a critical factor that drove the increase in debt levels. The regular publication of comprehensive public debt information and parliamentary oversight can be expected to generate close scrutiny from the media and civil society and lead to greater accountability and more informed decision-making on public debt issues.

PPA2 is aimed at strengthening fiscal sustainability by setting clear fiscal targets and debt levels and establishing compliance mechanisms to ensure consistency and adherence to fiscal responsibility.¹⁰ The FRRF will mandate the creation of an independent fiscal oversight council to review fiscal performance and adherence to the FRRF and to prepare public reports to parliament on fiscal performance. It also includes mechanisms for the Fiscal

Council and parliament to recommend fiscal adjustments should performance deviate from established targets, and time-bound responses and actions from the minister of finance and the administration to address such deviations. Enshrining fiscal targets through a fiscal rules framework and ensuring compliance are important steps toward fiscal consolidation.¹¹ In addition, there is no or only limited value-added, as the COVID-19 development policy credit (DPC) included the same requirements as two of the Prior Actions.

Remaining Debt Issues

Because the PPA2 had not been implemented at the time of this writing (June 2021), the country needs to ensure the adoption and implementation of the FRRF to return fiscal and debt paths to sustainable trajectories. The SDFP committee has formally granted Dominica a waiver, given a determination that the administration had made a good faith effort to pass the act, which was being held up by parliamentary procedure. However, it is expected to pass within the next several months. With the adoption and implementation of the FRRF and other reforms supported by the COVID-19 DPC, the government has committed to a target primary balance of 2.0 percent of GDP to achieve debt sustainability, which is metricized as a debt-to-GDP ratio of 60 percent by 2030 (Dominica 2018).¹²

PPAs do not focus on domestic revenue mobilization or rationalizing or curbing expenditures that are key to debt sustainability. The COVID-19 DPC includes a prior action to strengthen revenue mobilization by reducing tax exemptions and increasing taxpayer compliance. The DPC also supports in improving targeting and rationalization of social programming and fundamental public procurement reform.^{13, 14} The DPC also supports PIM through approval of a public sector performance framework to strengthen budget allocations, public investment planning, prioritization, and reporting, which is important for facilitating a resilient recovery and building climate change-resilient infrastructure.

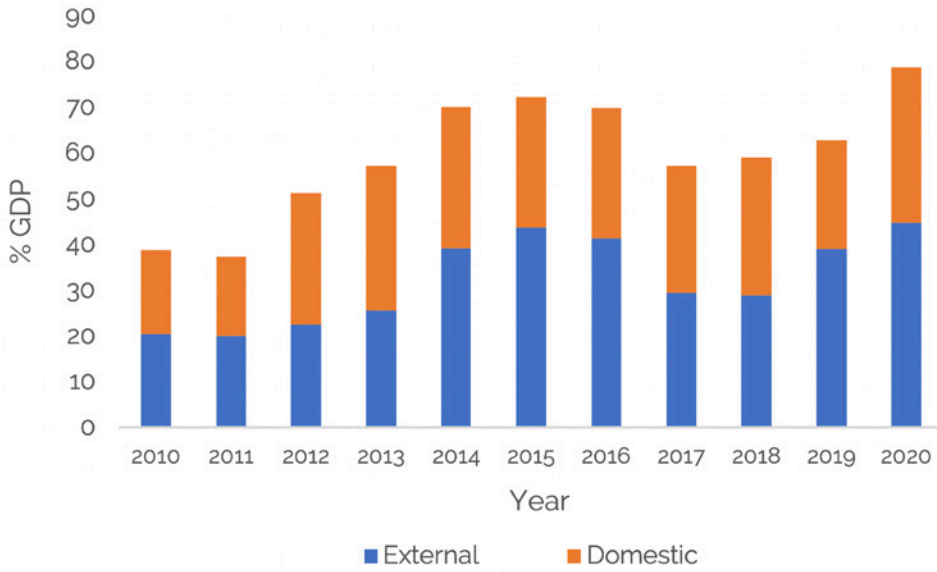
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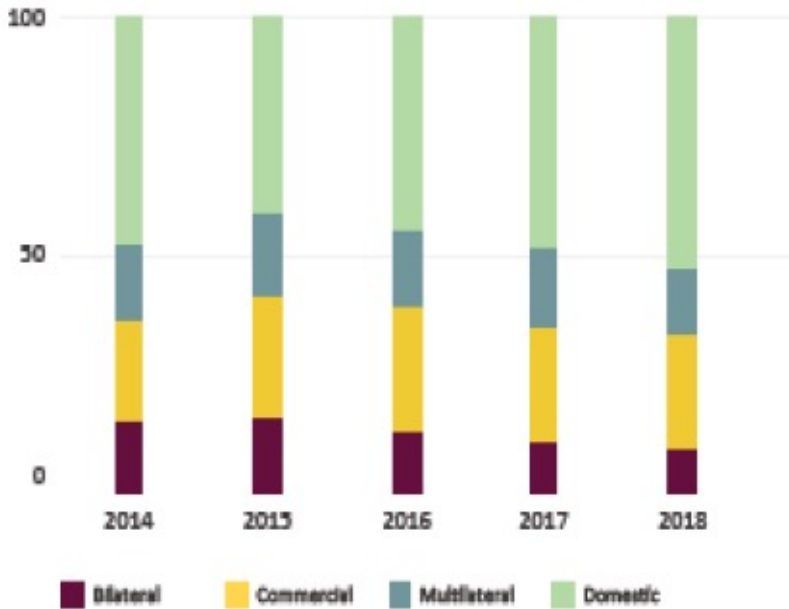
Ghana

Figure E.2. Ghana

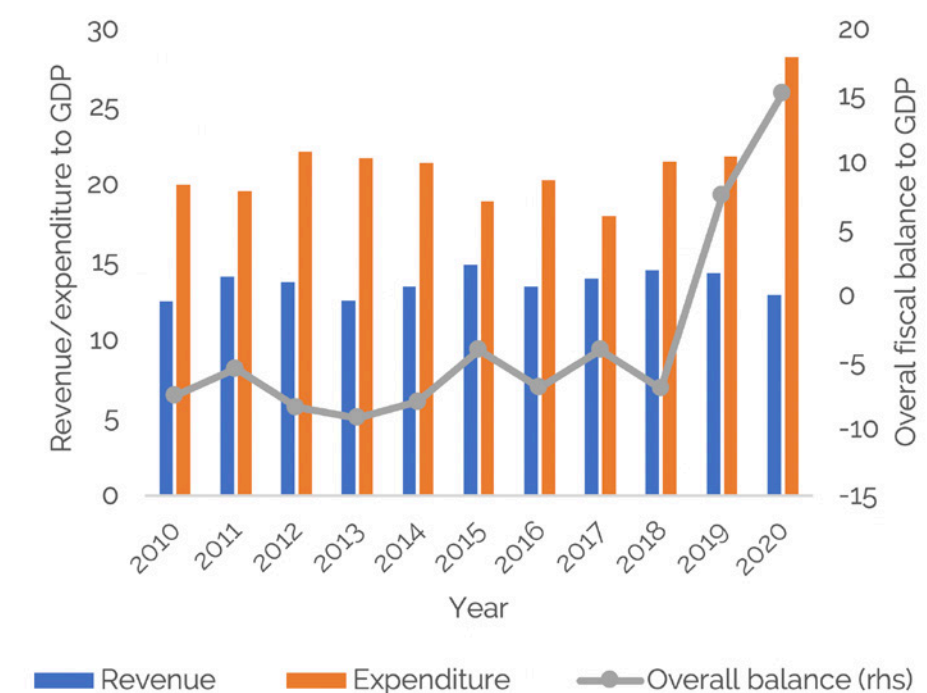
a. Public debt-to-GDP 2016–20



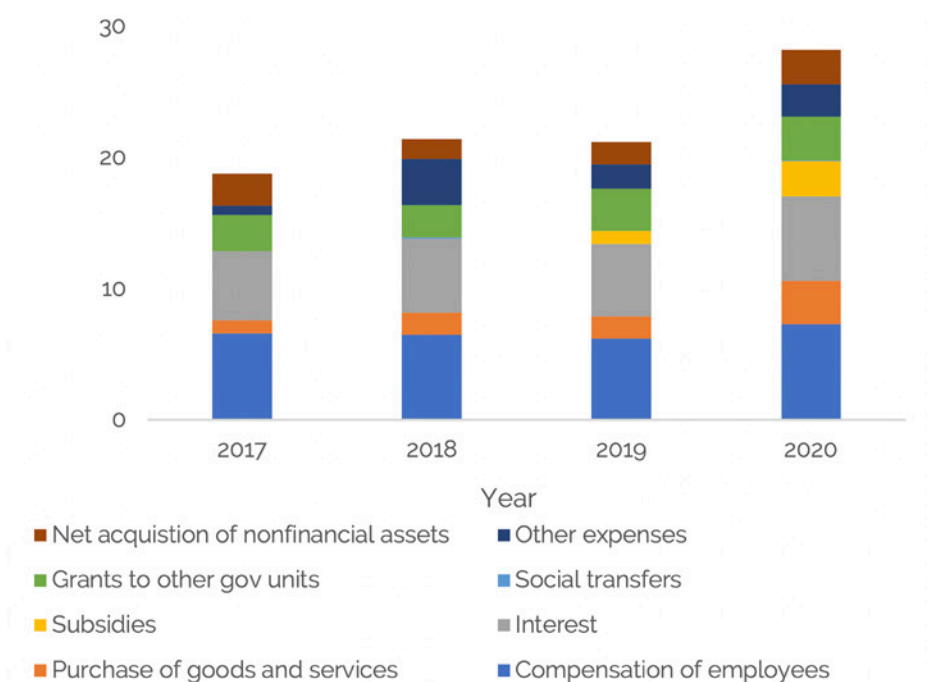
b. Evolution of financing sources (percent of total)



c. Fiscal aggregates (percent of GDP)



d. Government expenditure (percent of GDP)



Source: Panel a: IMF Article IV Staff Reports and 2020 Debt Sustainability Analysis; panel b: World Bank staff calculation; World Bank World Development Indicators 2019, IDS 2019, and debt sustainability analysis 2019 (performance and policy action note); panel c: International Monetary Fund World Economic Outlook and Article IV Staff Reports 2021; panel d: IMF Article IV Staff Reports 2019 and 2021.

Note: GDP = gross domestic product; gov = government; rhs = right-hand scale.

Debt Situation

Ghana's public debt has more than doubled over the past 10 years. Public debt increased from 38.9 percent of GDP in 2010 to 62.9 percent in 2019 and to 78.9 percent in 2020 (figure E.2, panel a), driven by structural fiscal deficits and rising interest costs. Domestic revenues have been stagnant at about 14 percent of GDP since 2010. The 2018/19 financial sector cleanup and start of energy sector reforms in 2019 have increased fiscal pressures further and resulted in a fiscal deficit of 7.5 percent of GDP in 2019.¹⁵ The government accrued an additional 2.1 percent of GDP in domestic arrears (IMF 2021). Domestic debt accounted for 48.3 percent of total public debt in 2019, compared with 40.2 percent in 2015, and borrowing from external creditors rose from 23.9 to 25.1 percent of public debt over the same period. The share of concessional multilateral debt fell from 20.4 percent in 2015 to 16.6 percent in 2019. Market financing has driven up the share of nonconcessional borrowing, shortened debt maturities, and raised interest rates. The effective nominal interest rate on external debt (including domestic debt held by non-residents) increased from 5.5 in 2017 to 7.6 percent in 2019.¹⁶ With higher costs of financing, interest payments rose from 5.3 percent of GDP in 2017 to 6.4 percent of GDP in 2020 (figure E.2, panel d).

The intensification of debt and fiscal vulnerabilities resulted in Ghana's assessed risk of debt distress rising from moderate to high in 2014. Ghana's assessed risk of debt distress has remained high since then. The DSA also highlights risks from the realization of contingent liabilities from SOE borrowing and off-budget operations.

There are several main drivers of rising debt vulnerabilities. These include the following: (i) high energy sector cost from excess power generation capacity and gas supply, large distribution losses, electricity tariffs significantly below cost recovery levels, and financial losses from SOEs (IMF 2017, 2021; World Bank 2016); (ii) low domestic revenue mobilization (5 percentage points of GDP lower than the average for lower-middle-income countries); (iii) realization of contingent liabilities in the energy sector; (iv) growing debt service bill because of increased nonconcessional borrowing; and (v) undisclosed debt linked to contingent public liabilities of SOEs without a government guarantee and off-budget operations.

Key Debt Priorities

Tax revenue mobilization is key for Ghana's debt sustainability.¹⁷ The main impediments to increasing domestic resource mobilization are a narrow tax base, low tax compliance, weak tax administration, and overly generous exemptions (World Bank 2016).¹⁸ Since 2016, the government has tried to tackle revenue performance mainly through tax administration reforms.

There is a need to mitigate SOE-related fiscal risks through stronger central controls and monitoring and improve reporting of SOE liabilities. Materialization of contingent liabilities in the SOE sector represents a continued fiscal risk. The 2021–24 Medium-Term Debt Management Strategy and DSA (July 2021) point to significant fiscal risks linked to domestic debt embedded in the current debt portfolio, particularly contingent liabilities from SOEs. The 2018 Systematic Country Diagnostic highlights the need for higher levels of transparency and accountability by improving SOE governance and performance. Many of SOEs underperform and incur losses. SOEs account for one-half of all public sector arrears.

Relevance of Performance and Policy Actions to Drivers of Debt Stress

Ghana implemented three PPAs: two in the fiscal sustainability category and one in the debt transparency category.¹⁹ The PPAs agreed among the authorities and the World Bank for FY21 are the following:

- » **PPA1 (fiscal sustainability):** Recipient's parliament has amended the Revenue Administration Act 2016 (Act 915), to (i) strengthen the volunteer disclosure program to promote self-declarations and correction of omissions and misstatements in returns, thereby increasing the number of registered taxpayers and consequently expanding the tax base; and (ii) establish a tax appeals board to enhance confidence in the tax system and thus improve compliance and collection.
- » **PPA2 (debt transparency):** Recipient's Ministry of Finance has published its Annual Debt Report for 2020 (in keeping with Section 72 of the Public Financial Management Act 2016 [Act 921]), which includes information on the debt of the energy sector SOEs and discloses the [list of] SOEs and statutory bodies that have undergone a centralized credit risk assessment by the end of 2020.²⁰

- » **PPA3 (fiscal sustainability):** A draft State Ownership Policy has been submitted to the Recipient's Cabinet to provide the framework for (i) the rationalization of government SOE investments (including the principles for divestment and privatization of SOEs when warranted), and (ii) improvement of SOE corporate governance (including ensuring that audits are done and submitted in the mandated time frame).

