

What Policy-Makers Should Watch for in the Review of the Low-Income Country Debt Sustainability Framework

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Summary

- The ongoing Low-Income Country Debt Sustainability Framework (LIC-DSF) review is a meaningful and welcome attempt to adapt the framework to a more complex debt landscape characterized by higher domestic debt, greater creditor heterogeneity, and stronger external vulnerabilities.
- The revised framework moves the LIC-DSF closer to a full public debt sustainability analysis (DSA), particularly through the incorporation of domestic debt modules and new overall public debt indicators.
- Despite these improvements, the LIC-DSF still does not clearly distinguish between public debt sustainability and external sustainability, even though they involve different constraints, indicators, and policy responses.
- A more sophisticated single framework is not necessarily a clearer one. Greater complexity only improves policy-making if it produces more operational and interpretable signals.
- Low-income countries increasingly require two complementary analytical tools: a public DSA focused on fiscal dynamics and a separate external DSA focused on balance-of-payments pressures and foreign-exchange risks.
- The revised LIC-DSF should therefore be used primarily as a public DSA, whereas external borrowing decisions and external vulnerability assessments should rely more heavily on a dedicated external sustainability framework.
- Present-value indicators remain useful in some creditor negotiations, particularly for comparability of treatment, but simpler stock-flow indicators are often more operationally relevant for fiscal policy, debt management, and restructuring design.



- Better DSA alone will not solve debt crises if the broader institutional architecture continues to create incentives for delayed restructurings and “too little, too late” responses.
- The objective should not be to build a single increasingly complex framework, but to provide policy-makers with clearer, more transparent, and more policy-relevant diagnostics.

Introduction

The LIC-DSF is the main tool used by the International Monetary Fund (IMF) and the World Bank to assess debt vulnerabilities in low-income countries (IMF, 2018). Developed jointly by the two institutions and revised periodically since its introduction (IMF, 2017; IMF & World Bank, 2004a, 2004b, 2005, 2006a, 2006b, 2009, 2013a, 2018), the framework plays a central role in shaping borrowing and lending decisions, as well as broader debates on debt sustainability and financing strategies.

The LIC-DSF is currently being revised, in an ongoing review at a time when debt vulnerabilities among low-income countries remain persistently high and the debt landscape they face has changed significantly (see Box 1 for review timeline). External public debt has become more exposed to foreign-currency risk and private creditors, domestic public debt vulnerabilities have become more important, and long-term pressures linked to climate and development needs are increasingly difficult to ignore (IMF, 2025). The review is therefore both timely and necessary.

Box 1. The review process and timeline: what policy-makers should know

The review process is already underway. The IMF and World Bank have launched a public consultation on the 2026 LIC-DSF review, supported by a joint background note outlining the main areas under consideration (IMF & World Bank, 2026). The consultation is part of a broader engagement process involving borrowing countries, creditors, civil society organizations, and other stakeholders. Formal approval of the revised framework is expected in Autumn 2026, followed by implementation in 2027 through a new template, revised guidance, and outreach activities.

For policy-makers, this timing matters. It suggests that there is still some space to engage with the review process, but also that countries should begin preparing now for implementation. Once approved, the revised framework is unlikely to become fully operational overnight. There will be a transition period while templates, guidance, and training are rolled out. In practice, this means lower-income country authorities may soon face a mixed environment: the revised framework will be known and increasingly referenced before it is yet uniformly applied. That makes it especially important for country officials and advisers to understand not only what is changing, but how to interpret those changes and prepare to use the revised framework effectively.



This brief does not seek to comment on every technical feature of the review. Instead, it asks a practical question: What should lower-income country policy-makers watch for in the revised framework, and how should they use it in practice? Its starting point is that the LIC-DSF is not merely a technical model. It is an operational tool embedded in debt management, multilateral lending, and debt restructuring. Any meaningful assessment of its reform must therefore begin not only with methodology but also with the uses to which the framework is actually put.

