Approach Paper

The World Bank's Role in and Use of the Low-Income Country Debt Sustainability Framework

April 14, 2022

Report to the Board from the Committee on Development Effectiveness

The Committee on Development Effectiveness (CODE) met to consider the Independent Evaluation Group (IEG) Approach Paper The World Bank's Role in and Use of the Low-Income Country Debt Sustainability Framework.

CODE welcomed the opportunity to discuss the Approach Paper and emphasized the relevance of finalizing the proposed evaluation in time to provide inputs to the upcoming joint International Monetary Fund (IMF)–World Bank review of the Low-Income Country Debt Sustainability Framework (LIC-DSF) planned for fiscal year 2023. Acknowledging the need to rely on a credible framework to address debt issues, the committee noted their appreciation for IEG's efforts to accommodate CODE's request to undertake the evaluation within its current work program. CODE and management noted the importance of having a robust evaluation of the LIC-DSF that considers how well-specified and calibrated the framework is for supporting the World Bank's twin goals and to assess how well it serves as a key part of the World Bank's operating model. Some members noted that countries' commitments, such as the Sustainable Development Goals s and the Paris Agreement need to be better reflected in the assessment of debt sustainability. However, members agreed with the need to balance the depth, breadth, and timeliness of the evaluation, noting that the focus within IEG's institutional mandate on how the World Bank contributes to the LIC-DSF, uses the framework's outputs in various corporate and country-level decisions and could better leverage the LIC-DSF to address debt vulnerabilities in LICs would provide useful inputs for the design and substance of the forthcoming joint review. While emphasizing that, as a co-owner of the LIC-DSF, the World Bank should be able to evaluate the framework in its entirety, management acknowledged that mandate boundaries and the time available for the evaluation might limit the feasibility of a broader scope of the evaluation.

IEG clarified that it would not be able to assess the accuracy of longer-term projections given that the framework has only been in place since 2017 but noted it would compare long-term forecasts with historical performance to assess whether projections deviate from past performance. Members appreciated IEG's commitment to assessing the extent to which climate considerations are explicitly addressed in the articulation of long-term projections; how Debt Sustainability Analyses (DSAs) recognize problems in data quality and coverage; and how often and how well the World Bank and the IMF coordinate and resolve their differences on the LIC-DSF, particularly to counter optimism bias. Some asked management about its plan to delineate the joint review with the IMF, including whether the joint review would include some of the elements left out of the IEG evaluation. Alluding to the pandemic and the war in Ukraine, some asked IEG if it planned to look at future trends in interest rates and disruption in supply chains. They encouraged IEG to also do the following: (i) assess how DSA work has informed operations at the country level in terms of structural debt reforms, portfolio reorientation, and cancellation of projects; (ii) incorporate client countries' and other stakeholder's feedback; (iii) show the changing structure and composition of debt toward commercial and non-Paris Club creditors; (iv) ensure regional and country diversity on a comprehensive sample of case studies; (v) look at whether LIC DSAs have been used consistently across country teams to inform operations; (vi) assess the efficiency of these reforms against the current increased external borrowing of International Development Association–eligible countries; and (vii) assess the influence of consumption-fueled growth on the DSA and how to better differentiate this.

While acknowledging that a joint IEG–Independent Evaluation Office assessment was not possible at this time, members underscored the importance of IEG maintaining a close dialogue with the Independent Evaluation Office and IMF during the evaluation process. They welcomed IEG's confirmation that the evaluation would include subnational entities such as municipalities' debt, as a source of contingent liabilities to central governments and committed to consider members' views.