PPA1 is relevant for increasing domestic revenue by strengthening tax compliance and promoting voluntary disclosure. Providing a framework for a voluntary plan is expected by the authorities and World Bank staff to promote self-declarations of variances, omissions, and underreporting in tax returns. Establishing a tax appeals board is intended to facilitate tax arbitration, instill taxpayer confidence, and thus encourage tax compliance. The World Bank has supported these activities through technical assistance under the Ghana Economic Management Strengthening project. The Revenue Administration (Amendment) Act 2020 was passed by parliament in July 2020 and received assent by the president in October 2020 (World Bank 2021). Over the medium term, PPA1, together with a Tax Exemption Bill (currently scheduled for parliamentary review), is expected to strengthen institutional capacity for revenue management and enhance domestic tax revenue.

PPA2 supports general good practice to enhance debt transparency by including more comprehensive SOE debt data, which is necessary given the role that SOEs played in the country's debt stress. PPA2 was completed with technical assistance from the World Bank. The government published the Annual Debt Report for 2020 in March 2021, which included breakdowns on the debt of major SOEs in the energy sector (World Bank 2021). The coverage of SOE debt to be made public under this PPA was limited to guarantees and onlending extended by the central government. It does not include energy sector debts to the private sector, such as those related to independent power producers and gas projects, and the debts of SOEs that engage in quasi-fiscal activities. These are expected to be covered by an FY22 PPA, which will also increase the number of SOEs covered. It is unclear if this PPA refers only to the 2020 debt report or if it establishes a statutory requirement for annual publication, which would have a more meaningful and lasting impact on improving debt transparency with respect to SOEs.

PPA3 aims to address debt vulnerabilities by improving oversight and corporate governance of SOEs, thereby mitigating fiscal risks linked to SOEs. The framework is expected to provide the operating framework to rationalize state participation in, and provide stronger oversight of, SOEs. The World Bank has supported five SOEs, through the Ghana Economic Management Strengthening project, to prepare and implement action plans, which include publishing of audited annual financial reports to improve external oversight. The government has also passed the State Interests and Governance Authority Act in 2019 and established the act as the authority in charge of SOE reform and disclosure of SOE financial performance. It has also been developing a state ownership policy and framework for financial oversight, “Guidelines and Performance Management Framework,” and a code of corporate governance for the SOE sector.

Remaining Debt Issues

For PPA1 to be effective, the country will need to ensure the implementation of the Revenue Administration Act. The Ghana Revenue Authority is drafting the implementation guidelines to roll out the permanent program in 2021. Since the act’s revision, the government has prepared a budget and developed a rollout and communications plan for setting up the independent tax appeals board, which is expected to be completed in 2021 (World Bank 2021). The benefits of the action are expected to take time to emerge.

PPAs do not address other revenue-related drivers of debt distress, including the need to reduce overly generous tax exemptions. The draft Tax Exemptions Bill (currently scheduled for parliamentary review) seeks to improve transparency and centralize the process for granting exemptions, but it does not directly address the magnitude of existing tax emptions. A PPA that addresses this would have a more immediate impact on the already high debt service burden.

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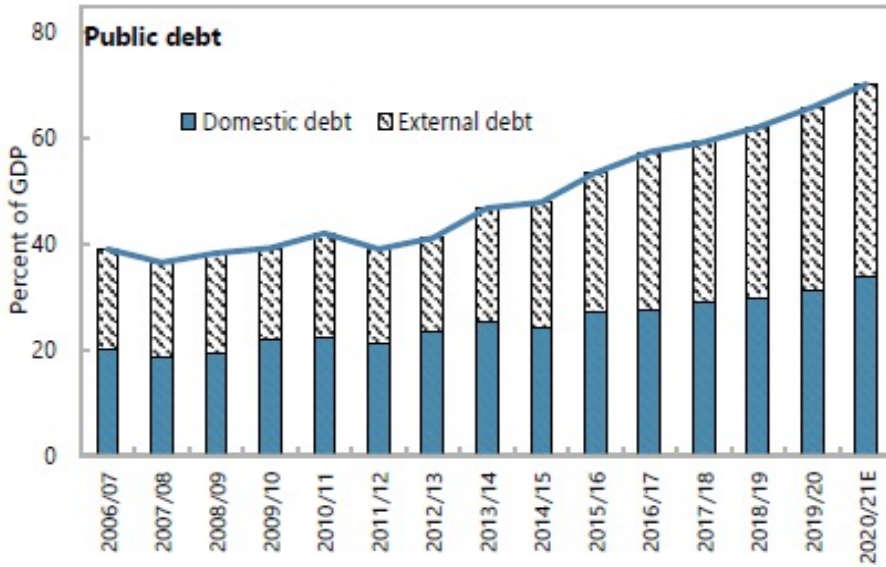
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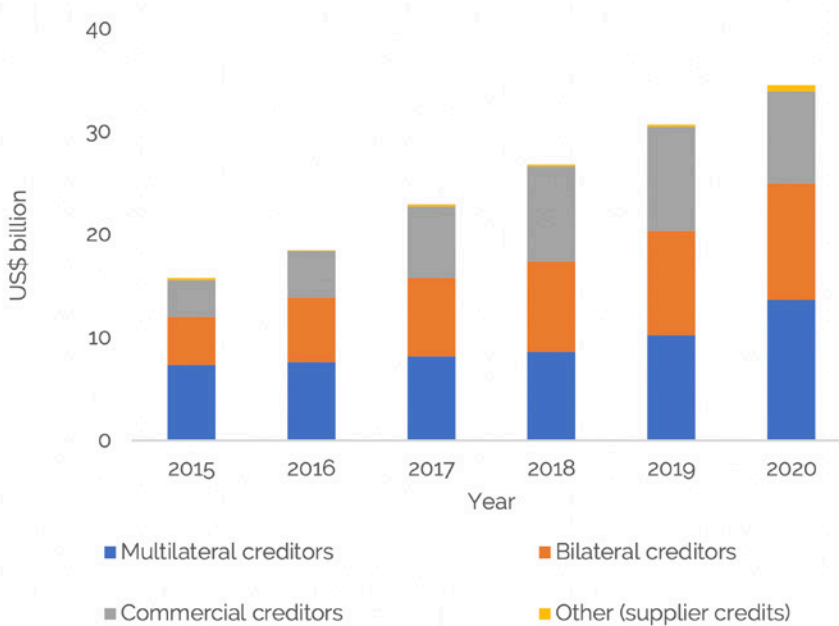
Kenya

Figure E.3. Kenya

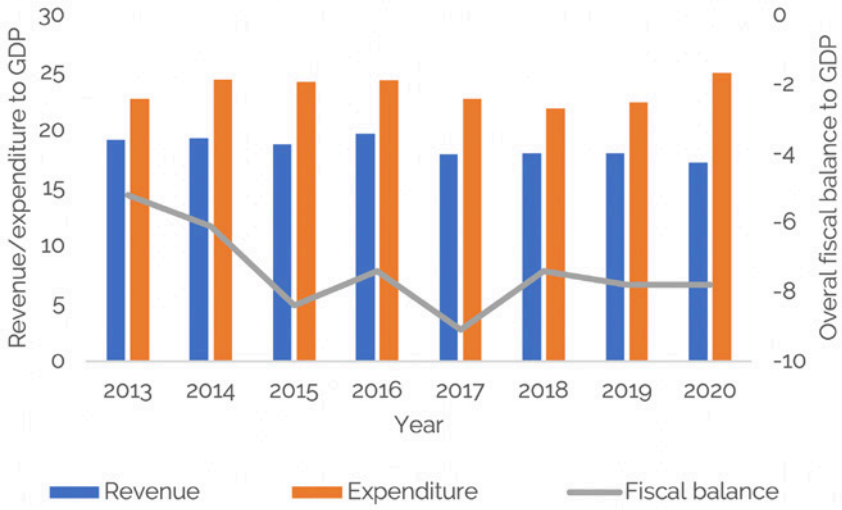
a. Total public debt composition (percent of GDP)



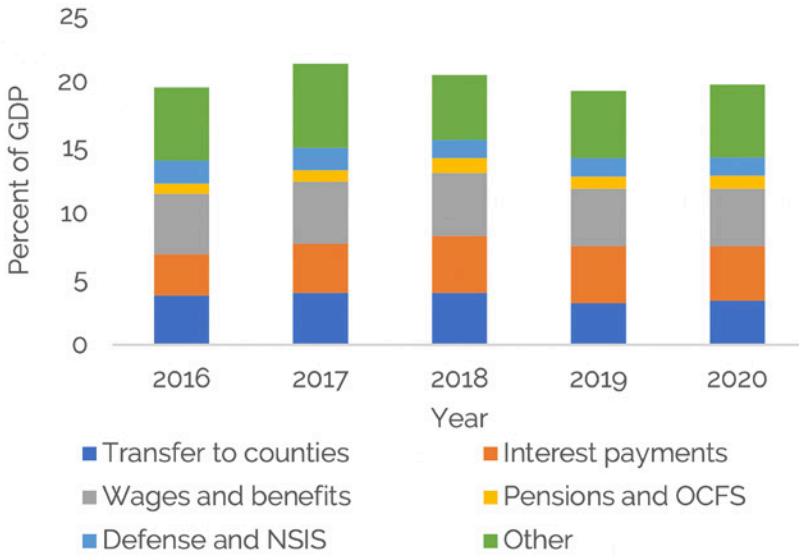
b. External public debt by creditor group



c. Fiscal aggregates (percent of GDP)



d. Recurrent expenditure decomposition (percent of GDP)



Source: Panel a: IMF 2021b; panel b: IMF 2021a; panel c: IMF 2016, 2018, 2020, 2021b.

Note: GDP = gross domestic product; NSIS = National Security Intelligence Service.

Debt Situation

Kenya's public debt has been gradually increasing over the past five years (figure E.3). Public debt increased from 48.6 percent of GDP in 2015 to 66.7 percent of GDP in 2020, driven mostly by public and publicly guaranteed external debt, as the government tapped bilateral and commercial sources (including Eurobonds and syndicated bank loans). Most of Kenya's external public debt remains on concessional terms. Much of the country's public debt is nonguaranteed debt of public entities. Group of Twenty support under the Debt Service Suspension Initiative (DSSI) helped reduce debt service by approximately \$640 million in 2021.

Kenya's debt sustainability has rapidly deteriorated: its risk of debt distress downgraded from low to moderate in 2018 and from moderate to high in 2020. A recent increase in the share of nonconcessional debt (external and domestic) increased interest payments, which now absorb more than 20 percent of government revenues (World Bank 2021). Approximately 63 percent of official bilateral debt (which accounts for close to 33 percent of external debt) is owed to non-Paris Club members (mainly China, to finance construction of the Standard Gauge Railway and other infrastructure projects). High deficits have contributed to the deterioration in solvency and liquidity indicators.²¹ Fiscal consolidation is expected to improve debt indicators, supported by a projected recovery in exports and outputs (IMF 2021b).

Kenya's deteriorating debt situation reflects high but inefficient public investment and weak domestic revenue mobilization. Kenya has run fiscal deficits averaging 7.9 percent over 2015–19 due to two main factors: (i) an overly ambitious public investment agenda that failed to yield adequate returns, and (ii) lower-than-expected domestic revenue mobilization (with the tax-to-GDP ratio of 16.8 percent in 2014 falling to 15.0 percent in 2019) due in part to tax exemptions that had widened to an estimated 6 percent of GDP. There was also a lack of transparency in relation to increased borrowing from non-Paris Club creditors, particularly with respect to on-guaranteed debt of SOEs and due to lags in publishing audited statements of public debt on the National Treasury website.

Key Debt Priorities

A key debt priority for Kenya is to control expenditures and increase tax revenues. Debt has crept up over the past eight years alongside overly ambitious public investment initiatives and the fiscal costs of devolution (a by-product of the country's decentralization reforms in 2013). The country's tax-to-GDP ratio has been steadily declining since 2014. The government had begun fiscal consolidation that included tighter expenditure controls and passage in early 2020 of a new income tax bill aimed at closing tax loopholes, but this was put on hold when the COVID-19 pandemic began.

Another priority involves increasing the efficiency of public investment. Billions of dollars of debt have been contracted in the past several years to address the country's infrastructure gap. Many of these loans were either nonconcessional or semiconcessional. An overly ambitious public investment agenda, alongside shortcomings in the quality of PIM, has led to an unsustainably high number of projects, approximately 522 of which are dormant. Canceling one-third of these projects would deliver one-off expenditure savings of 1.5 percent of GDP, according to the latest public expenditure review (World Bank 2020).

Relevance of FY21 Performance and Policy Actions to Drivers of Debt Stress

The PPAs agreed between the government and World Bank in FY21 are the following:

- » **PPA1:** (i) The National Treasury has approved PIM regulations, covering all phases of the public investment project cycle, including the provisions relating to the identification, economic appraisal, selection, implementation, and monitoring and evaluation of all proposed, active, and completed projects; and (ii) to rationalize the portfolio, the National Treasury has completed an inventory of all public investment projects in the education, health, and infrastructure sectors that are currently active in the capital budget, including financial and nonfinancial information regarding the status of each project.
- » **PPA2:** The National Treasury has published on its website the latest audited statement of public debt, including the external debt register.

- » **PPA3:** The National Treasury completes a financial evaluation of the nine SOEs with largest fiscal risk to the FY20/21 budget and uses this as the basis for any extraordinary support to these SOEs (the supplementary budget limits this to 0.3 percent of GDP).²²

PPA1 is highly relevant to Kenya's debt vulnerabilities, given significant inefficiencies in the country's PIM and the extent to which these have contributed to the buildup of debt. It will ensure that future public investments are subject to transparent and rigorous identification and economic appraisal procedures. It will also inventory current investment projects in education, health, and infrastructure as a first step to canceling dormant projects. This rationalization has the potential to deliver significant fiscal savings by supporting identification of stalled projects to be terminated. A recent public expenditure review estimated the value of stalled projects to be 11 percent of GDP (World Bank 2020). The PPA1 for FY22—canceling identified nonviable projects (that is, those with less than a 25 percent implementation rate and more than a decade of implementation)—would reduce the country's level of debt stress.

