Debt sustainability analysis and methodologies revisited:

The case for reforms

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Debt sustainability is usually defined in terms of a country's repayment ability without recourse to debt restructurings and, until recently, accumulating arrears. The methodology to assess debt sustainability, primarily developed at the IMF, essentially involves a comparison of projections of borrowings in the long-term (up to 20 years), based on macroeconomic assumptions about a country's overall future economic performance, with its repayment capacity, defined by a few core ratios of debt stock, present value or debt servicing costs over GDP, as well as the ability to generate trade and budgetary surpluses.

Core changes to the financial landscape of (sovereign) debt contracting in developing economies – such as a marked shift from official to private creditors, the rapid increase of external corporate debt in emerging economies, and the increased reliance on borrowing in domestic markets in low-income countries – are increasingly being recognised, not least by the IMF. Less clear is, however, whether, or to what extent, recent attempts at a reform of existing debt sustainability frameworks move on from a purely financial (ultimately creditor-oriented) perspective on developing country debt sustainability to a more development-oriented one that takes account of the long-term role of debt as a core instrument to finance structural transformation in developing economies.

This contribution takes stock of existing critiques of developing country debt sustainability frameworks and methodologies. On this basis, it develops a set of initial proposals for a substantial reform agenda of existing methodologies for the assessment of developing country debt sustainability, including underlying macroeconomic modelling as well as ways to construct relevant debt sustainability indicators.