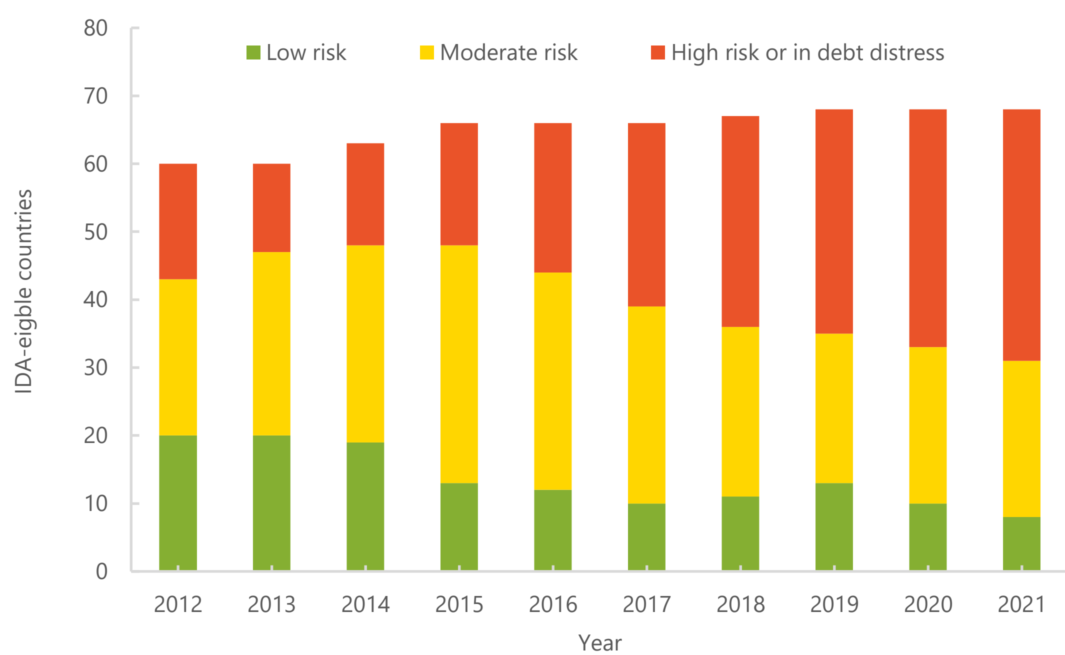
1. Context and Motivation for the Evaluation

1.1 This evaluation has been requested by the Committee on Development Effectiveness of the Executive Board of the International Development Association (IDA). It is intended to provide input and insight into the upcoming World Bank–International Monetary Fund (IMF) *Review of the Debt Sustainability Framework for Low-Income Countries* currently planned for fiscal year (FY)23.[1] Consistent with the mandate of the Independent Evaluation Group (IEG), this evaluation will only assess the World Bank's role in and use of the Low-Income Country Debt Sustainability Framework (LIC-DSF). Collaboration with the IMF will be reviewed only to the extent that it informs the World Bank's role in and use of the LIC-DSF.

1.2 Interest in this topic is high in light of the sharp rise in debt stress among low-income countries and the changing global risk landscape in the years leading up to and during the coronavirus pandemic (COVID-19). IDA-eligible countries have increased external borrowing in the wake of the global economic and financial crisis,[2] and much of the new borrowing comes from non–Paris Club and commercial creditors, often on nonconcessional terms. Moreover, some of this new borrowing has been in the form of complex lending arrangements under opaque terms, including some collateralized debt, often reducing budget flexibility through the earmarking of revenues.

1.3 Since 2015, the number of IDA-eligible countries at high risk of or in debt distress has more than doubled (figure 1.1). More than one-third of IDA countries have seen an increase in their debt vulnerability levels, and most of those countries have fallen into high risk of debt distress. Since the start of the COVID-19 pandemic, the number of countries at high risk of or in debt distress has increased further, from 33 in 2019 to 37 in 2021 (figure 1.1). As a result, IDA-eligible countries are expected to face significant debt-related policy challenges in the next few years. These countries will need to continue to support their near-term economic recoveries and finance the investments needed to support their longer-term development goals and adapt to ever-increasing climate change challenges, which will increase the likelihood, severity, and costs of climate-related disasters, while damaging supply chains and threatening rain-fed agricultural systems. At the same time, fiscal sustainability requires that these priorities be balanced against the need to ensure debt sustainability.

Figure 1.1. Evolution of Debt Distress in IDA-Eligible Countries, 2012–21



Sources: World Bank 2020b; International Monetary Fund Debt Sustainability Analysis database.
Note: IDA = International Development Association.

