



**Comments for consultation on the review of the  
IMF-World Bank debt sustainability framework for low income countries**  
*22 September 2016*

David Mihalyi, Economic Analyst, Natural Resource Governance Institute

I welcome the opportunity to contribute to the consultation initiated by the IMF on its debt sustainability framework for low income countries.

Of the 70 countries where the IMF conducts debt sustainability analysis for low income countries,<sup>1</sup> 13 were classified as resource rich and an additional 11 as prospective natural resource exporters by the IMF in 2012.<sup>2</sup> At the time, the majority of them had low debt burdens as a result of HIPC debt relief initiative and a favourable economic outlook due to rising commodity prices. But following the recent sustained decline in commodity prices many of them now face grave debt sustainability challenges. Between 2013 and 2016, according to a list of the then latest debt sustainability analysis undertaken<sup>3</sup>, the risk of debt distress increased in 8 resource rich and prospective countries while it only decreased in 1.<sup>4</sup> Out of the 24 resource rich and prospective countries only 3 are currently characterized as facing low levels of debt distress risk.<sup>5</sup> Hence the review of the IMF-WB debt sustainability framework is timely to better incorporate the specific challenges these countries are facing.

Resource rich developing countries have important characteristics which warrant special attention when analysing their debt sustainability: larger vulnerability to terms of trade shocks, the depletion of finite subsoil wealth, weaker governance and in particular an opaque resource sector. The following comments provide recommendations on how the IMF-World Bank's debt sustainability framework for low income countries could take these considerations better into account. The note also provides suggestions on making the IMF debt sustainability framework (DSF) more accessible for reuse.

## 1. Addressing volatility

All countries are vulnerable to terms-of-trade shocks but non-renewable commodity exporters even more so, given the magnitude and persistency of oil and mineral price shocks. Measures of volatility in resource-rich developing economies (e.g. the variation of export revenues) typically exceed those of non resource-rich countries by 50 percent for mineral-rich countries and more than 100 percent for oil-rich countries<sup>6</sup>. Lower commodity prices typically squeeze export earning, government revenue and result in lower FDI. These risks are generally taken into account when conducting debt sustainability analysis by adjusting the outlook proportionately to the size of the terms of trade shock. But in many cases, especially in countries labelled prospective, the result of the price drop has been that large mining projects were cancelled or closed down, dramatically altering the outlook. The Simandou project in Guinea and the Tonkolili project in Sierra Leone were both projected to double their countries' GDP.<sup>7</sup> By now development on both of these transformative projects has been halted. In Tanzania and Mozambique, major LNG projects have stalled for many years waiting on a final investment decision by the petroleum companies. The problems and delays in executing these

<sup>1</sup> <https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>

<sup>2</sup> <https://www.imf.org/external/np/np/eng/2012/082412.pdf>

<sup>3</sup> <https://web.archive.org/web/20131203034420/http://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>

<sup>4</sup> This compares with a reported increase in risk in 7 and a decrease in risk 5 of the other countries during the same period.

<sup>5</sup> <https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>

<sup>6</sup> <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.30.1.161>

<sup>7</sup> <http://www.imf.org/external/pubs/ft/scr/2011/cr11361.pdf>,

[http://www.riotinto.com/documents/RT\\_Simandou\\_Economic\\_Impact\\_Report\\_EN.pdf](http://www.riotinto.com/documents/RT_Simandou_Economic_Impact_Report_EN.pdf).

projects partly stems from the governance challenges these countries face.<sup>8</sup> In all of these cases the IMF-WB staff faces the difficult decision on whether to include or exclude these projects from the debt sustainability analysis (it included the mines in Guinea and Sierra Leone and the LNG project in Mozambique but not in Tanzania). The analysis would greatly benefit from presenting alternative (or risk) scenarios with and without the project or assuming project delay. Clear and transparent criteria on when the effects of such transformative extractive projects are included in DSF calculations would also increase the credibility and transparency of the analysis.