PPA2 will increase the timeliness and granularity of debt information but will not directly address a major driver of debt distress. The PPA makes the latest audited statement of public debt available online (2018)—previously, the latest report available was from 2015. A programmatic PPA, the FY22 target includes expanding coverage of reporting to liabilities of SOEs (which is important, given the country's large public sector, which has consolidated total financial liabilities estimated at 34 percent of GDP) and a more detailed description of the implementation and performance of the government's debt management strategy.

PPA3 is a critical first step toward greater fiscal sustainability, helping contribute to addressing Kenya's debt drivers in the medium to long term. Improved debt transparency and dissemination of information on SOE debt is essential to reducing the drivers of debt stress. The initial focus is on the nine SOEs with the largest fiscal risk to the FY20–21 budget and strengthening the SOE monitoring and oversight capacity of the National Treasury. One of the objectives of this PPA is to contain the risks posed by the pandemic to SOEs that could crystallize contingent liabilities by strengthening analysis

and management of fiscal risks from SOEs, revisiting governance arrangements, and improving monitoring and reporting systems.

PPA3 is already a requirement of the current IMF Extended Fund Facility (EFF) and Extended Credit Facility arrangement, so the additionality of this PPA is unclear. In fact, the IMF structural benchmark goes further: by the end of May 2021, the National Treasury will prepare an in-depth, forward-looking financial evaluation not only on those 9 SOEs, but on an additional 6–11 SOEs. The World Bank is supporting this work through the Program to Strengthen Governance for Enabling Service Delivery and Public Investment Program-for-Results. As such, it is unclear whether this PPA makes a meaningful contribution beyond what is taking place through other development partner engagements.

Remaining Debt Issues

Although PPA3 establishes a financial evaluation of nine SOEs and limits public support to 0.3 percent of GDP, it makes no mention of the remedial actions necessary to limit the size of fiscal support, ensure their continued viability, or both. Although there is passing reference in the PPA notes to a development policy operation (DPO) working on four of the identified SOEs, the PPA does not mention complementary actions required to address this debt driver, including with respect to improvements in SOE governance, debt restructuring, or otherwise.

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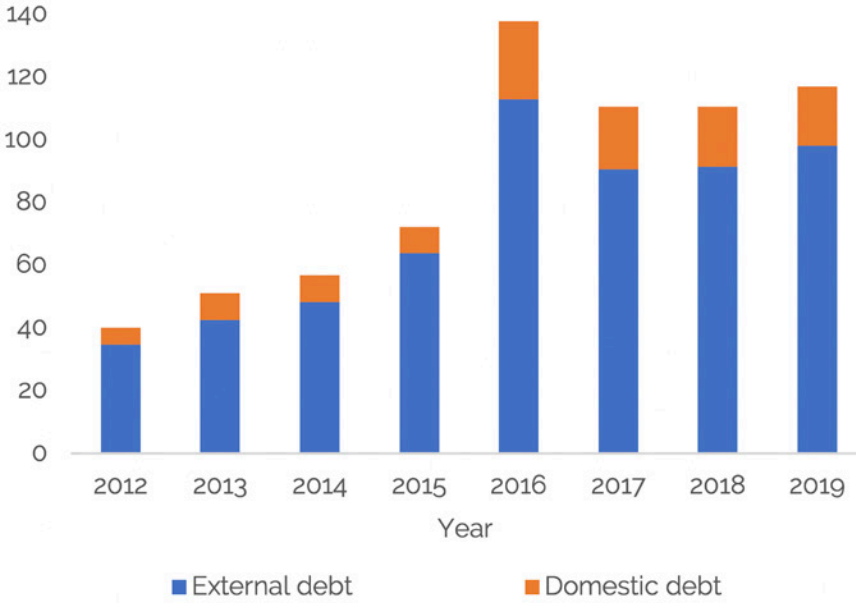
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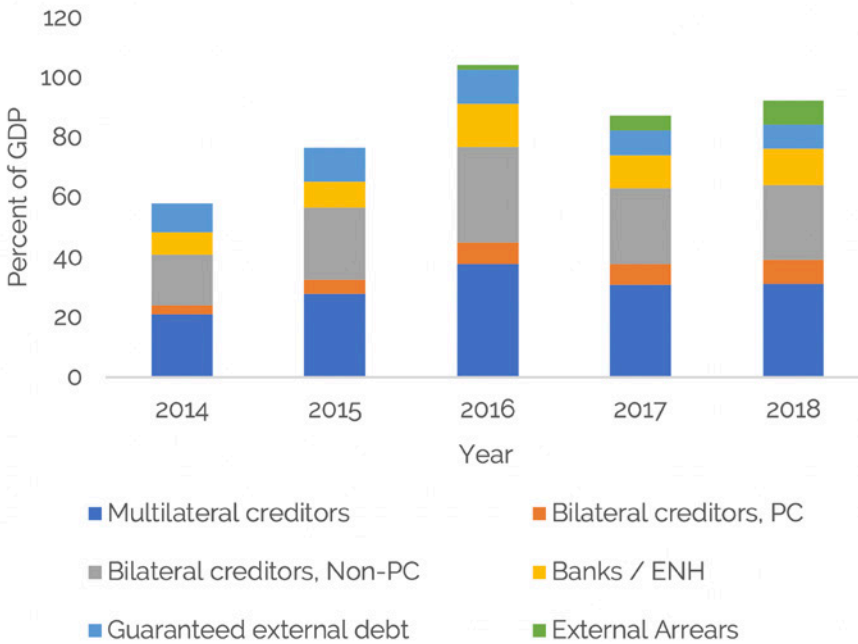
Mozambique

Figure E.4. Mozambique

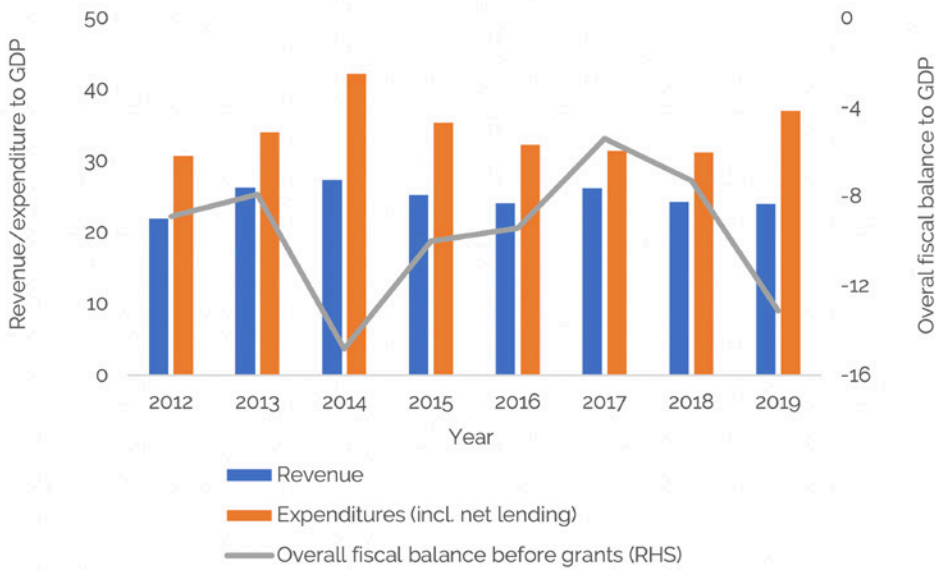
a. Total public debt composition (percent of GDP)



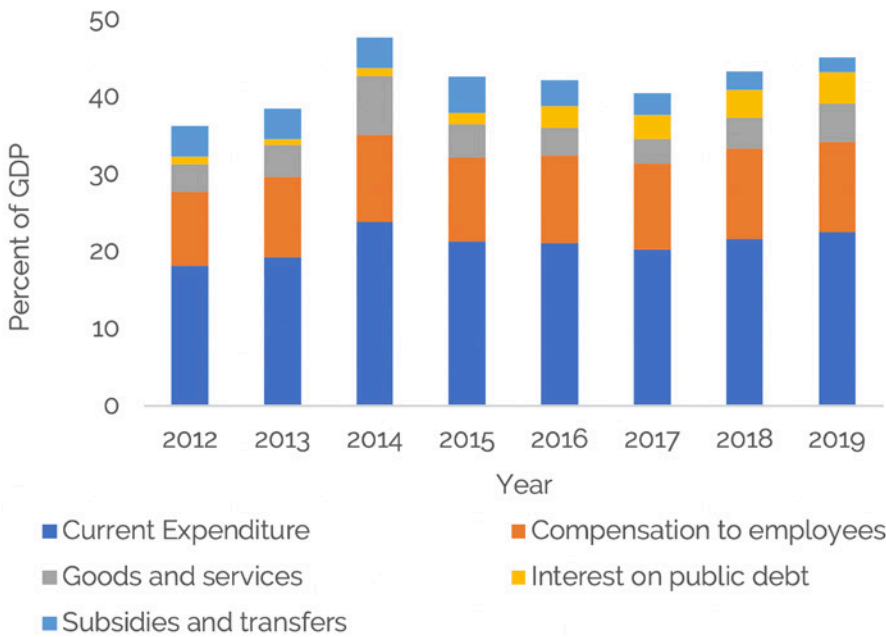
b. External public and publicly guaranteed by creditor group (percent of GDP)



c. Fiscal aggregates (percent of GDP)



d. Current expenditure decomposition (percent of GDP)



Source: Panel a: IMF 2015, 2019; panel b: World Bank and IMF 2020; panel c: IMF 2019; panel d: IMF 2019.

Note: Banks/ENH in panel b includes liquid natural gas debt. GDP = gross domestic product; PC= Paris Club; RHS = right-hand scale.

Debt Situation

Mozambique's debt situation has deteriorated precipitously over the past decade (figure E.4). Mozambique experienced one of the largest increases in public debt burdens among International Development Association–eligible countries, with its debt-to-GDP ratio increasing by 80 percentage points between 2010 and 2020 to more than 120 percent (IMF 2021). A significant portion of this increase was due to the 2015 discovery of previously undisclosed state guarantees that the minister of finance had issued in 2013 and 2014 to SOEs that had incorporated as private enterprises; these state guarantees had not been disclosed to the debt management unit (or creditors).²⁵ The resulting “hidden debt crisis” greatly degraded investor and donor confidence in the government's commitment to sound fiscal and debt management. At the same time, Mozambique was also increasing nonconcessional borrowing from non-Paris Club lenders, often on opaque terms.

Mozambique's risk of debt distress worsened from moderate to in debt distress due to the revelation of previously undisclosed loans and contingent liabilities. The 2018 downgrade occurred in the wake of the drying up of concessional loans after the hidden debt crisis. Under the baseline scenario of the latest DSA (2020), all external debt indicators breach policy-relevant thresholds in both the near and medium terms. The net present value of external public debt-to-GDP is expected to remain above the prudent threshold until 2027. External public debt service to revenue is projected to breach the prudent threshold until 2030 (except in 2020); external public debt service to exports is expected to drop below the prudent threshold in 2024 and remain below it during the rest of the projection period.

There were several main drivers behind the elevation of debt distress in Mozambique. These include (i) nontransparent sovereign guarantees and other contingent liabilities and,²⁴ relatedly, a weak institutional framework for debt management;²⁵ (ii) natural disasters that have taken a toll on growth, particularly the twin cyclones in early 2019 and now the COVID-19 pandemic;²⁶ and (iii) other drivers, including the large increase in debt resulting from the government's guarantees on infrastructure development in relation to exploitation of liquid natural gas and equity investments in these projects,²⁷

and fiscal imbalances (due to weaknesses on both the revenue and expenditure sides).

The country's debt service burden is manageable, and the country appears poised to leave debt distress status soon. Arrears to the government of Brazil are currently keeping Mozambique in debt distress, the settlement of which is currently under discussion.

Key Debt Priorities

Improving the transparency of the process for granting sovereign guarantees is a central priority for addressing the drivers of rising debt in Mozambique. The government of Mozambique has undertaken significant governance reforms since disclosure of the hidden debt crisis. This reform agenda is encapsulated in the government's 2019 publication *Report on Transparency, Governance, and Corruption* and has committed the government to greater transparency and SOE reform, including through the development of an institution for the management of public enterprises (Mozambique and IMF 2019).

The country also needs to continue fiscal consolidation and follow a prudent borrowing strategy. Mozambique's 2019 IMF Article IV Consultation report commended the government's commitment to gradual fiscal consolidation over the medium term but noted that this required greater domestic revenue mobilization and a reduction of spending inefficiencies, reining in the public sector wage bill, which increased from 8 percent of GDP in 2008 to 11.6 percent in 2019 (IMF 2019).

There is also a need to strengthen the government's debt management function. The capacity of the Ministry of Economy and Finance's debt unit needs to be strengthened to exercise effective oversight of the public debt portfolio and implement stronger safeguards (IMF 2019, World Bank 2020a). The last Debt Management Performance Assessment showed deficiencies along all debt performance indicators, with only 6 of 32 subindicators achieving the minimum standard (World Bank 2017).²⁸

Relevance of FY21 Performance and Policy Actions to Drivers of Debt Stress

The World Bank agreed with the authorities on the three PPAs shown in table E.1 for FY21 (tentative PPAs for FY22 and FY23, which have not yet been negotiated, were included in the PPA notes).

Table E.1. Mozambique Performance and Policy Actions

PPAs	Year 1 (FY21)	Year 2 (FY22)	Year 3 (FY23)
PPA1	Government of Mozambique publishes the 2020 annual debt report with coverage of SOE and liquid natural gas debt	Per year 1 (for 2021 annual debt report), plus the government develops and approves a medium-term debt management strategy	Per year 2 (2022 annual debt report), plus the government reports annually on debt management strategy implementation in fiscal reports
PPA2	The government uses newly published credit risk assessment framework to produce credit risk reports for seven SOEs	Per year 1 (for 15 SOEs), plus the government establishes a credit risk committee that is required to issue a technical opinion on any new guarantees or on lending using the credit risk reports	Per year 2 (for all SOEs), plus the government introduces guarantee fees and establishes a guarantee fund to mitigate fiscal risks
PPA3	Zero nonconcessional borrowing limit on external public and publicly guaranteed debt	n.a.	n.a.

Source: World Bank 2020b.

Note: FY = fiscal year; n.a. = not applicable; PPA = performance and policy action; SOE = state-owned enterprise.