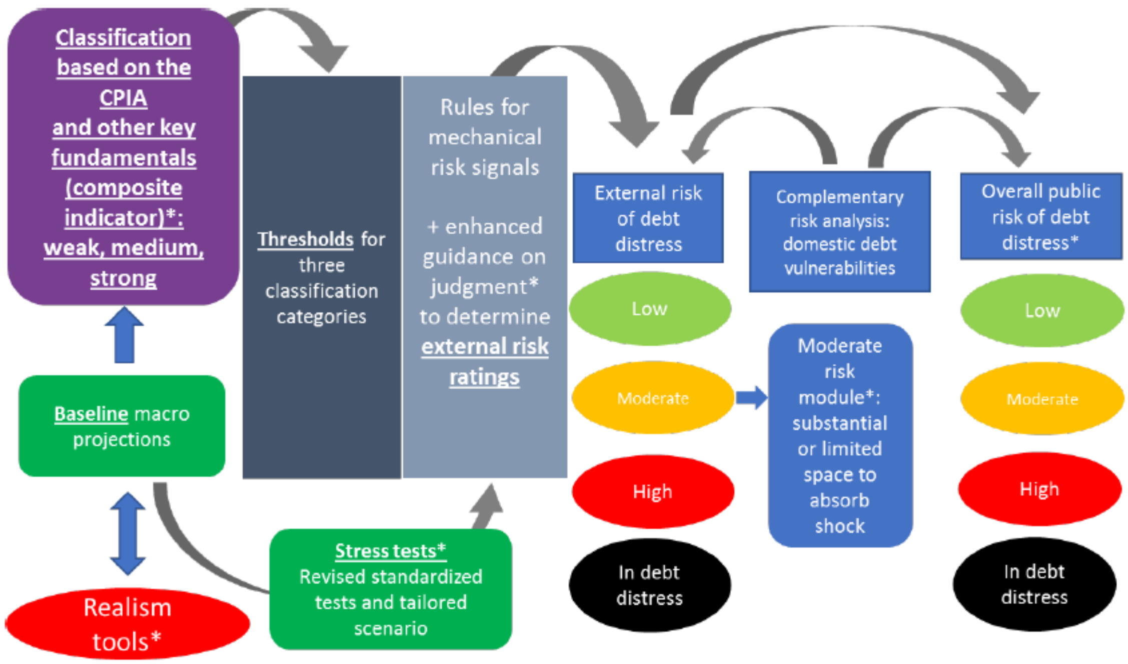
1.4 As the key instrument to assess the debt sustainability of IDA-eligible countries, the LIC-DSF is intended to guide the World Bank's advice and support to these countries. It also provides an important signal to private sector creditors and investors. In light of weakening debt sustainability indicators and the forthcoming review of the joint framework, an evaluation of the World Bank's contribution to and use of the LIC-DSF is both timely and important.

2. The Low-Income Country Debt Sustainability Framework

2.1 Introduced in 2005 and most recently updated in 2017, the joint World Bank–IMF LIC-DSF has been a cornerstone of debt sustainability analyses in IDA-eligible 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 ratings for the risk of debt distress.

2.2 The most recent (2017) review of the LIC-DSF maintained the basic structure of the DSF but with some modifications.[3] These reforms were designed to make the framework comprehensive, more transparent, and simpler to use, while enabling the DSF to better capture risks of debt distress (figure 2.1). As a result of the review, World Bank and IMF management (i) introduced realism tools; (ii) transitioned to a composite measure for debt-carrying capacity; (iii) improved the identification of debt distress episodes; (iv) introduced tailored scenario tests; (v) simplified debt indicators, thresholds, and standardized tests; (vi) expanded the assessment of risks; and (vii) enhanced guidance for the application of staff judgment.

Figure 2.1. Structure of the Low-Income Country Debt Sustainability Framework after 2017 Reforms



* New features

Source: International Development Association and International Monetary Fund 2017b.
Note: CPIA = Country Policy and Institutional Assessment

3. The World Bank's Role in the Low-Income Country Debt Sustainability Framework

3.1 The LIC-DSF guidance note describes the process for producing a Debt Sustainability Analysis (DSA) for a LIC (IDA and IMF 2017b). All LIC-DSAs should be produced jointly by IMF and World Bank staff. All DSAs are expected to be submitted to both the IMF and IDA Executive Boards, either for discussion or for information. A full LIC-DSA should be produced at least once every calendar year. For the World Bank, an annually produced DSA is needed to determine the IDA credit-grant allocation and to inform the Sustainable Development Finance Policy (SDFP).[4]

3.2 A jointly produced guidance note specifies how IMF and World Bank staff are to coordinate in producing DSAs, based on their respective areas of expertise. According to the note, the IMF "generally" takes the lead on medium-term macroeconomic projections (three to five years), and the World Bank takes the lead on longer-term growth prospects, and when required, on assessing the investment-growth relationship. World Bank and IMF staff should agree on the broad parameters and projections of the

DSA, including growth and new borrowing, before producing the DSA draft. In the case of large deviations among the IMF and World Bank projections, staff use an agreed dispute resolution mechanism.

3.3 The World Bank's procedures for participating in the preparation and approval of the LIC-DSAs were adjusted in April 2021. The updated accountability and decision-making guidelines clarified the respective roles of World Bank staff and management in the preparation of DSAs and the corporate review process as it relates to coordination with the IMF. The revisions established a more formal structure for DSA preparation, approval, and clearance within the World Bank.