The central message of this brief is straightforward. The ongoing review contains real and welcome improvements, especially in its treatment of domestic debt, country heterogeneity, and some long-term challenges. Yet these improvements do not fully resolve one of the framework's core weaknesses: it still does not clearly distinguish between public debt sustainability and external sustainability, even though the two involve different constraints and often call for different policy responses. A more sophisticated single framework is not the same as a complete solution. The revised LIC-DSF should therefore be used primarily as a public DSA and be paired with a separate external sustainability assessment where the binding constraint is balance-of-payments pressures, foreign-exchange liquidity, or external rollover risk. Finally, for practical policy purposes, countries should use both instruments for debt management and debt restructuring, rely primarily on the external assessment for external borrowing decisions, and use a simpler public DSA for fiscal rules and fiscal anchors.

In short, the revised LIC-DSF may become a better tool. But it should still not be asked to do all jobs at once.

Why the LIC-DSF Matters—and Why It Is Under Renewed Scrutiny

The LIC-DSF is much more than a technical model. In practice, it functions as an early warning system for low-income countries, projecting debt-burden and debt-service indicators against predefined thresholds and assigning a risk rating of debt distress (IMF, 2018; IMF & World Bank, 2018). Those ratings, in turn, are used for distinct functions. First, the LIC-DSF is intended to be used by debt managers and other country authorities as a forward-looking risk assessment tool (Table 1). Second, it directly shapes the terms of multilateral financing, especially through the World Bank's concessional window, where the risk rating affects the mix of grants and credits a country receives (Independent Evaluation Group, World Bank, 2023; International Development Association, 2006). Third, it provides a common analytical reference point in debt restructuring processes, helping define the scale of adjustment required to restore sustainability and anchoring negotiations among debtor governments, multilaterals, and other creditors (IMF, 2024; Rivetti, 2022). Taken together, these roles make the LIC-DSF a coordinating device across the broader system, not just an analytical input.



Table 1. Main uses of the LIC-DSF

Function	Role in practice
Debt management	Supports forward-looking assessments of debt vulnerabilities and borrowing capacity by country authorities.
Guidance for lending decisions	Determines access to concessional financing and influences the mix of grants and loans provided by multilateral institutions.
Debt restructuring	Serves as a common analytical benchmark to assess financing gaps and anchor restructuring negotiations among creditors and debtor countries.

Source: Authors' own analysis.

But much has changed since the framework's original design in the mid-2000s. At that time, many countries still relied predominantly on concessional financing from multilateral institutions and Paris Club creditors. Today, creditor bases are far more diverse. Domestic borrowing has increased, foreign-currency exposure remains significant, and private external debt—including debt that is not publicly guaranteed—has become more important as a source of vulnerability. Low-income countries have also become more heterogeneous, with some operating in an increasingly blurred space between traditional low-income country status and market exposure (IMF, 2025).

In that context, external pressures have become more salient. Many low-income countries now face tighter external financing conditions, rising debt-service obligations, and growing pressure on foreign-exchange earnings. These dynamics have been intensified by successive shocks, including the COVID-19 pandemic, the war in Ukraine, the sharp tightening of global financial conditions, and, more recently, the Iran shock. In this context, a central concern is whether a framework originally designed for a different debt structure still provides timely and policy-relevant signals.

The review is also taking place against a wider field of criticism. Methodological concerns have focused on optimism bias in baseline projections, the limited integration of climate adaptation and public investment needs, and the discretionary use of judgment in final risk ratings (Gaudin et al., 2024; Graf von Luckner, 2024; Raga, 2024). Development-oriented critiques have argued that the framework does not adequately capture the trade-offs between debt sustainability, development finance, and resilience investment (Task Force on Climate, Development and the IMF, 2024; Zucker-Marques et al., 2024). These critiques are important. But they do not exhaust the problem. The deeper issue is that the LIC-DSF is being used in practice for several distinct functions—debt management, lending decisions, and debt restructuring—without being fully designed for all of them at once.

That is the starting point of this brief. The brief aims to engage constructively with the ongoing review and recognizes a number of important improvements currently under consideration. But the question is not only whether the LIC-DSF is being improved methodologically but also whether it is becoming better suited to the jobs it is expected to perform.