PPA1 seeks to address shortcomings in transparency, a key driver of increased debt stress. This PPA responds to the need to reduce government opacity, particularly in relation to SOE debt, which was a major contributor to the rise in debt stress. The increase in coverage of debt reporting is meaningful and well targeted. The publication and submission to parliament of the 2020 annual debt report is a positive measure,²⁹ but it does not require publication in subsequent years. Instead, the World Bank used dialogue about this PPA to convince the government to integrate annual publication

of debt reports that include SOE debt into Mozambique’s new Public Financial Management Law, which was passed earlier this year. Notional PPAs in subsequent years will require the development and publication of a medium-term debt management strategy, underpinned by robust debt analysis.³⁰

PPA2 seeks to strengthen the management of debt and fiscal risks originating from SOEs. This entails using the new credit risk assessment framework for SOEs, supported through the COVID-19 DPO, to publish credit risk reports for seven SOEs.³¹ Proposed PPAs for subsequent years include publication of reports for an additional eight SOEs, although the value-added of broadening the scope is not large since the original seven accounted for 99.6 percent of the SOE external debt stock at the end of 2018. Likewise, this PPA would be supported by an investment project to strengthen SOE oversight.

Remaining Debt Issues

FY21 PPAs address Mozambique’s central debt drivers, except for the need to increase revenues. Although domestic revenue mobilization in Mozambique is relatively high compared with the rest of the region and fiscal deficits were not the dominant contributor to Mozambique’s debt stress, the country does regularly run fiscal deficits. Mozambique’s 2019 IMF Article IV Consultation report does note the potential fiscal space that could be created by, for example, removing value-added tax exemptions on select food products and public works.

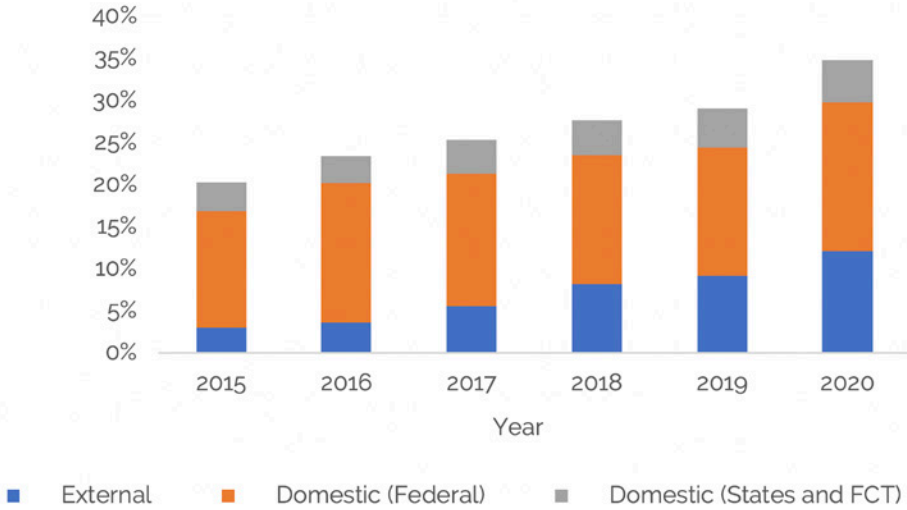
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Nigeria

Figure E.5. Nigeria

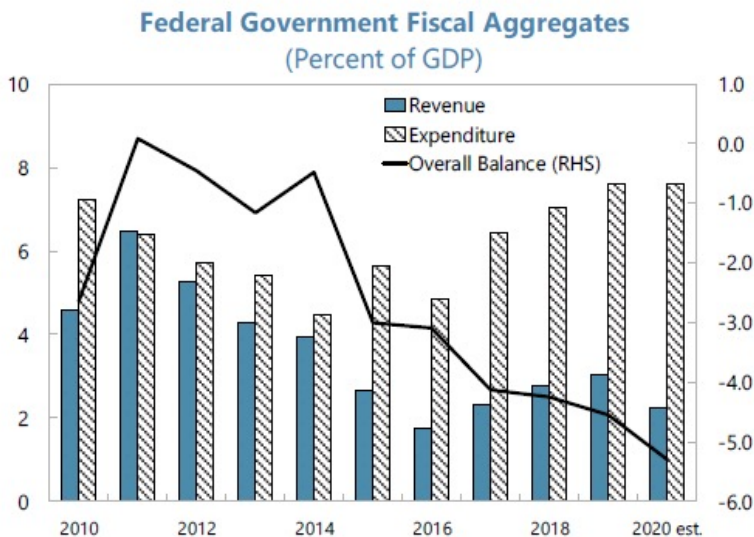
a. Public debt-to-GDP, 2015–20



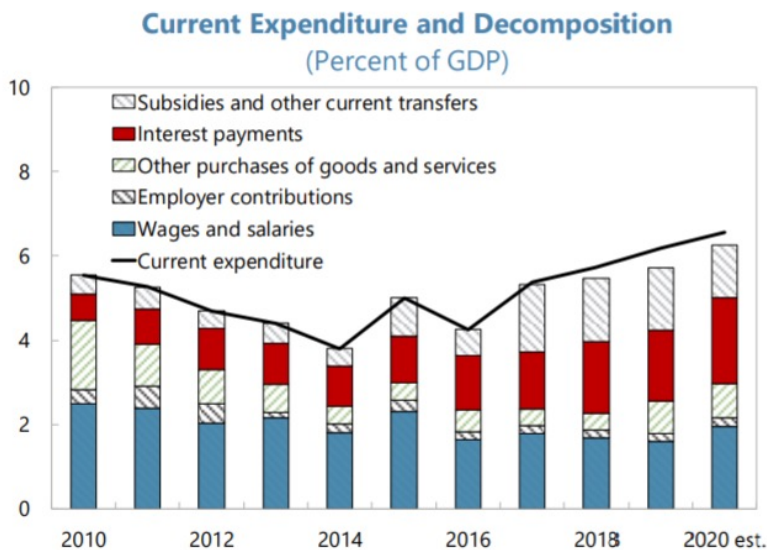
b. Public and publicly guaranteed debt by official creditors



c. Federal government fiscal aggregates (percent of GDP)



d. Current expenditure and decomposition (percent of GDP)



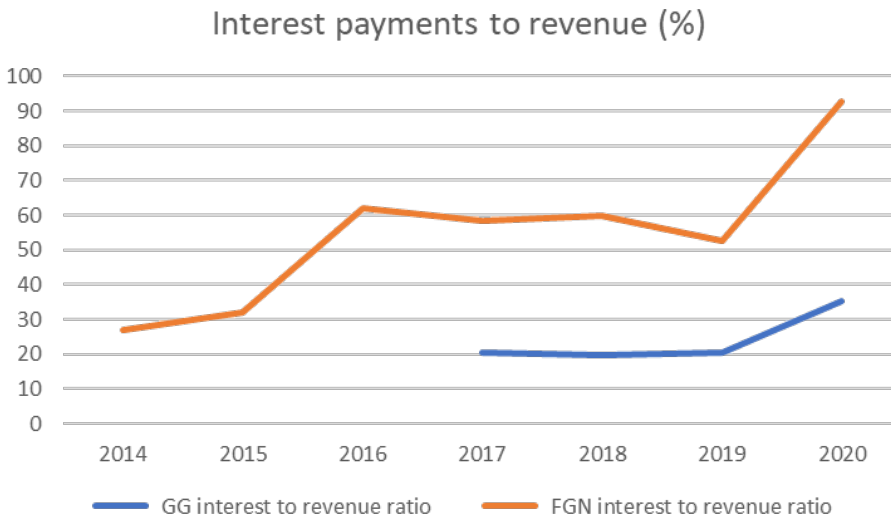
Source: International Monetary Fund, Article IV consultation reports.

Note: FCT = Federal Capital Territory; GDP = gross domestic product; RHS = right-hand scale.

Debt Situation

Before the pandemic, Nigeria was already confronting significant economic vulnerabilities, which affected its risk of debt distress. Though richly endowed and officially a lower-middle-income country (having graduated from low-income status in 2008), the country is marked by pervasive geographic inequity and poverty, with some 42.8 percent of the population living in extreme poverty in 2016. The economy and public finances are highly vulnerable to oil shocks, with oil accounting for some 90 percent of export earnings and 50 percent of general government revenues. Some 80 percent of the labor force works in the informal sector, which has implications for government tax revenue. Nigeria’s government revenue to GDP ratio, at 8 percent, is the lowest in the world. Governance and public financial management challenges are significant, and corruption and lack of transparency and accountability have greatly affected the quality of public service delivery. Nigeria was classified as a fragile and conflict-affected country in FY20, and it ranks in the bottom 10 percent of countries in political stability and the absence of violence and terrorism.

Figure E.6. Interest Payments to Revenue (percent)



Source: Independent Evaluation Group.

Debt (and debt service) have grown significantly over the past five years. Public debt expanded eightfold between 2015 and 2020, from \$10.3 billion

to \$86.3 billion. With the sharp decline in economic activity stemming from COVID-19, public debt as a share of GDP is estimated to have increased from 20 percent in 2015 to 34 percent in 2020 (figure E.5, panel a), though both public debt and fiscal gross financing needs remained below the debt burden benchmarks for the Debt Sustainability Analysis for Market Access Countries under the baseline and stress tests. Debt service represents the greater debt vulnerability, having escalated significantly over the past decade. Interest payments to federal government revenue (the level of government tasked with servicing the debt) has risen from less than 30 percent in 2014 to more than 90 percent in 2020 (figure E.6). Debt service absorbed about 25 percent of the consolidated government budget in 2021, almost three times the allocation to education and health combined.³² The rising debt service burden both crowds out other vital spending and increases vulnerability to domestic and external shocks, such as a drop in oil prices.

Compositionally, Nigeria's debt has shifted toward commercial debt. Nigeria's public debt is largely domestic and mostly issued by the federal government. About 38 percent of public debt is external, and 62 percent is domestic. Although multilateral concessional debt has remained broadly stable over the past decade, Nigeria's debt profile has seen an increase in nonconcessional debt, including through Eurobond issuances (which now account for 20 percent of debt outstanding and disbursed). Nigeria has also drawn increasingly on bilateral loans from China for large infrastructure deals. As of March 2020, China accounted for 11.2 percent of Nigeria's external debt stock of \$27.67 billion.³³

Key Debt Priorities

Over the longer term, a critical priority for addressing Nigeria's debt vulnerabilities is a significant increase in revenue capacity. Government revenues are among the lowest of all countries, at 8 percent of GDP before the pandemic, and they are estimated to have plunged some 2 percentage points of GDP further over 2020. Although debt is sustainable in a variety of shock scenarios, falling government revenues threaten liquidity indicators in the short term. Public expenditure, especially for capital investments, is already low by international standards (IMF PIMA 2019).

In the short term, deficit financing by the central bank is not cost-effective. In recent years, the federal government of Nigeria has increased its recourse to central bank financing, which is less transparent and more expensive than other (marketable and concessional) debt instruments. One of the primary institutional factors behind the increased deficit financing from the central bank arises from the budgeting practices. The borrowing limits are defined by the (planned) federal government budget deficit and are presented and approved as part of the budget. The planned budget deficits are guided by the fiscal rule limiting the budget deficit to 3 percent of the GDP (the actual deficits are not effectively bound by a fiscal rule). With vastly rigid expenditures, the annual budget systemically sets overoptimistic budget revenue targets to meet the deficit rule in the budget appropriation. With the transparent debt issuance through traditional instruments bound by the underestimated borrowing limits, the actual financing gap is plugged by the central bank. Not only is the total borrowing limit approved by the parliament as part of the budgetary process fixed, but the split between domestic and external borrowing is fixed, too. Any shocks to the external financing are also absorbed by the central bank financing (or, when they are substantial, contraction in capital spending). For example, in 2019, because the government did not proceed with the Eurobond issuance, more than 60 percent of the federal government fiscal deficit was monetized using the central bank's overdraft facility.

Relevance of Performance and Policy Actions to Drivers of Debt Stress

Nigeria's PPAs span all three SDFP priority areas of debt management, debt transparency, and fiscal sustainability, but they do not address the key sources of the country's debt vulnerabilities. The three PPAs are noted as follows (World Bank 2020b):

- » **PPA1 (debt management):** To reduce the cost of domestic borrowing by curtailing recourse to the Central Bank of Nigeria (financing through the overdraft facility), the government will enact an Amended Budget for 2020 that raises domestic and external borrowing limits, which allows issuance of cheaper and more transparent marketable (or concessional) debt instruments.

- » **PPA2 (fiscal sustainability):** To enhance the monitoring of tax incentives to inform tax-expenditure rationalization efforts, the government, through the Federal Ministry of Finance, Budget, and National Planning, will, for the first time, prepare and present to the National Assembly along with the annual Federal Budget 2021 an annual tax-expenditure statement with the estimated cost (in 2019) of tax exemptions, incentives, and rebates provided under Nigeria’s corporate income tax, value-added tax, and customs laws.
- » **PPA3 (debt transparency):** To enhance the transparency and management of public debt and contingent liabilities, the government will publish by January 31, 2021, on its website information on contracted federal government loans that have been signed but not yet disbursed as of the end of June 2020.

PPA1 aims to reduce the immediate costs of the stock of domestic borrowing (improving debt management) and incentivize adherence to the fiscal rule. Under PPA1, Nigeria raised the domestic and external borrowing limit from 25 percent of GDP to 40 percent. The PPA note states that in recent years, when the government has breached its fiscal rule (3 percent deficit, under the Fiscal Responsibility Act of 2007), its recourse has been the Central Bank of Nigeria (CBN), whose rates are more expensive and less transparent than other (marketable and concessional) debt instruments.

PPA1 reduces the short-term costs of debt, and it also reduces the perception of fiscal dominance. By increasing the borrowing limit, the budget deficits can be financed by market and concessional instruments (CBN’s rate is set at the monetary rate plus 3 percent, making it very expensive). In 2019, the federal government paid \$1 billion in interest on the use of the CBN overdraft. Because these expenditures are not explicitly planned in the budget, they squeeze the fiscal space throughout the year and perpetuate the underestimated deficit and borrowing limit issue. Moreover, resorting to the CBN perpetuates the perception of fiscal dominance. In a country with high inflation, continually financing the budget gaps with CBN financing does not allow inflation to anchor to expectations.