4. How the World Bank Uses the Output of the Low-Income Country Debt Sustainability Framework

4.1 The output of the LIC-DSF plays an important role in several World Bank corporate financing and policy decisions. This includes the SDFP, the IDA grant allocation framework for performance-based allocations, and access to IDA special windows. It also informs World Bank–supported country strategies and decisions on the nature and composition of World Bank lending and nonlending support to client countries, including for development policy financing

4.2 Debt risk ratings produced by the LIC-DSF play a key role in the IDA resource allocation decisions at the country level. The risk of external debt distress assessed by the LIC-DSF contributes to decisions on the following:

- Grant provisioning to IDA-only countries, where countries at low risk of debt distress receive 100 percent credit, those at moderate risk received 50 percent credit and 50 percent grants, and those at high risk or in debt distress receive 100 percent grants.

- Access to the IDA Scale-Up Window, which is restricted to countries at low or moderate risk of external debt distress.

- Access to the Window for Host Communities and Refugees, which provides 100 percent grant financing for countries at high risk of debt distress. Those at low or moderate risk of debt distress receive 50 percent of this financing as grants and 50 percent as concessional credit.

- The Country Policy and Institutional Assessment (CPIA), where the debt risk rating informs the Debt Policy and Management score, thereby affecting the size of a country's performance-based allocation from IDA resources.

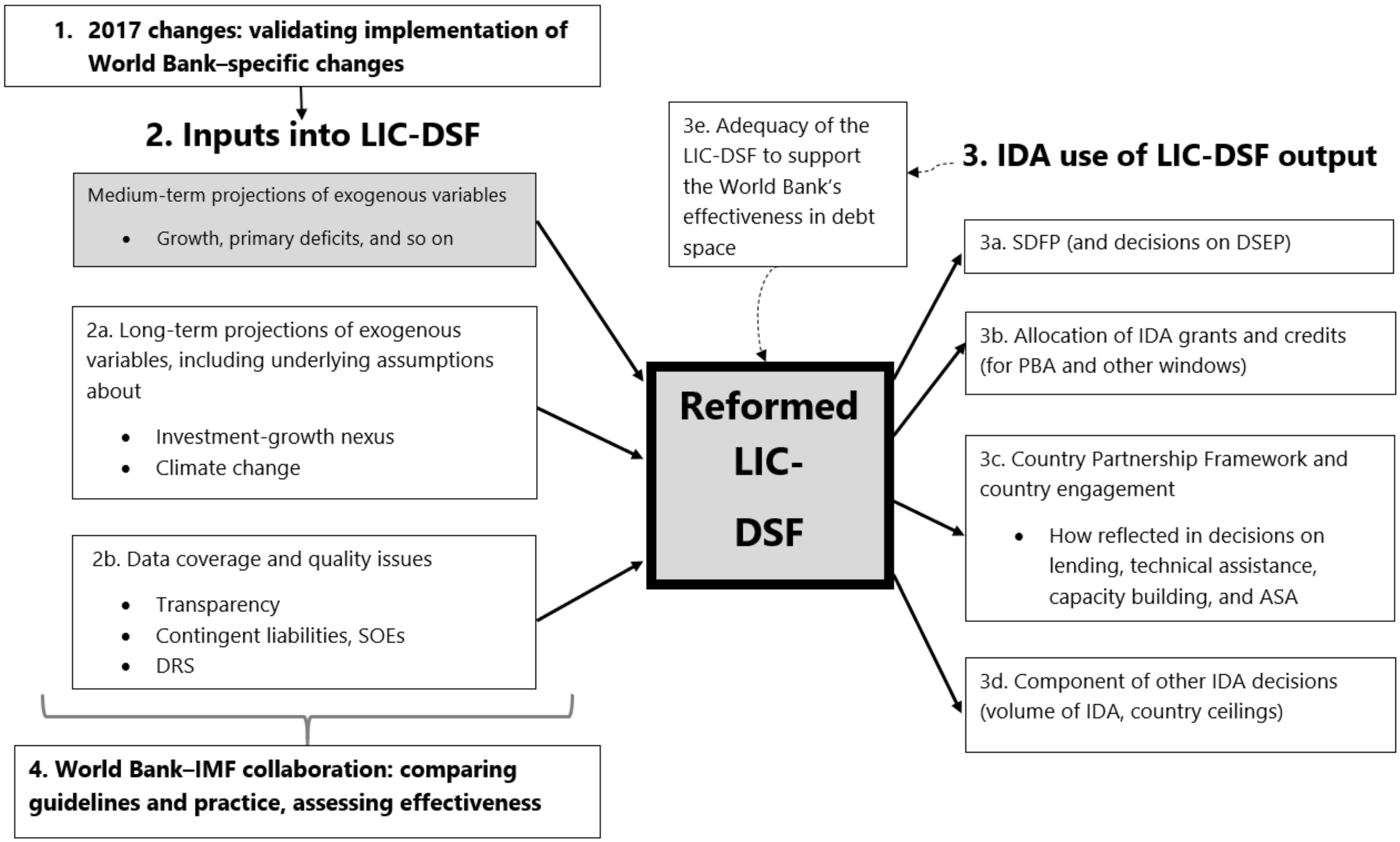
- The content of lending and nonlending support in the context of a Country Partnership Framework.