## 2. Non-traditional debt instruments and depletion of natural assets

We have seen an increased sophistication in means to collateralize future resource wealth. Rents from natural resources may take decades for governments to recover after discovery through production and taxation. Hence sophisticated ways are emerging in which they are securitized in return for investment, such as oil backed borrowing by state owned enterprises or resource for infrastructure deals. There has been a proliferation of such deals in recent decade across Africa often financed by Chinese and Korean Development Banks to build roads, power plants and railroads.<sup>9</sup> These deals are hard to value and are often beyond the scope of DSFs for LICs if there are no financial flows. This creates a risk that resource rich countries finding it difficult to access traditional borrowing may be incentivized to favour such deals to avoid raising alarms of debt sustainability. The DSF should ensure that deals depleting or putting at risk future revenues from resources are incorporated into DSF calculation and subject to same scrutiny as regular external loans. A more comprehensive approach to measuring sustainability would account for the depletion of natural capital directly, although this may be beyond the scope of the DSF.

## 3. Transparency of resource sector

Resource rich countries tend to have lower overall institutional quality<sup>10</sup> and 80% of them fall short of satisfactory standards of transparency and accountability in reporting on their oil and mining sector.<sup>11</sup> This lack of transparency in the sector poses a great threat for fiscal sustainability as institutions such as natural resource companies and natural resource funds manage very large assets and can accumulate long-term fiscal liabilities. These institutions often operate off-budget and provide limited reporting on their operations and balance sheets. Development banks and state owned companies also issue external debt with implicit or explicit government guarantees on the back of future resource wealth, which in some cases goes unreported to statistical authorities. For example, in Mozambique the borrowing of a state owned Tuna Fishing company on the back of gas revenues, with a government guarantee, went unreported.<sup>12</sup> The evaluating of resource sector transparency in these countries could be used as an input to derive ratings in the DSF. The IMF's recently revised Natural Resource Fiscal Transparency Code,<sup>13</sup> to which NRGI provided detail comments,<sup>14</sup> could serve as a basis for identifying basic, good and advanced requirements. NRGI's Resource Governance Index<sup>15</sup> provides a detailed evaluation of transparency and accountability across 58 countries producing 85 percent of the world's petroleum, 90 percent of diamonds and 80 percent of copper.

## 4. Making the DSF more accessible to all

As stated by the IMF, "the effectiveness of the DSF in preventing excessive debt accumulation hinges on its broad use by borrowers and creditors." In order to make DSF more easily accessible for reuse, the IMF may want to consider publishing the results of the analysis in machine readable form. While it is encouraging that the excel template for conducting the debt sustainability analysis is available from the IMF website,<sup>16</sup> making the input and output data more easily accessible would allow actors within and beyond government (e.g. parliamentarians, fiscal councils, financial sector including borrowers and creditors, think tanks, NGOs,) to reuse the results, evaluate alternative scenarios or dispute findings more easily and more constructively.

---

<sup>8</sup> See for example: <http://www.resourcegovernance.org/blog/miracle-became-debacle-iron-ore-sierra-leone>

<sup>9</sup> <http://siteresources.worldbank.org/EXTPREMNET/Resources/EP123.pdf>

<sup>10</sup> <http://www.imf.org/external/pubs/ft/fm/2015/02/pdf/fm1502.pdf>

<sup>11</sup> <http://www.resourcegovernance.org/resource-governance-index>

<sup>12</sup> <http://www.wsj.com/articles/tuna-and-gunships-how-850-million-in-bonds-went-bad-in-mozambique-1459675803>

<sup>13</sup> <http://www.imf.org/external/np/fad/trans/>

<sup>14</sup> <http://www.resourcegovernance.org/sites/default/files/NRGISubmission-DraftResourceRevenueManagementPillar20150220.pdf>

<sup>15</sup> <http://www.resourcegovernance.org/resource-governance-index>

<sup>16</sup> <https://www.imf.org/external/pubs/ft/dsa/temp/dsatemp.xlsm>