Although PPA1 fails to address the underlying causes behind the consistent breach of the fiscal rule, it does provide incentives for fiscal discipline. Fiscal breaches are in part incentivized by the way the fiscal rule is defined (the government is limited to a planned fiscal deficit of only 3 percent according

to the budget, but actual deficits are not bound by the rule; thus, there are incentives for overly optimistic budget revenue targets). Because the government has consistently breached the rule, it has had to draw on the CBN overdraft for deficit financing. The current use of the CBN overdraft perpetuates the underestimated deficit. By financing the underestimated deficit through the market, where there is competition, consistent breaches of the fiscal rule are more likely to be penalized through higher interest rates. That could ultimately serve to reduce the occurrence of fiscal rule breaches.

PPA2 is aimed at addressing fiscal sustainability by requiring a report on tax expenditures. The action is more related to fiscal transparency than fiscal sustainability. The focus is a report, and although the expected objective of the PPA is “increased revenues, reduced debt vulnerabilities,” it is unclear how the report does anything to increase revenues, since there are no accompanying actions to actually cut the tax expenditures (nor does the PPA address other revenue-raising measures).

PPA2 is positioned within a range of recent actions in support of improved fiscal sustainability. Through the Nigeria COVID-19 Federal Fiscal and Economic Response DPO (FY21), several prior actions are aimed at safeguarding revenues and financing flows and strengthening expenditure and debt management. Among them, the Federal Inland Revenue Service and the Nigeria Customs Service have issued regulations to enhance the administration of the value-added tax and raise the current rate from 5 to 7.5 percent, while also making it easier to declare and pay taxes online; in the oil sector, the Ministry of Petroleum Resources is strengthening the collection of gas-flaring payments, and the Nigeria National Petroleum Corporation has, for the first time in history, published its audited financial statements and detailed monthly reports to the Federation Account Allocation Committee. Within debt management, along with PPA1’s publication of undisbursed loans, the government has established procedures to collect data on both contingent and current liabilities from all ministries, departments, and agencies, including parastatals.

Although PPA2 is a first step toward rationalizing tax exemptions, it is not articulated within a sequenced reform agenda where its relevance would be clarified. Reporting on tax expenditures clearly needs to be followed up with actions that consolidate overall tax expenditures to have real meaning.

Although it may not be feasible to increase tax collection over the first year of implementation, the plans for stronger revenue collection efforts could be articulated now to ensure the agenda moves forward.

Without a clear articulation of the reform agenda (in a programmatic sense), it is not clear what the impact of reporting on tax expenditures will contribute to the very clear problem with low revenue collection.

Finally, PPA3 aims to enhance debt transparency by publishing federal government loans that have been signed but not yet disbursed. The PPA note suggests that undisbursed loans represent 8 percent of the existing stock of debt, certainly material for debt sustainability. At the same time, there is no indication that Nigeria's elevated debt risks were the result of inadequate consideration of undisbursed loans. Complementary actions under the COVID-19 Federal Fiscal and Economic Response DPO reinforce the agenda, requiring all ministries, departments, agencies, and parastatals (including SOEs) to provide information on contingent liabilities, current liabilities, and abandoned projects to the Budget Office and the Debt Management Office.

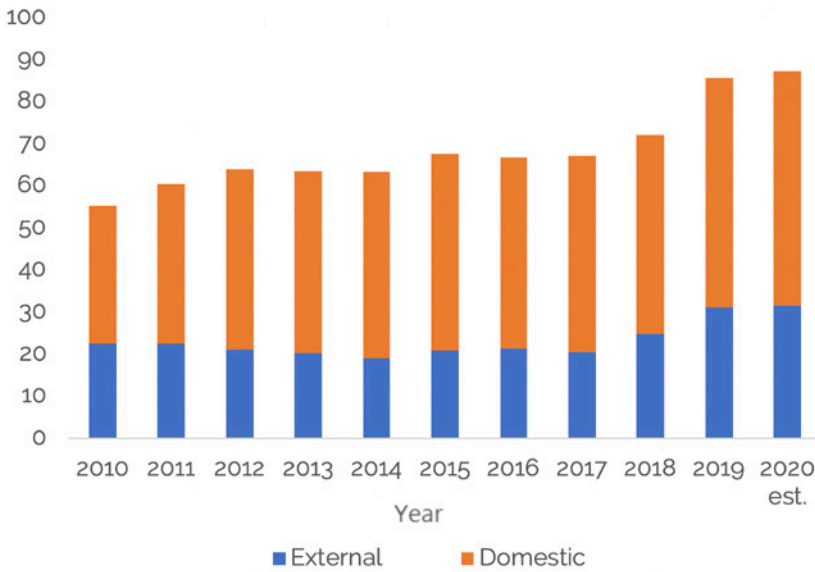
Remaining Debt Issues

One of the main limitations of the PPA note is that the programmatic agenda for any area is not articulated. Management views the tax-expenditure report as part of a sequenced process for tax rationalization. However, it is not possible to see the PPA within a holistic reform agenda by which its relevance could be better judged. In the PPA note, management says that although the PPAs for FY21 are not programmatic, the dialogue and technical assistance to the government is through technical assistance, advisory services and analytics, and lending engagements. This explanation does not make up for the fact that the agenda is not specified.

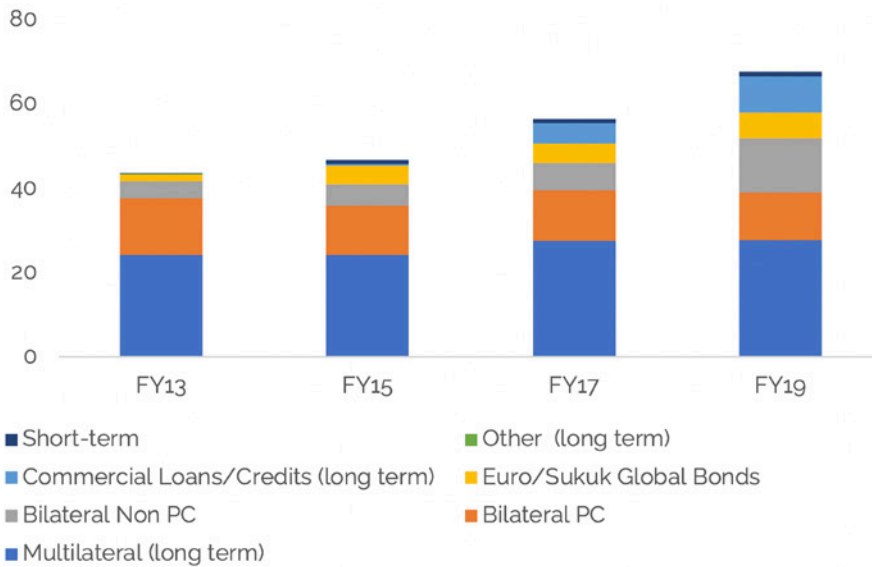
Pakistan

Figure E.7. Pakistan

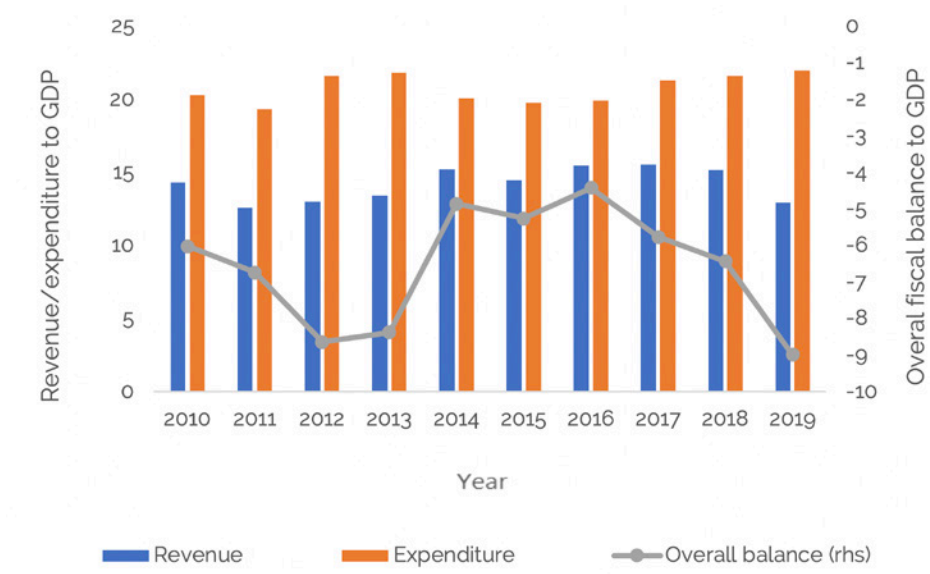
a. Public debt-to-GDP 2016–20 (percent of GDP)



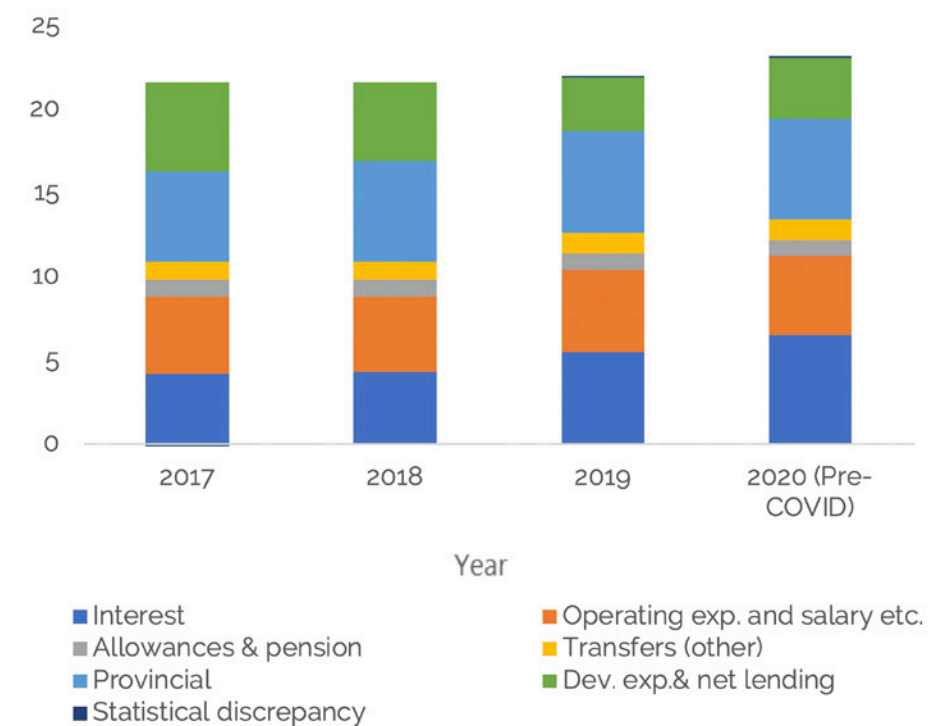
b. Government external debt by creditor group (\$, billions)



c. Fiscal aggregates (percent of GDP)



d. Central government expenditure (percent of GDP)



Source: Panel a: International Monetary Fund Article IV staff reports, and Extended Fund Facility staff reports 2019 and 2021; panel b: Ministry of Finance Medium-Term Debt Management Strategy; panel c: International Monetary Fund World Economic Outlook; panel d: World Bank Staff calculations and estimates.

Note: Panel b: "Short term" includes multilateral, local currency securities, and commercial loans or credits. GDP = gross domestic product; PC = Paris Club; rhs = right-hand scale.

Debt Situation

Pakistan's public debt has significantly increased over the past decade, in the face of persistently high fiscal deficits. Pakistan's debt-to-GDP ratio increased from 55.3 percent in 2010 to 85.6 percent in 2019 (figure E.7, panel a). Low domestic revenue mobilization (approximately 14 percent of GDP) and an inefficient power sector have been key drivers of deficits, which have averaged about 6.5 percent of GDP (figure E.7, panel c). In addition, increasing circular debt (unstainable stock of arrears)³⁴ in the power sector has been a long-standing issue.

The increase in public debt has been accompanied by a rise in borrowing costs and debt service. Interest payments increased from 4.3 percent of GDP in 2017 to 6.5 percent of GDP in 2020 (pre-COVID-19) (figure E.7, panel d), reflecting increased nonconcessional borrowing from non-Paris Club bilateral creditors, commercial lenders, and issuance of Euro/Sukuk Global Bonds (figure E.7, panel b). Multilateral (long term) as a share of external public debt declined from 55 percent in FY13 to 41 percent in FY19. The average interest rate on new external public and publicly guaranteed loan commitments was 2 percent in 2013, 2.9 percent in 2016, and 4.8 percent in 2018.³⁵ Interest payments accounted for about 42 percent of revenue in FY19. About two-thirds of total public debt is domestic, and the government relied heavily on borrowing from the State Bank of Pakistan on costly terms up until FY19.³⁶ To create fiscal space for social and development spending, Pakistan requested an arrangement under the IMF's EFF (July 2019 to October 2022) and debt service suspension under the DSSI.³⁷

Debt sustainability risks have risen and remain high in the short and medium term. The April 2021 DSA highlights several risks, including crystallization of contingent liabilities of loss-making SOEs and macro-fiscal shocks. However, it projects that public debt will decline steadily over the medium term as the EFF-supported reforms are implemented (IMF 2021).

Key Debt Priorities

Over the medium term, tax revenue mobilization is a key priority and central to debt sustainability. Pakistan has substantial potential to increase tax

receipts by strengthening compliance. A recent tax gap analysis by the World Bank indicated that Pakistan's tax revenue would reach 26 percent of GDP if tax compliance were raised to 75 percent, a realistic level for a middle-income country (World Bank 2019). This implies that tax authorities have been capturing only half of the country's revenue potential. The size of the tax gap is especially large for the goods and services tax (GST) and even larger for taxes assigned to the provinces. High compliance burden with five jurisdictions is a major impediment.³⁸

A second priority is strengthening debt management and reporting. Weak debt management did not drive the rise of public sector debt stress but contributed to the deterioration in the quality of the debt portfolio. Debt management is fragmented across five entities and their subentities. No single entity is responsible and accountable for achieving the objectives of the Medium-Term Debt Management Strategy. Because of debt management fragmentation, information on debt is scattered across several reports prepared by different entities. Information on fiscal risks and contingent liabilities is neither comprehensive nor fully disclosed.

Relevance of Performance and Policy Actions to Drivers of Debt Stress

The World Bank agreed with the authorities on the three PPAs shown in table E.2 for FY21. Tentative PPAs for FY22 and FY23 were included in the PPA notes.