4.3 LIC-DSF risk ratings also play an important role in the SDFP. The SDFP aims to incentivize IDA-eligible countries to move toward transparent, sustainable financing and to promote coordination between IDA and other creditors in support of these countries' efforts to address their debt-related vulnerabilities. As part of the SDFP, the Debt Sustainability Enhancement Program enhances incentives for countries to move toward transparent and sustainable borrowing and investment practices. LIC-DSF countries rated at moderate or high risk of or experiencing external debt distress are required to prepare Policy and Performance Actions each year. If countries do not achieve these actions, the LIC-DSF debt stress rating determines the size of the subsequent set-aside of their IDA allocation**.** For countries at high risk of or already experiencing external debt distress, the amount is 20 percent of the country's annual country allocation; it is 10 percent for countries at moderate risk of external debt distress or for those at low risk that are required to prepare Policy and Performance Actions.

5. Evaluation Purpose, Scope, and Audience

5.1 This evaluation seeks to assess how the World Bank contributes to the LIC-DSF, how it uses LIC-DSF output in various corporate and country-level decisions, and how it can better leverage the LIC-DSF to address debt vulnerabilities in LICs (figure 5.1). In doing so, it will seek to identify opportunities for the World Bank to strengthen its role in the preparation and use of the LIC-DSF in a changing global context and to highlight potentially important questions that may need to be addressed in the upcoming joint review, including the extent to which the LIC-DSF meets IDA's needs in serving its clients. Recommendations from this evaluation will focus on aspects of the LIC-DSF that are within the World Bank's ability to change or influence.

Figure 5.1. The World Bank's Role in and Use of the 2017 Low-Income Country Debt Sustainability Framework: An Evaluation



Source: Independent Evaluation Group.
Note: Shaded boxes indicate aspects that are out of scope for this evaluation. ASA = advisory services and analytics; DRS = Debtor Reporting System; DSEP = Debt Sustainability Enhancement Program; IDA = International Development Association; IMF = International Monetary Fund; LIC-DSF = Low-Income Country Debt Sustainability Framework; PBA = performance-based allocations; PPA = Policy and Performance Actions; SDFP = Sustainable Development Financing Policy; SOE = state-owned enterprise.

5.2 The scope of the evaluation will be carefully calibrated to focus on inputs into the LIC-DSF that the World Bank is either solely responsible for or that it leads the provision of and on how the World Bank uses the consequent outputs. The structure of the underlying LIC-DSF model and assumptions therein (thresholds, interest rates, and so on)—which is a joint IMF–World Bank product—will not be assessed because this would require a broader scope and timeline and is already set to be carried out in the upcoming joint review. As such, this evaluation should be seen as a possible input to rather than a substitute for the scheduled joint evaluation. Similarly, as the guidance note indicates that the IMF generally takes the lead on key variables in medium-term projections, these will not be in scope. However, agreed guidance on the use of the LIC-DSF indicates that the World Bank leads in providing long-term projections for the model, and therefore the content and preparation of these projections is in scope. This includes how these projections reflect assumptions about climate change's impact on growth and the investment-growth nexus and how debt data quality and coverage issues affect these projections.[5] In addition, the evaluation will focus on the World Bank's use of the LIC-DSF in corporate decisions—notably for the SDFP and IDA grant allocation process—and to inform country engagement and policy advice, including lending, technical assistance, capacity building, and analytical work. Although the evaluation will largely focus on the period after the 2017 reforms were adopted, it may include some comparison with data and analyses from before 2017.

5.3 The main audience for this evaluation is the IDA Board of Executive Directors and World Bank management. It may also be of interest to borrowing governments of low-income countries and multilateral, bilateral, and private sector creditors.