What the Review Proposes to Change

The ongoing review (IMF & World Bank, 2026a) contains real and welcome improvements. It responds to important changes in the debt landscape facing low-income countries: greater heterogeneity across countries, a larger role for domestic debt vulnerabilities, increased exposure to private and foreign-currency debt, and growing pressure to reflect climate and development challenges more explicitly in debt assessments. It is a serious attempt by the IMF and the World Bank to update the framework and make it more robust in a more complex environment.

Accounting for Low-Income Countries' Heterogeneity

The proposed review refines the composite indicator of debt-carrying capacity by incorporating additional variables, including output volatility and a measure of exposure to global macro-financial conditions. The objective is to better differentiate frontier economies and fragile and conflict-affected states from other low-income countries, recognizing that countries with similar income levels may face very different financing conditions, institutional capacities, and debt vulnerabilities. This is a welcome step toward a more realistic treatment of country heterogeneity.

Strengthening the Treatment of Domestic Debt Vulnerabilities and Public Debt Dynamics

The review proposes a significant strengthening of the public debt dimension of the framework. In addition to a new domestic debt risk module, it would introduce separate burden and liquidity indicators for overall public debt, including face-value public debt-to-GDP, gross financing needs-to-GDP, and interest payments-to-revenue indicators. It would also incorporate realism tools to assess domestic financing assumptions, including the absorptive capacity of the financial system, sovereign-bank nexus risks, and the potential crowding out of private credit. Given how much more important domestic debt has become in many low-income countries, this is one of the most significant improvements in the proposed reform, shifting the framework from a predominantly external public debt assessment toward a more comprehensive public DSA.

Improving Debt Coverage and Transparency

The review also recognizes that debt coverage remains a critical source of uncertainty in debt sustainability assessments. The proposed reforms include adjustments to baseline indicators to address gaps in state-owned enterprise liabilities and the introduction of a confidence flag intended to signal the quality and completeness of debt data. Although these reforms do not eliminate coverage problems, they represent a useful acknowledgement that risk assessments are only as reliable as the information on which they are based.



Integrating Long-Term Risks

The review introduces new modules to assess the implications of climate-related risks, adaptation policies, and development spending for debt dynamics. One module would examine how climate risks and adaptation policies affect public debt and gross financing needs, while another would do something similar for broader development policies. These modules are useful insofar as they recognize that debt sustainability increasingly interacts with climate resilience, human and physical capital investment, and long-term structural transformation. Importantly, these modules are intended to complement rather than directly determine debt-distress ratings, allowing longer-term vulnerabilities to be incorporated without mechanically altering short-term sustainability assessments.

Balancing Mechanical Signals and Expert Judgment

Finally, the revised framework would retain the current architecture of model-based signals complemented by structured judgment, while introducing several enhancements. Judgment will remain central in arriving at final assessments of debt stress and sustainability. At the same time, the proposed reforms would introduce a mechanical signal for overall public debt stress and greater granularity within high-risk ratings transparency. These changes could improve the quality and discipline of assessments, even if they do not eliminate the role of discretion.

Overall, then, the review deserves to be taken seriously. It does not merely tweak the existing framework; it attempts to “future-proof” it by strengthening areas that have clearly become more important over time. The proposed reforms on heterogeneity, domestic debt, overall public debt indicators, and long-term challenges are all improvements. But acknowledging this is consistent with a second observation: the review still approaches the LIC-DSF primarily as a single evolving framework, rather than asking more fundamentally whether one framework can effectively perform all the distinct functions it is expected to serve. A deeper revision of the LIC-DSF should ideally begin more explicitly with the question of what practical uses the framework is expected to serve. Our reading is that the current review improves the tool along several dimensions but does not fully take that question as its starting point. As a result, some core tensions remain, even as important weaknesses are being addressed.

What the Review Does Not Solve

The proposed reforms improve the LIC-DSF in important ways. But they do not fully resolve the framework’s deeper design problem: it is still being asked to perform several analytically distinct functions at once. As a result, even a more sophisticated and better calibrated LIC-DSF may continue to generate signals that are useful in some contexts but less clear, or even misleading, in others.