Table E.2. Pakistan Performance and Policy Actions

PPAs	Year 1 (FY21)	Year 2 (FY22)	Year 3 (FY23)
PPA1 (debt management):	The Finance Division issues administrative rules assigning all debt management functions to the DMO after amendments to the 2005 Fiscal Responsibility and Debt Limitation Action—by end-April 2021	The DMO establishes Service Level Agreements with the Economic Affairs Division, the External Finance Wing, the State Bank of Pakistan, and the CDNS on data recording and reporting	The Macro Fiscal Policy Unit publishes the Debt Sustainability Analysis
PPA2 (fiscal sustainability)	The Finance Division and provincial finance departments issue implementing regulations after the approval of common GST laws passed by the federal and provincial assemblies to harmonize the sales tax—by May 2021	The Federal Finance Division implements updated Fiscal Rules—post-Fiscal Responsibility and Debt Limitation Act—especially on publication of reports on updated fiscal rules and use of adjustment mechanisms when/if the country/federal government is in breach of the updated fiscal rules	Provincial governments (i) establish fiscal management functions, including revenue policy, and roll out fiscal rules legislation in line with the national Fiscal Rules Legislation; and (ii) publish their Medium-Term Fiscal Frameworks, in line with the National Medium-Term Fiscal Framework
PPA3 (debt transparency)	The Finance Division publishes (i) semiannual debt bulletins; (ii) an annual report comparing debt management strategy implementation with targets for end FY21; and (iii) a report on federal COVID-19-specific expenditure for FY21—by March 2021	The DMO publishes (i) an annual report on public debt stock and guarantees that compares debt management strategy implementation with targets, and (ii) semiannual debt bulletins with a creditor-wise breakdown of debt outstanding	The DMO publishes an annual report on public debt that compares debt management strategy implementation with targets, and the provincial finance departments publish fiscal risks and debt bulletin bi-annually

Source: Independent Evaluation Group.

Note: DMO = Debt Management Office; FY = fiscal year; GST = goods and services tax; PPA = performance and policy action.

PPA1 is not directly relevant to the drivers of debt stress over the past decade, but weak debt management practices have been contributing factors and are a risk going forward. PPA1 addresses long-standing institutional and technical capacity weaknesses by establishing a fully integrated Debt Management Office and clarifying and assigning all debt management functions and responsibilities, which are critical steps to strengthening debt management. The Debt Management Office is expected to take integrated decision-making responsibility and enforcement authority for domestic wholesale and retail market issuance, external borrowings, loan terms for bilateral and multilateral financed projects, and issuance of guarantees. By strengthening the Debt Management Office, it will be easier for the government to balance the debt portfolio, for example by lengthening the maturity profile of the domestic debt component.

PPA2 partially addresses a key driver of rising public debt levels. PPA2 aims at increasing tax revenue by harmonizing the GST nationwide and reducing the heavy compliance burden. Under the Resilient Institutions for Sustainable Economy DPO (World Bank 2020), the World Bank has been supporting the government to advance the GST reform through the approval of common GST laws (a prior action). Following approval of common GST laws by the federal and provincial assemblies, PPA2 requires the central government Finance Division and provincial finance departments to issue implementing regulations.³⁹ Implementing common principles, definitions of goods and services, and a single rate is expected to make the tax administration simpler. The issuance and implementation of new and common regulations is expected to reduce the time to file and administrative costs of GST, thereby helping to strengthen compliance and increase revenue collection.

PPA3 will increase the timeliness and comprehensiveness of debt information, but its additionality is modest. Although PPA3 supports steps to ensure a coordinated mechanism to debt reporting and transparency, Pakistan already publishes quite comprehensive data on public debt. PPA3 underscores a prior action of the first World Bank Resilient Institutions for Sustainable Economy development policy financing, which mandated the publication of the Medium-Term Debt Management Strategy and semiannual debt bulletins.⁴⁰ The PPA3 requirement for a comparison of the MTDS targets and actual outcomes is unlikely to have any meaningful impact on the drivers of

rising debt levels and vulnerabilities given that public debt levels breached the limits set out in the Fiscal Responsibility and Debt Limitation Act (2005) for several years.

In addition, the publication of a report on federal COVID-19–specific expenditure (under PPA3) does not address a key driver of debt vulnerabilities. Although COVID-19 spending added to public debt, this is a one-off measure that cannot be compared with persistent fiscal deficits. Moreover, the IMF is already supporting the government’s resumption of its fiscal consolidation measures including the gradual unwinding of crisis-related spending in the context of the EFF.

Remaining Debt Issues

Additional measures to enhance domestic revenue mobilization are required to reduce debt vulnerabilities. These include personal income tax reforms (increasing progressivity), a reduction in exemptions,⁴¹ and tax administration. Many of these reforms have been initiated and are supported by the World Bank’s Pakistan Raises Revenue investment project,⁴² technical assistance from the IMF and World Bank, and the IMF EFF. Nevertheless, given the long-standing nature of this problem and its significance to debt accumulation, one might have expected additional PPAs dedicated to revenue mobilization, perhaps with respect to the cancellation of some existing exemptions.

PPAs did address public expenditures in FY21. However, the government has already taken several important steps for fiscal consolidation, including adjusting electricity prices to reform energy subsidies as an action under the IMF EFF. The World Bank Resilient Institutions for Sustainable Economy DPO includes a prior action to approve the National Tariff Policy for rationalizing the tariff structure. This DPO also supports the government in approving the Circular Debt Management Plan, which includes policy measures to gradually eliminate the stock of circular debt in the energy sector.

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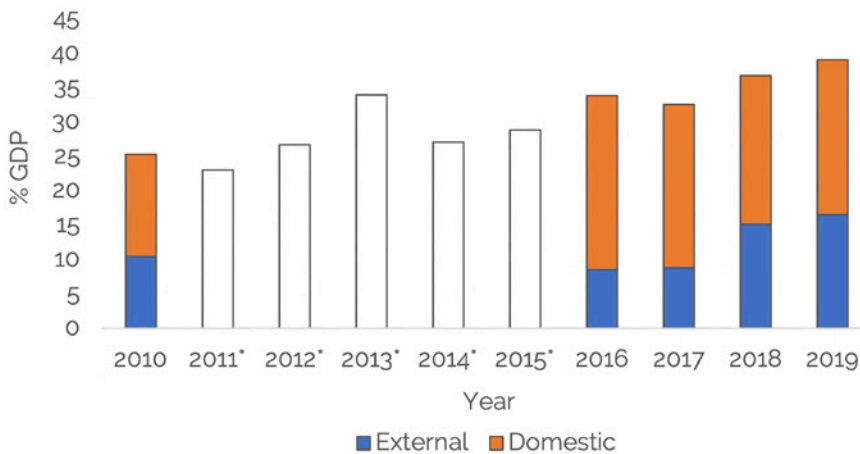
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Papua New Guinea

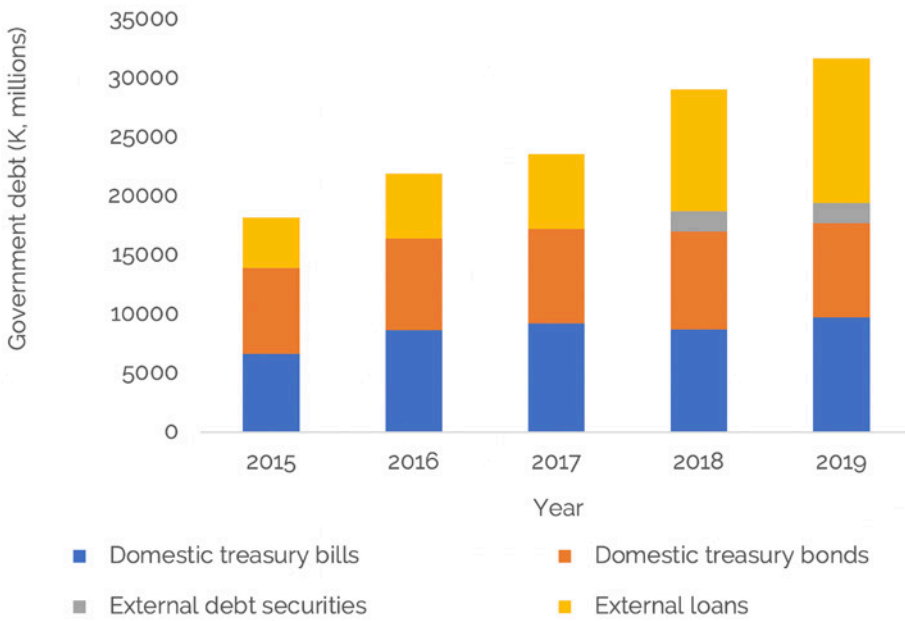
Figure E.8. Papua New Guinea

a. Public debt-to-GDP, 2010–19

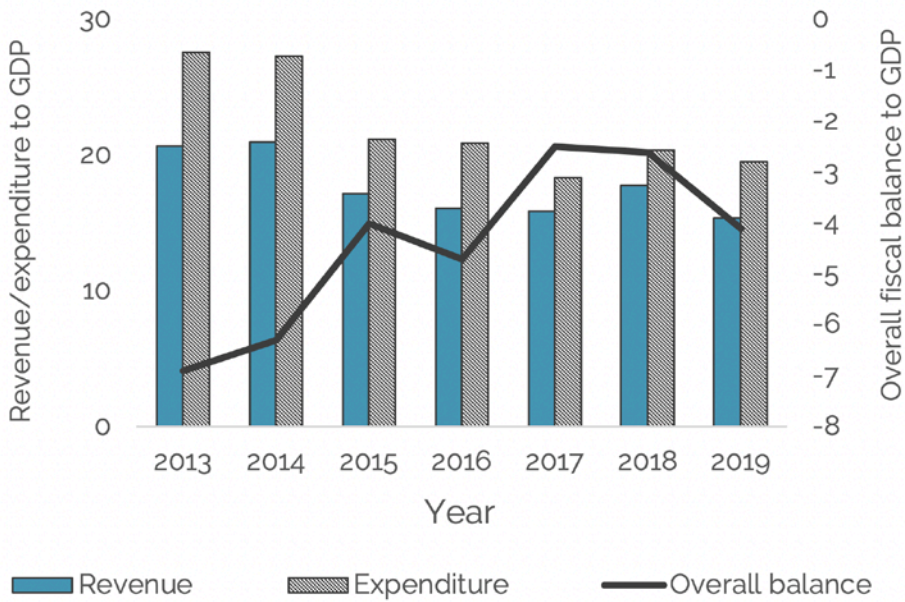


* Domestic/external not available

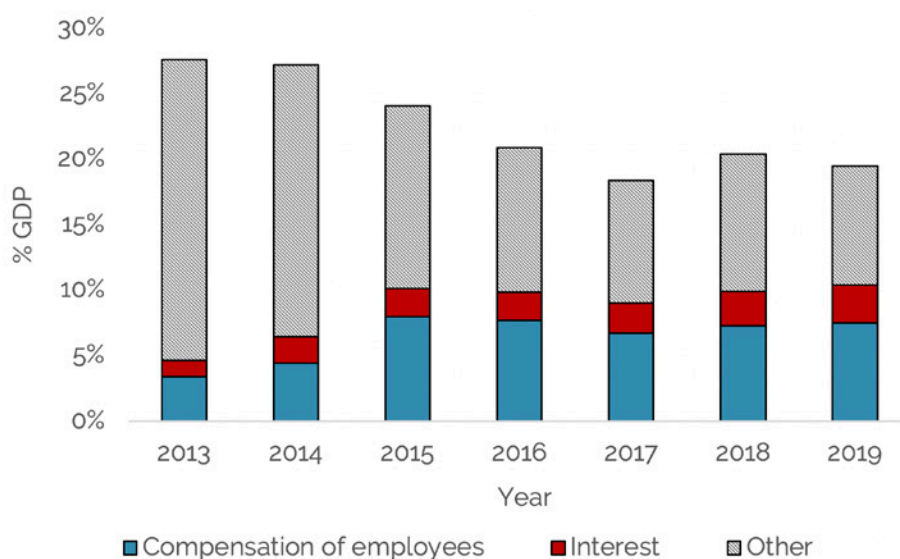
b. Gross government debt by source



c. Central government fiscal aggregates (percent of GDP)



d. Total expenditure decomposition (percent of GDP)



Source: Independent Evaluation Group.

Note: GDP = gross domestic product; K = kina.

Debt Situation

Papua New Guinea experienced a two-level increase in its assessed risk of debt distress since 2016.⁴³ Although public and external debt remain moderate relative to peers (and below the debt threshold of 45 percent under the revised Fiscal Responsibility Act), public debt increased from 25 percent of GDP in 2010 to 39 percent by 2019 (figure E.8, panel a). As the authorities were beginning to implement wide-ranging reforms under the IMF Staff-Monitored Program (SMP),⁴⁴ the COVID-19 pandemic hit, leading to significant declines in economic activity and export earnings (and the assessed risk of debt distress rose from moderate in 2019 to high in June 2020).⁴⁵

Between 2010 and 2019, domestic debt rose from 14.9 percent of GDP to 22.5 percent of GDP, accounting for about 60 percent of the increase in the debt-to-GDP ratio. Domestic debt is concentrated in short-term instruments, with just over half held in treasury bills. Regarding external debt, about two-thirds of the increase (4.3 percent of GDP) reflects increased borrowing from non-Paris Club and commercial creditors. The remainder (1.8 percent of GDP)

reflects the revaluation of foreign currency debt at current exchange rates in 2019, in line with international best practice (and as advised by the IMF).

Several factors have contributed to the increase in debt stress. Beyond the one-time increase in external debt related to revaluation, weak revenue collection (revenues to GDP fell from 21 percent in 2013 to 15.4 percent in 2019), and a realization of state loan guaranteed loans for SOEs taken over by the central government (amounting about 1.4 percent of GDP) were major contributing factors to Papua New Guinea's debt stock increase. Tax revenues are low and have fallen with lower commodity prices and economic contraction on the back of a major earthquake. Nontax revenue has also declined. Expenditure has not contributed to the debt buildup (expenditures/GDP are relatively low). Central government payment arrears from the previous government are substantial and are estimated to have accounted for approximately 1 percent of GDP over 2019 and 2020.⁴⁶

Key Debt Priorities

Over the longer term, Papua New Guinea's debt sustainability hinges on increased revenue mobilization and stronger export growth. Reforms under the government's Medium-Term Revenue Strategy (MTRS), focusing on increased domestic revenue mobilization, are essential for reducing the buildup of debt. Reducing debt vulnerabilities also depends on higher growth and export earnings, particularly in the nonresource sector (with the natural resource sector subject to boom-and-bust cycles).