6. Evaluation Questions and Methods

6.1 Consistent with IEG's mandate, the evaluation will focus on areas of relevance to the World Bank's role in and use of the LIC-DSF and will be guided by the following evaluation questions:

- How well has the World Bank implemented the relevant changes to the LIC-DSF, adopted in the 2017 reform?[6] Have these changes resulted in a framework that effectively meets the needs of IDA in its support to IDA-eligible countries?
- To what extent are inputs into the LIC-DSF for which the World Bank is responsible coherent and based on sound country-specific analytics and diagnostics? Do they adequately capture the impact of expected long-term developments (for example, climate change and its expected impact on growth)?

    - This section will include an assessment of assumptions underpinning the investment-growth nexus, the expected impact of climate change over the longer term, and how IDA lending projections are incorporated into the DSA. Given the considerable impact of climate change on small island economies in particular, the evaluation will undertake a focused assessment of how climate change is reflected in DSAs for these economies.

- How well does the World Bank consider data quality, coverage, and transparency in its use of the LIC-DSF, particularly in light of rapidly changing global risk dynamics? This question will have two parts:
    - To what extent do country-specific LIC-DSAs include an adequate assessment of the quality and coverage of the data used, and how does that assessment influence World Bank staff's use of the resulting DSA output on the level of debt stress?
    - What progress has the World Bank made in improving the quality, transparency, and coverage of debt data used in the LIC-DSF, including with respect to contingent liabilities and state-owned enterprises?
- How have the World Bank's strategic and operational decisions and policies, both institutionally and at the country level, been influenced by LIC-DSAs prepared over the past decade? How have rapidly changing debt risks and increasing climate risks affected the adequacy of the LIC-DSF to support the World Bank's work in the debt space?
- Is World Bank–IMF collaboration on the LIC-DSF consistent with the agreed guidelines? How well have the guidelines on collaboration worked in supporting the objectives of the LIC-DSF?

6.2 The evaluation will rely on various methods. It will review relevant World Bank and IMF reports, strategies, and evaluations, including DSAs and their associated Excel files; Systematic Country Diagnostics and Country Partnership Frameworks; SDFP documents, updates, and evaluations; program documents from relevant development policy operations; and Debt Management Performance Assessments. It will also carry out semistructured interviews with key stakeholders inside the World Bank and external stakeholders, including IMF staff. With some 68 countries completing a DSA each year, the evaluation will carry out analysis using the full sample when possible but otherwise will need to focus on a subset of countries. Potential sampling criteria may include income level, debt data quality and coverage, level of debt distress or a change of debt stress status and economic structure (for example, oil exporting countries in a decarbonizing world). Countries that have prepared a Country Partnership Framework since the introduction of the new LIC-DSF guidelines will be prioritized in an effort to trace the extent to which World Bank engagement is influenced by debt sustainability consideration. Case studies will include a focus on IDA-eligible small island countries as an illustrative example to better understand the extent to which climate change is reflected in DSAs for a set of countries facing similar challenges and the consistency with which climate change influences the assessment of debt stress. The team will solicit client views on the LIC-DSF for country case studies, although, given time constraints, these may not be representative.

6.3 The evaluation will benefit from the analysis and findings of several recent IEG evaluations. These include *World Bank Support for Public Financial and Debt Management in IDA-Eligible Countries* (World Bank 2021d), *Addressing Country-Level Fiscal and Financial Sector Vulnerabilities: An Evaluation of the World Bank Group Contributions* (World Bank 2021a), and *The International Development Association's Sustainable Development Finance Policy: An Early-Stage Evaluation* (World Bank 2021c).

6.4 There are a few limitations to the methodology underpinning this evaluation. Because actual practice may diverge from formal guidance, this evaluation will draw to a significant degree on interviews with country economists from both the World Bank and IMF. Many may not fully recollect experience with individual DSAs from several years ago; others may not be reachable. Internal documentation on decisions about key aspects of the LIC-DSF may not always exist. Country visits are not expected to be necessary for this evaluation, so COVID-19–related travel restrictions will not be a constraint. Due to time limitations, views obtained from client countries may not be representative.