Lack of Clear Separation Between Public and External Sustainability

Public debt sustainability and external sustainability are related, but they are not the same analytical object (Table 2). They involve different constraints, different indicators, and often different policy responses. Public debt sustainability is ultimately about the government’s ability to generate fiscal resources and manage refinancing pressures. External sustainability is about the economy’s ability to generate foreign exchange and meet obligations to non-residents without triggering persistent balance-of-payments stress (Allen et al., 2023; Cubeddu et al., 2019). Yet the LIC-DSF still blends them into a single framework rather than treating them as two related but separate questions.

Table 2. Public and external sustainability: a conceptual comparison

Dimension	Public DSA	External DSA
Core objective	Assess the government’s capacity to sustain fiscal policy and service public debt	Assess the economy’s capacity to generate net external revenues and service external liabilities (public and private)
Main constraint	Government budget constraint	Balance-of-payments/foreign-exchange constraint
Debt-burden concept	Public debt	Net international investment position/external debt
Key sustainability drivers	GDP growth, interest rates, primary fiscal balance, public debt service	Export growth, external financing conditions, interest and dividend payments, current account dynamics
Main risks	Fiscal stress, refinancing pressures, loss of market access	Sudden stops, reserve losses, balance-of-payments crises
Typical indicators	Public debt-to-GDP, gross financing needs, interest-to-revenue	External debt-to-exports, debt service-to-exports, reserve adequacy

Source: Authors’ own analysis.

The stronger treatment of domestic debt improves the realism of the public-side assessment, whereas the external side of the framework still does not fully operate under the logic of a distinct external sustainability analysis. As a result, the framework becomes broader without always becoming conceptually clearer. This can still leave policy-makers with an ambiguous signal: Is the country’s problem mainly fiscal, mainly external, or a combination of both? And what follows for borrowing, adjustment, or restructuring decisions? The revised framework improves coverage, but it still does not consistently organize those questions around distinct analytical instruments.



Growing Complexity

The review adds realism tools, stress tests, a domestic debt risk module, long-term modules, data-confidence flags, and greater rating granularity. Each of these additions responds to a real gap. But taken together, they also increase the number of moving parts within a framework that is already used by debt managers, IMF and World Bank staff, executive directors' offices, official creditors, restructuring advisers, and civil society actors. In an operational framework, complexity is justified only if it improves the mapping from indicators to decisions. Otherwise, it risks making the framework more difficult to interpret without necessarily making it more useful for the policy choices it is meant to inform.

Persistence of Legacy Debt Metrics

One of the meaningful improvements in the review is the move toward face-value and flow-based indicators for overall public debt—such as face-value debt-to-GDP, gross financing needs-to-GDP, and interest payments-to-revenue. This is a constructive step because these measures are more transparent and easier to connect to fiscal realities. But the broader legacy-metrics problem remains. Net present value (NPV) based indicators continue to play a central role. These indicators were inherited from an earlier concessional lending and debt-relief architecture in which official concessional debt dominated and comparability with Heavily Indebted Poor Countries Initiative/Multilateral Debt Relief Initiative practices mattered (IMF & World Bank, 2006b, 2013b). In today's debt landscape, however, they are often difficult to interpret and do not map cleanly onto the policy questions authorities actually face.

The underlying difficulty is that the LIC-DSF's NPV measures occupy an ambiguous position between nominal and market-based valuations. By relying on a fixed discount rate, they do not provide a market-consistent measure of the economic value of debt. At the same time, the framework applies different valuation conventions across instruments, calculating external debt in present-value terms while treating domestic debt at nominal value. As a result, debt indicators combine distinct concepts of valuation within a single analytical framework. Moreover, because NPV-based measures depend on assumptions regarding discount rates, financing terms, and debt composition, changes in debt indicators may reflect not only borrowing needs and policy choices but also modelling conventions embedded in the framework. This reduces transparency and makes it harder to translate movements in debt indicators into clear implications for fiscal policy, financing needs, or debt restructuring.

The Institutional Incentives and Implementation Issue

A further unresolved issue is that methodological improvements do not solve the institutional incentive problem. The LIC-DSF's role as a signal for multilateral lending can distort how its warnings are interpreted and acted upon (Independent Evaluation Group, World Bank, 2023; International Development Association, 2006). In particular, a framework used to determine access to concessional resources can end up encouraging the postponement of necessary restructurings rather than supporting timely resolution. This problem is not fundamentally methodological. It arises from the institutional architecture in which the LIC-DSF is



embedded. A better model may improve diagnosis, but it does not automatically ensure that the signals it generates will translate into timely, coherent, and effective policy action.