The sharp increase in public debt from the realization of contingent liabilities from state loan guarantees underscores a need to strengthen guarantee approval and recording to ensure that exposures under guarantees are well understood. The 2016 State Guarantee Policy provides a set of documented procedures for the approval and issuance of loan guarantees, but transparency and reporting practices hinder the ability to get information on current exposures under the guarantees. The policy does not address the issues related to risk monitoring of the current guarantees or issues related to hon-

oring the guarantees (World Bank 2021). The authorities requested a suspension of debt service under the Group of Twenty COVID-19 DSSI.

Relevance of Performance and Policy Actions to Drivers of Debt Stress

As a country affected by fragility, conflict, and violence, Papua New Guinea was required to implement only two PPAs. Its approved PPAs are the following:

- » **PPA1 (fiscal sustainability):** The government may enter into contractual obligations for new long-term external public and publicly guaranteed non-concessional debt in a total amount not exceeding \$1,200 million in FY21. For the period through June 2021, the nonconcessional debt limit may be adjusted as determined by the World Bank: (i) to reflect any material change of circumstances or (ii) coordination with the IMF, in particular in line with adjustment in the IMF’s Debt Limit Policy.
- » **PPA2 (debt management):** The government has approved amendments to the State Guarantee Policy, which incorporates policies and procedures relating to (i) monitoring of outstanding loan guarantees, (ii) loan guarantee payments and recovery, and (iii) recording and reporting of loan guarantees.

PPA1 has been implemented in the context of an International Development Association Crisis Response and Sustainable Recovery DPO. The prior action, aimed at ensuring medium-term fiscal and debt sustainability, consists of two parts: (i) the passage of a Budget Strategy Paper, including a commitment for fiscal consolidation and (ii) a limitation of the contractual obligations for new long-term external public and publicly guaranteed nonconcessional debt to less than \$1,200 million from July 1, 2020, to March 31, 2021.

Outside of SDFP PPAs, fiscal actions are largely concentrated on the expenditure side. According to its 2021 Budget Strategy Paper, the government will undertake several recurrent expenditure-reducing measures. The wage bill will be controlled by expanding the overdue retirement program and by instituting a government-wide ceiling on new hiring. Revenue-side actions depend on reforms advancing under its MTRS. Within the context of an IMF SMP (2020–21), the authorities committed to submit a budget law for 2020

that met the SMP quantitative targets for the deficit and the spending levels. The SMP also includes actions to establish an interagency office in treasury for the identification, verification, and clearance of arrears and limiting the growth of new domestic arrears (structural benchmark); appoint a permanent Commissioner General for Internal Revenue Collection (structural benchmark); have treasury lead an interagency team to review best institutional arrangements for tax and customs revenue collection (structural benchmark); implement provisions of a new Tax Administration Act (structural benchmark); and pass the Income Tax Act (structural benchmark).

Although PPA1 caps the increase in nonconcessional debt, it does not specifically address the source of the buildup in Papua New Guinea's debt stress. It sets a limit on nonconcessional external borrowing, but it does not address the *causes* of that borrowing, which relate primarily to low and declining domestic revenue mobilization and the government's assumption of servicing of state loan guaranteed debts of SOEs (in addition to a revaluation of external debt).

In addition, at the level set, it is unclear whether the debt limit changes the trajectory of debt accumulation meaningfully. The nonconcessional borrowing limit, at \$1,200 to the end of 2020, was set about 30 percent higher than average yearly external borrowing over the previous four years. Rather than constraining new external debt, the nonconcessional borrowing ceiling has been developed with specific consideration of the new loan commitments by the government of Australia, the Asian Development Bank, and the International Bank for Reconstruction and Development in the approved budget. At a minimum, the nonconcessional borrowing ceiling reflects the budgetary actions already being undertaken in the context of the IMF SMP.⁴⁷

PPA2 is more directly relevant for addressing a key source of rising debt stress in Papua New Guinea. The 2016 State Guarantee Policy provides a set of documented procedures for the approval and issuance of loan guarantees, but it does not address the need for better information on current exposures under the guarantees. The policy does not address risk monitoring of current guarantees. The current loan guarantee portfolio is substantial, and recording and monitoring has been a concern for a long time. State auditors have noted several deficiencies in guarantee recording. The PPA amends the policy to better monitor and report outstanding loan guarantees, payments, and

recovery, which reduces the risk of unexpected increases in public debt from the realization of contingent liabilities from loan guarantees.

Remaining Debt Issues

Domestic resource mobilization remains key to reducing the risk of debt distress. As part of the Crisis Response and Sustainable Recovery DPO, the World Bank is supporting Papua New Guinea’s commitment to resume fiscal consolidation in the postcrisis period. The operation includes a prior action to approve a Budget Strategy Paper, which includes a commitment to fiscal consolidation (the operation also includes the nonconcessional borrowing ceiling as a prior action).

The IMF SMP does not contain revenue mobilization–specific measures, which need to be implemented in the context of the government’s MTRS. To date, implementation of the MTRS has been slow, though the government considers the appointment of a new tax commissioner important to lifting revenue collection.

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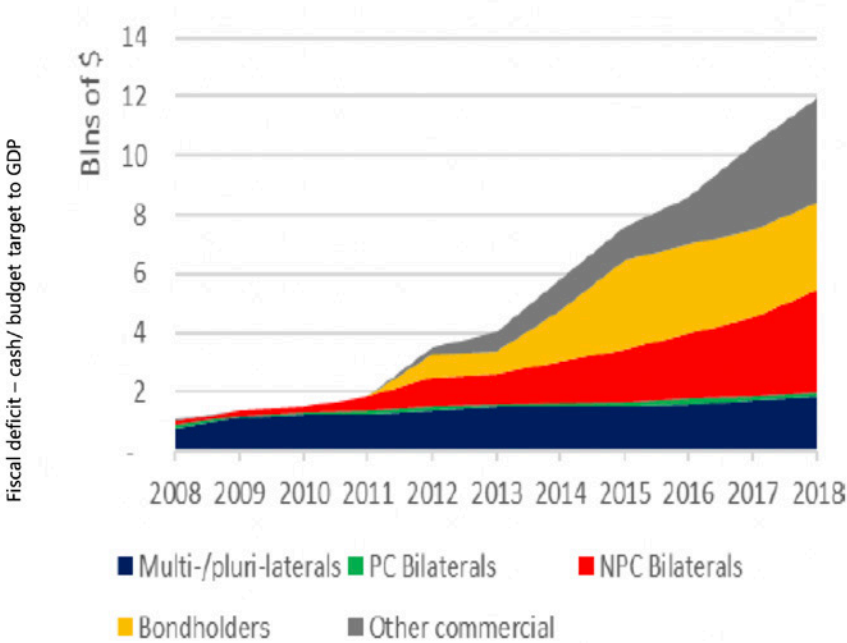
Zambia

Figure E.9. Zambia

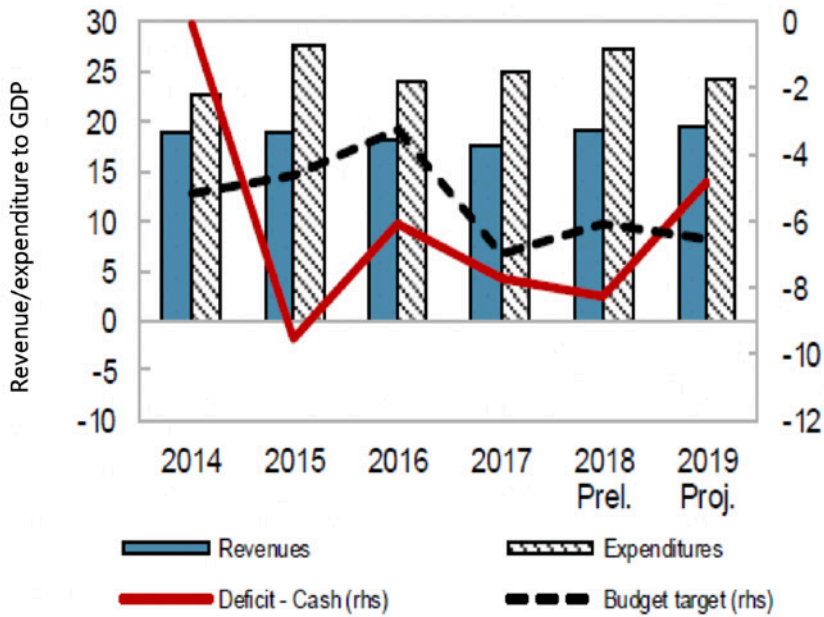
a. Public debt-to-GDP 2010–20



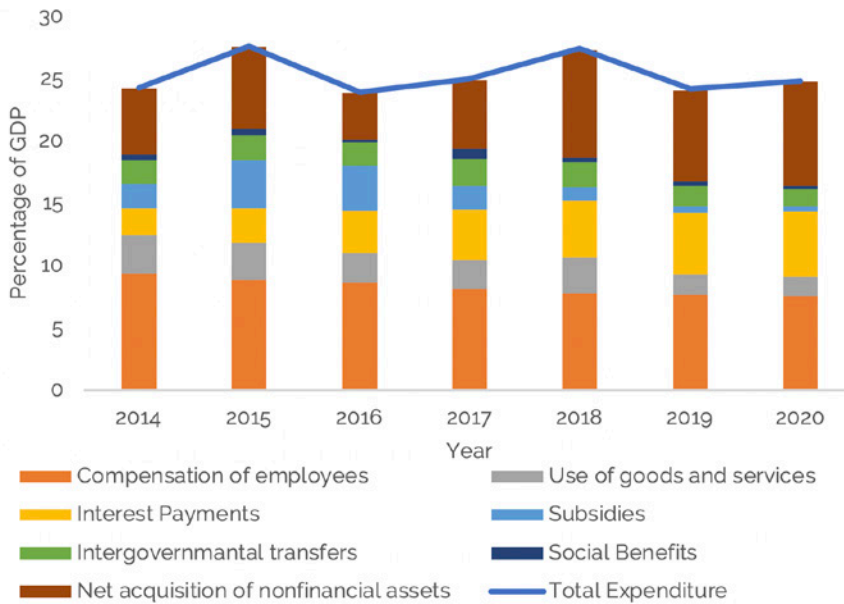
b. External public and publicly guaranteed debt by creditor group (\$, billions)



c. Fiscal imbalance (percent of GDP)



d. Expenditure (percent of GDP)



Source: Panel a: IMF 2015, 2017, 2019; panel b: IMF 2017, 2019; panel c: IMF 2019; panel d: IMF 2017, 2019.

Note: In panel a, 2019 onward are projections. GDP = gross domestic product; PC = Paris Club; NPC = non-Paris Club; rhs = right-hand scale.

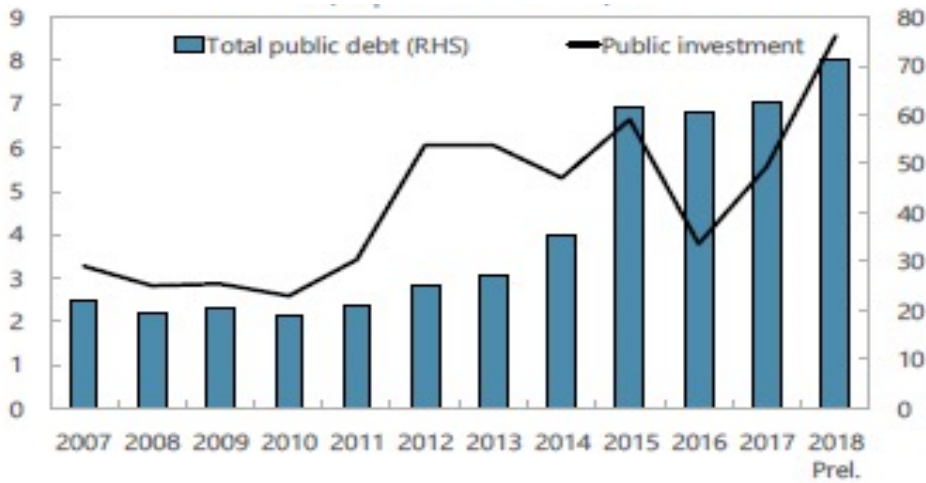
Debt Situation

Zambia's debt situation has been deteriorating steadily for several years (figure E.9). Good fiscal management in the years after 2005, when Zambia received \$6.5 billion of debt relief through the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative, gave way to expansionary fiscal policies and a sharp rise in debt beginning in 2011. This was when Zambia started borrowing significantly through Eurobonds (in 2012, 2014, and 2015) and from non-Paris Club donors, including China and India. The debt-to-GDP ratio increased by 99 percentage points between 2010 and 2020 to just under 118 percent, with Zambia accumulating more than \$842 million in external arrears between October 2019 and December 2020. Public sector interest payments were an increasing share of budget expenditures and GDP, rising from 2.2 percent of GDP in 2014 to an estimated 5.2 percent of GDP in 2020.

Zambia is currently in debt distress. This represents a deterioration from the past 2019 DSA, which assessed the risk of external and overall public debt distress as very high. The rise in debt distress since the receipt of debt relief reflects lower-than-expected growth, kwacha depreciation since the end of 2017, and large fiscal deficits. All four external debt burden indicators breach their indicative thresholds, three of them by large margins. Just over one-third of revenue went to servicing external debt payments over 2019–21.

There were several main drivers of rising debt distress in Zambia. These include the following: (i) expansionary and procyclical fiscal policies to finance the country's large infrastructure gap (see figure E.10), (ii) the failure of many of these large public investments to yield the growth or revenue forecasted, (iii) increased nonconcessional borrowing (including from non-Paris Club debt), and (iv) large exogenous shocks, including the fall in copper prices in 2014–15, and climate-induced droughts that created power shortages. Other drivers included weak commitment controls and, to a lesser extent, a stagnating tax-to-GDP ratio over the past few years, caused in part by large exemptions and tax expenditures. COVID-19 significantly worsened an already troublesome debt situation.

Figure E.10. Public Investment and Debt (Percent of GDP)



Source: IMF 2019.

Note: GDP = gross domestic product; RHS = right-hand scale.