7. Quality Assurance Process, Resources, and Staffing

7.1 The evaluation will follow standard IEG quality assurance processes, including external peer review. The Approach Paper and final report will be peer-reviewed by Kalpana Kochhar (director, development policy and finance, Gates Foundation), Hanan Morsy (deputy executive secretary and chief economist, United Nations Economic Commission for Africa), and Mark Plant (co-director of development finance, senior policy fellow, and chief operating officer for the Center for Global Development [Europe]). The evaluation team will be led by Patrick Hettinger (senior economist, IEG). Team members include Chris Towe (consultant, IEG), Juan Pradelli (consultant), Patricio Merlani (consultant), Johan Lopez (consultant), and Dung Chu (program assistant, IEG). The team may draw on other staff and consultants, to be identified. The work will be conducted under the guidance of Jeff Chelsky (manager, Economic Management and Country Programs Unit, IEG) and Oscar Calvo-Gonzalez (director, IEG), and under the overall direction of Alison Evans (Director-General, Evaluation, IEG).

7.2 The evaluation report will be submitted to the Committee on Development Effectiveness in November 2022. This timing is intended maximize the evaluation's potential to inform the review of the LIC-DSF to be conducted by management in FY23.

7.3 The budget for this evaluation is estimated at US$525,000, largely consisting of staff and consultant time.

8. Expected Outputs, Outreach, and Learning

8.1 The main output will be a report that presents relevant findings, lessons, and recommendations to the Committee on Development Effectiveness of the Executive Board. A dissemination and outreach strategy will be developed in consultation with World Bank management and other key stakeholders.

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[1] A review of the Low-Income Country Debt Sustainability Framework (LIC-DSF) is undertaken by the World Bank and International Monetary Fund (IMF) periodically.

[2] International Development Association–eligible countries using the LIC-DSF are not exclusively low income but also include lower-middle-income countries and some upper-middle-income countries.

[3] The LIC-DSF has been jointly reviewed by IMF and World Bank staff four times: in 2006, 2009, 2012, and 2017. The 2017 review was informed by a broad external consultation process including dialogue with country authorities, staff of multilateral banks, members of the Paris Club, and civil society organizations. For the 2017 review, see IDA and IMF (2017a).

[4] A Debt Sustainability Analysis (DSA) should also be produced in some additional situations (even when an annual DSA has already been prepared). These circumstances include when an IMF-supported arrangement is prepared, for proposed modification to an associated performance criterion or waiver for noncompliance related to debt limits; for World Bank financing requests, when countries subject to the International Development Association's Non-Concessional Borrowing Policy (replaced in 2020 by the SDFP) seek non-concessional borrowing; or when countries experience significant changes in economic circumstances and borrowing assumptions (including those caused by conflict and natural disasters).

[5] The guidance note indicates that "IMF and World Bank staff should coordinate closely in producing DSAs, based on their respective areas of expertise. The IMF generally takes the lead on medium-term macroeconomic projections (3–5 years), while the World Bank takes the lead on longer-term growth prospects, and when required on assessing the investment-growth relationship. [World] Bank and [IMF] country teams should agree on the broad parameters and projections of the DSA, including growth and new borrowing, prior to producing the DSA draft. In the case of large deviations among IMF and World Bank projections, teams are to revert to the dispute resolution mechanism described in appendix I" (IDA and IMF 2017b).

[6] These are described in appendix B.

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Appendix A. Evaluation Design Matrix

Table A.1. Evaluation Design Matrix

Key Questions	Information Sources	Data Collection and Analysis Methods
1. How well has the World Bank implemented the relevant changes to the LIC-DSF adopted in the 2017 reform? Have these changes resulted in a framework that effectively meets the needs of IDA in supporting IDA-eligible countries?	DSA reports and Excel files	Review DSAs to assess if particular stress tests, other potential risk factors, judgment were applied
2. To what extent are inputs into the LIC-DSF for which the World Bank is responsible coherent and based on sound country-specific analytics and diagnostics? Do they adequately capture the impact of expected long-term developments (for example, climate change and its expected impact on growth)? • This section will include an assessment of assumptions underpinning the investment-growth nexus, the expected impact of climate change over the longer term, and how IDA lending projections are incorporated into the DSA. Given the considerable impact of climate change on small island economies in particular, the evaluation will undertake a focused assessment of how climate change is reflected in the DSAs for these economies.	DSA reports and Excel files; recent evaluations, guidance, and research on investment and long-term growth, climate change, DPOs, interviews with CTs	Review of DSAs to assess what assumptions are being made for long-term projections; semistructured interviews with World Bank and IMF economists and the Macro and Debt Group of the World Bank on long-term projections Case studies on small island states vulnerable to climate change risk to assess what extent to which climate change factors incorporated into long projections
3. How well does the World Bank consider data quality, coverage, and transparency in its use of the LIC-DSF, particularly in light of rapidly changing global risk dynamics? This question will have two parts: • To what extent do country-specific LIC-DSAs include an adequate assessment of the quality and coverage of the data used, and how does that assessment influence World Bank staff's use of the resulting DSA output on the level of debt stress? • What progress has the World Bank made in improving debt data quality, transparency, and coverage in the LIC-DSF including with respect to contingent liabilities and state-owned enterprises?	DSA reports and Excel files; recent evaluations, assessments, and research on data quality and coverage, DPO program documents, interviews with CTs	Analysis of recent DSAs, research and evaluations on debt transparency, contingent liabilities, state-owned enterprises, and the Debtor Reporting System to assess implications for the DSA Case studies on countries where new or nontraditional lending increased, "hidden" debt was uncovered, transparency improved, risk rating worsened, and so on

Key Questions	Information Sources	Data Collection and Analysis Methods
4. How have the World Bank's strategic and operational decisions and policies, both institutionally and at the country level, been influenced by LIC-DSAs prepared over the past decade? How have rapidly changing debt risks and increasing climate risks affected the adequacy of the LIC-DSF to support the World Bank's work in the debt space?	CPFs, SDFP reports, DPOs program documents and ICRRs, DMF reports, DeMPA reports, interviews with CTs, IEG evaluations	Review of CPFs, SDFP reports, DPOs, DMF reports to assess how risk ratings were influenced engagement with country clients Case studies on a cross-section of countries, particularly those at high level or where risk rating has worsened Semistructured interviews with country teams, DFI, SDFP committee, MTI debt unit
5. Is World Bank–IMF collaboration on the LIC-DSF consistent with the agreed guidelines? How well have the guidelines on collaboration worked in supporting the objectives of the LIC-DSF?	IMF–World Bank LIC-DSF guidance notes, interviews with World Bank MTI economists and relevant IMF staff	Review of relevant World Bank and IMF documentation, assessing how the collaboration worked in practice Semistructured interviews with World Bank colleagues from the Macro and Debt unit and country economists on a cross-section of countries for insight into how collaboration has worked in practice

Source: Independent Evaluation Group.
Note: CPF = Country Partnership Framework; CT = Country Team; DeMPA = Debt Management Performance Assessments; DMF = Debt Management Facility; DPO = development policy operation; DSA = Debt Sustainability Analysis; ICRR= Implementation Completion and Results Report Review; IDA = International Development Association; IEG = Independent Evaluation Group; IMF = International Monetary Fund; LIC-DSF = Low-Income Country Debt Sustainability Framework; MTI = Macroeconomics, Trade, and Investment; SDFP = Sustainable Development Financing Policy.

Appendix B. Reforms to the Debt Sustainability Framework for Low-Income Countries

Table B.1. 2017 Reforms to the Debt Sustainability Framework for Low-Income Countries

Reforms	2012 DSF	2017 DSF
Realism tools		• To support stronger baseline projections and implementation of new classification (for example, realism of projected fiscal adjustment and the investment-growth nexus)
Core debt distress model	• Identifies only severe debt distress episodes • Few country-specific explanatory variables	• Enhanced methodology to identify all debt distress episodes • Expanded specification including key country-specific fundamentals to improve predictive capacity
Country classification (debt-carrying capacity)	• Relies exclusively on the CPIA • Backward-looking classification	• Based on a composite measure covering the CPIA, growth, reserve coverage, remittances, and world growth • Incorporate forward-looking elements (enhancing engagement with country authorities)
Debt indicators and thresholds	• Complex: 5 debt indicators and 24 thresholds • Thresholds are derived individually without regard to the information of other debt indicators to predict debt distress (introducing conservative bias)	• Significant simplification: 4 debt indicators and 12 thresholds • Thresholds are derived jointly in line with the DSF's aggregation rule (eliminating a source of conservative bias)
Standardized stress tests	• Sixteen stress tests; uncommon testing across the external and public DSA	• Seven common recalibrated and redesigned stress tests across the external and public DSA, with improved macro-linkages
Tailored stress tests		• To better evaluate scenario risks of relevance for some countries (for example, natural disasters)
Assessment of other potential risk factors	• Tools to assess: domestic debt vulnerabilities	• Tools to assess: domestic debt vulnerabilities, market-financing pressures, diversity of debt vulnerabilities in countries rated as moderate risk
Enhanced guidance for the application of judgment	• On marginal or transitory breaches	• On severe domestic debt vulnerabilities and exposure to external market-financing pressures, among other factors

Source: International Development Association and International Monetary Fund 2017.
Note: CPIA = Country Policy and Institutional Assessment; DSA = Debt Sustainability Analysis; DSF = Debt Sustainability Framework.