Key Debt Priorities

To address Zambia’s debt situation, the country requires a large, up-front fiscal adjustment. The government has acknowledged this in its Economic Reform Program, which includes:

- » Cutting back on inefficient spending (including subsidies); and
- » Strengthening commitment controls to limit the accumulation of expenditure arrears.

Enhancing domestic revenue, particularly through scaling back exemptions and tax expenditures, will also need to be part of the country’s fiscal adjustment strategy, as will better-responding international copper price volatility to facilitate fiscal management and avoid procyclical fiscal policy.

Improved PIM is needed to prioritize capital expenditures and ensure that projects are implemented efficiently. Zambia’s development strategy targeted a rapid scale-up of public investment to address infrastructure needs, but the selection and quality of investments did not produce the expected growth dividend. According to Zambia’s 2017 Public Investment Management Assessment, public investment suffered from an estimated efficiency

loss of 45 percent, compared with a 36 percent average for all Sub-Saharan African countries. Key bottlenecks include weak vetting of projects and the nonsystematic conducting of appraisals of domestically financed projects before inclusion in the budget.

Relevance of Performance and Policy Actions to Drivers of Debt Stress

The PPAs agreed to among the authorities and the World Bank for FY21 are the following:

- » **PPA1 (debt management):** Zero nonconcessional borrowing ceiling on contracting new external public and publicly guaranteed debt in FY21.
- » **PPA2 (fiscal sustainability):** Government cancels at least \$1.0 billion in contracted but undisbursed external debt by May 2021.
- » **PPA3 (debt transparency):** Government publishes the 2020 Annual Public Debt Report, including coverage of debt, guarantees, and contingent liabilities for SOEs.

PPA1 is directly relevant to Zambia's sources of debt stress over the past decade. The PPA borrowing ceiling is consistent with the government's directive in December 2019 to postpone all new external borrowing indefinitely. The borrowing limit is to be operationalized within a 2021–23 Medium-Term Debt Management Strategy and corresponding Annual Borrowing Plan, which the government had planned to develop by December 2020. However, this debt ceiling has been government policy since 2019, raising questions about its additionality.

PPA2 is relevant in that it will reduce the country's external debt stock by canceling loans, taking into account associated legal and financial costs. The total value of contracted but undisbursed debt was estimated at \$9.7 billion, or 40 percent of 2018 GDP. This PPA is an attempt to address shortcomings in PIM retroactively by mandating the cancellation of loans that have not yet been drawn down. The PPA contributes to the government's December 2019 directive to cancel at least \$6 billion in contracted but undisbursed loans. The World Bank has worked with the government of Zambia to adopt widely

used criteria to identify stalled projects to cancel. The relevance of this PPA would depend partly on the extent to which the loans canceled are those with relatively low economic or social return, are concessional, and have high costs associated with breaking the contract.

PPA3 represents good practice in debt transparency, including with respect to guarantees, but it is unclear if it directly addresses a shortcoming that contributed to the intensification of Zambia's debt stress. The PPA note does not establish that timeliness or coverage of debt statistics was a problem in Zambia. That said, the 2019 DSA points to significant fiscal risks posed by the state-owned utility company, ZESCO, and the government has recently started regular collection of SOE financial data.

Although all PPAs are relevant to Zambia's debt situation to some degree, at least two of the three PPAs have, at best, modest value-added in that they reiterate preexisting government policy. At the same time, important drivers of Zambia's rising debt stress are not included in PPAs for FY21.

Remaining Debt Issues

Specifically, the agreed PPAs do not directly tackle, in an institutional or permanent manner, the drivers of rising debt stress over the past decade. These include significant shortcomings in fiscal and PIM, expenditure controls, domestic revenue mobilization, or SOE contingent liabilities. Although parallel support from the World Bank and other development partners is addressing some of these areas, their significance as drivers of current debt stress suggest that there is scope to use PPAs to bolster other efforts. Moreover, FY21 PPAs focus on either a single fiscal year or are retroactive efforts to address weaknesses in past borrowing decisions, not strengthen permanent institutional mechanisms for incurring excessive debt.

PPAs do not contribute to strengthening Zambia's PIM. The IMF's latest Article IV noted the importance of significantly lowering public investment spending, carefully prioritizing ongoing projects, and ensuring that only high-return projects are implemented. The Zambia PPA note does not assess the adequacy of the recently launched PIM system or discuss how it is performing in coordinating and undertaking ex ante appraisals of new public in-

vestment projects. An early-stage analysis of this new system could unearth issues during this pilot stage, with PPAs leveraged as a chance to course correct, strengthen the overall system of PIM, or both.

PPAs do not address systemic weaknesses in the management of public resources that led to large deficits and the accumulation of arrears. Weak expenditure controls have allowed domestic arrears to accumulate and fueled further borrowing. Although the Public Financial Management Act of 2018 was an important step forward—and the IMF has been providing technical assistance on budget preparation and execution and enhancing the medium-term macrofiscal framework—ministries and departments continue to issue purchase orders outside of the integrated financial management system.

PPAs do not contribute to reducing the large number of tax exemptions. The IMF's latest Article IV emphasized the importance of front-loaded revenue mobilization to help reduce debt-related vulnerabilities (IMF 2019). Debt service consumed almost half of domestic revenue in 2019, up from 36 percent in 2018, crowding out priority development spending. Measures to broaden the tax base, reduce tax expenditures and exemptions, strengthen compliance, simplify the tax system, and enhance tax audit capacity continue to require attention.

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¹ A \$25 million coronavirus (COVID-19) Response and Recovery Programmatic development policy operation, the first operation in a series of two, was approved in March 2021. The International Monetary Fund (IMF) approved financial assistance of \$14 million under the Rapid Credit Facility in 2020.

² The remainder is held domestically, mostly by commercial banks and other financial institutions. The debt of the rest of the public sector (state-owned enterprises and Petrocaribe debt, which accounts for about one-quarter of total debt) is about 20 percent of gross domestic product (GDP; IMF 2016, 2018).

³ No data are available before 2015.

⁴ Dominica's Citizenship by Investment program has been source of substantial fiscal revenues over the past decade. Revenue from the program is highly volatile, at 33 percent of GDP in 2016 and 9.5 percent in each of 2019 and 2020.

⁵ Capacity constraints slowed public investment for reconstruction (historically, execution rates of public investment have been approximately 70 percent of budget targets; IMF, 2016, 2017).

⁶ The Debt Portfolio Review is an annual report prepared by the Debt Management Unit, which provides an analysis of the public debt situation of Dominica, including the risks embedded therein.

⁷ See World Bank (2021a) for the performance and policy action (PPA) note and the Debt Reporting Heat Map.

⁸ The Debt Portfolio Review 2019 has been published on the Ministry of Finance website: <http://finance.gov.dm/announcements/press-releases/33-debt-portfolio-review-2019>.

⁹ Development Policy Credit 2 included a prior action to require preparation and public disclosure of Debt Portfolio Reviews annually.

¹⁰ The fiscal targets include wage bill ceilings and public expenditure growth limits.

¹¹ In fiscal year (FY)22, PPA2 (i) supports the government in adopting a revision to its Financial Administration Act that requires the formulation and publication of a Medium-Term Economic and Fiscal Framework to strengthen the legal framework for budget planning, preparation, and public financial management, and (ii) has created the Fiscal Council and nominated and appointed its members. In FY23, PPA2 ensures the government remains in compliance with its Fiscal Responsibility and Rules Framework and relevant targets.

¹² The target was set by the Eastern Caribbean Central Bank and is applicable to all its member states, including Dominica.

¹³ The prior action supported the approval and dissemination of the Public Procurement and Disposal of Public Property Bill 2020, which strengthens public procurement practices, including defining parameters for emergency public procurement, introducing considerations for e-procurement, and implementing other measures to promote environmentally, socially, and economically sustainable procurement.

¹⁴ Most of these reforms are supported by the COVID-19 development policy credit, while other reforms are being implemented by the government with counterpart resources and assistance from other development partners. IMF's Caribbean Regional Technical Assistance Centre has provided substantial technical assistance in areas on macroeconomic programming and analysis, tax reform, customs reform, and broader public financial management issues. The Caribbean Development Bank has also supported the procurement reforms.

¹⁵ The financial sector cleanup cost approximately 5 percent of GDP; the start of energy sector reforms is expected to cost about 1 percent of GDP per year between 2019 and at least 2023. The financial sector reform is largely completed, while progress on the implementation of the Energy Sector Reform Program has been slow.

¹⁶ The cost of debt (both external and domestic) as measured by the weighted average interest shows an increase from 10.6 percent in 2017 to 11.7 percent in 2020 (Ghana 2021, 3).

¹⁷ The government aims to lower the level of public debt to 60 percent of GDP and hold the overall fiscal deficit below the upper limit of 5 percent of GDP, in line with the Fiscal Responsibility Law (Ghana 2020).

¹⁸ Ghana Economic Management Strengthening project (World Bank 2016).

¹⁹ The nonconcessional borrowing limit was not proposed as a PPA, considering that the government has been effectively controlling nonconcessional borrowing and the fact that Ghana needs and has market access.

²⁰ The content of these risk assessments is confidential and not published.

²¹ Kenya's debt-carrying capacity was downgraded from strong to medium in October 2020 due primarily to the revision to global growth; other reasons included the downward revision to Kenya's 10-year average growth and lower reserves coverage.

²² The nine SOEs are Kenya Airways, Kenya Airports Authority, Kenya Railways Corporation, Kenya Power and Lighting PLC, Kenya Electricity Generating Company PLC, Kenya Ports Authorities, and three of the largest universities (Jomo Kenyatta University of Agriculture and Technology, University of Nairobi, and Moi University).

²³ Creditors discovered that Mozambique had secretly issued \$1.15 billion (9 percent of GDP at the end of 2015) in state guarantees over the two previous years; a year later, two additional loans were discovered, bringing the total to more than \$2 billion and leading to the arrest of the former finance minister. During restructuring of this debt into Eurobonds in 2016, the existence of two previously undisclosed loans was revealed, the loans contracted by Mozambique Asset Management and Proindicus (from Credit Suisse and VTB Bank) with an unconstitutional sovereign guarantee. These and several other smaller bilateral loans totaled \$1.4 billion.

²⁴ There has been widespread government opacity in Mozambique, which is both a cause and consequence of deep-rooted governance challenges (Mozambique and IMF 2019).

²⁵ The government has not published debt reports consistently, and state-owned enterprise (SOE) debt data have not been collected systematically.

²⁶ The government estimated that tropical cyclones Idai and Kenneth cost approximately 10 percent of GDP. The economic impact of these disasters has been exacerbated by the country's high sensitivity to exchange rate and export shocks due to a lack of export diversity.

²⁷ The government has borrowed from liquid natural gas producers, and repayment is linked to revenue from future gas production.

²⁸ These subindicators include managerial structure for central borrowings and debt-related transactions, reporting to the parliament, frequency of audits of the central government and publication of external audit reports, coordination with the central bank, segregation of duties for key functions, and staff capacity and human resource management (World Bank 2017a).

²⁹ This reinstates the disclosure practice (that excluded SOE debt), which was stopped in the aftermath of the hidden debt crisis.

³⁰ This PPA would be complemented by the Managing Public Resources for Service Delivery Project (P173178), which contains enhanced transparency requirements for SOEs and capacity building and technical assistance to selected SOEs to improve corporate governance and transparency.

³¹ The selected SOEs are prioritized by asset size and debt levels in close consultation with the World Bank. The prioritized SOEs for FY21 are Petróleos de Moçambique, Aeroportos de Moçambique, Linhas Aéreas de Moçambique, the telecommunications company (TmCel), Electricidade de Moçambique, Empresa Nacional de Hidrocarbonetos, and Caminhos de Ferro de Moçambique. These companies together accounted for 83.3 percent of all SOE assets and 99.6 percent of SOE external debt stock at the end of 2018.

³² Nigeria Government 2021 Budget Proposal.

³³ Premium Times 2021.

³⁴ Circular debt refers to the cash flow shortfall incurred in the power sector from the non-payment of obligations by consumers, distribution companies, and the government. The stock of circular debt has grown from approximately PRs 450 billion in fiscal year 2013 to PRs 1,618 billion in fiscal year 2019 (approximately 4.2 percent of GDP), with a more pronounced increase over the past two years (IMF 2019).

³⁵ The average maturity of new public and publicly guaranteed commitments was 21 years in 2013, 17 years in 2016, and 12 years in 2018 (World Bank 2021).

³⁶ About 24 percent of consolidated government domestic debt was in short-term securities. The government has committed to end State Bank of Pakistan borrowing, as per the conditions of the current IMF program.

³⁷ The Debt Service Suspension Initiative is expected to provide between \$1.8 and \$2.4 billion in temporary fiscal space (PPA Note).

³⁸ One of the reasons for Pakistan's low score on the Doing Business "paying taxes" indicator is the requirement to file monthly goods and services tax returns based on five different sets of rules and formats. Pakistan was ranked 173rd among 190 economies for this indicator in 2019.

³⁹ The World Bank's Pakistan Raises Revenue investment project moves down the results chain from the PPA by designing standardized tax returns, launching a single portal for filing and paying goods and services tax, and conducting taxpayer awareness campaigns to strengthen compliance.

⁴⁰ The MTDS, the first annual Debt Review and Public Debt Bulletin FY 2019–20, and the first semiannual Public Debt Bulletin (Jul-Dec 2020) are available on the Ministry of Finance website: http://www.finance.gov.pk/dpco_publications.html

⁴¹ One of the structural benchmarks under the Extended Fund Facility is “Avoid the practice of issuing new preferential tax treatments or exemptions.”

⁴² The project supports transparency with respect to the revenue forgone from each exemption and the industries that benefit.

⁴³ Assessed risk of debt distress rose from low in 2016 to moderate in 2017 to high in 2020, according to the Debt Sustainability Framework for Low-Income Countries.

⁴⁴ The IMF approved a Staff-Monitored Program for Papua New Guinea in February 2020.

⁴⁵ As a result, the debt threshold under the Fiscal Responsibility Act was revised to 60 percent in 2020.

⁴⁶ Payment arrears include separation payments for retirees still on the government payroll and capital investment projects financed by international development partners.

⁴⁷ Interviews with World Bank staff suggest that guidance was given to steer the fiscal policy-related PPA toward a nonconcessional borrowing ceiling. The team was also encouraged to diversify the two PPAs among the three pillars (debt management, debt transparency, and fiscal sustainability).



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