For policy-makers, the practical implication is important. The revised LIC-DSF may become a better and more comprehensive tool. But it still risks being asked to do too many things at once: to guide debt management, shape lending decisions, and anchor debt restructurings, while also serving as both a public debt framework and an external sustainability tool. The result is that the review may improve the framework substantially without fully resolving the mismatch between its design and its uses.

That is why the key question for lower-income country policy-makers is not only what the revised LIC-DSF improves, but how it should be used in practice.

How Policy-Makers Should Use the Revised LIC-DSF

The practical implication of this analysis is not that low-income country policy-makers should disregard the revised LIC-DSF. On the contrary, they should engage with it closely, understand what is changing, and prepare to use it actively once the revised framework is rolled out. The review is likely to improve the framework in important ways. A stronger treatment of domestic debt, new public debt indicators, greater attention to country heterogeneity, and additional modules on long-term climate and development challenges should all make the LIC-DSF more useful than the current version.

But policy-makers should also be clear about what the revised framework can and cannot do. The central risk is that a more sophisticated LIC-DSF will be treated as a complete solution to all debt sustainability questions. That would be a mistake. The LIC-DSF is used in practice for several distinct purposes: debt management, lending decisions, and debt restructuring. These uses are related, but they are not identical. A single framework that tries to answer all of these questions at once will inevitably blur signals. This suggests taking a more selective approach to how the revised LIC-DSF is used in practice.

Use the LIC-DSF Primarily as a Public Debt Sustainability Tool

The most useful way to approach the revised LIC-DSF is therefore as part of a two-instrument approach. The revised LIC-DSF should be used primarily as a public DSA, complemented by a separate external sustainability assessment. In this role, it can help governments assess fiscal dynamics, total public debt, gross financing needs, interest burdens, refinancing pressures, and the debt management trade-offs associated with different financing strategies. This is where the revised framework is likely to be strongest, especially if the new public debt indicators move the analysis closer to the questions policy-makers actually face: how much debt the public sector carries, how costly it is to service, how it is financed, and what fiscal effort would be required to keep it on a sustainable path.

At the same time, policy-makers should not treat the LIC-DSF as a complete stand-alone diagnosis of external sustainability. This distinction matters because the relevant policy responses differ. If the problem is fiscal, the central questions concern revenue mobilization, expenditure paths, the primary balance, domestic financing conditions, interest costs, and



debt-service burdens. If the problem is external, the central questions concern export capacity, reserve adequacy, rollover risks, foreign-currency liquidity, exchange-rate pressures, capital flows, and the structure of external liabilities. Fiscal adjustment may help in some cases, but it is not automatically the right response to an external sustainability problem. In some cases, excessive fiscal tightening can weaken growth and aggravate external vulnerabilities rather than resolve them.

Pair the LIC-DSF With a Dedicated External Sustainability Framework

This external DSA should focus explicitly on balance-of-payments pressures and foreign-exchange constraints. It should examine the country's capacity to generate and access foreign exchange, including through exports, remittances, reserves, concessional financing, foreign direct investment, and other external flows. It should also assess the structure of external liabilities, including maturity profiles, currency denomination, creditor composition, rollover risk, and, where relevant, private non-guaranteed external debt. This is especially important in countries where vulnerability increasingly arises not only from public and publicly guaranteed external debt but also from broader external exposure and market-based financing.

Use Both Instruments for Debt Management Decisions

The public DSA should help debt managers understand the fiscal consequences of alternative borrowing strategies: how different instruments affect gross financing needs, interest payments, maturity risks, and the public debt path. The external DSA should help them understand the foreign-exchange consequences of those same choices: how external borrowing affects reserve needs, external debt service, exposure to exchange-rate movements, and vulnerability to global financial conditions. This would enable debt managers to distinguish between financing options that may look manageable from a fiscal perspective but create external liquidity risks, and options that may appear more costly in budgetary terms but reduce foreign-currency exposure or rollover pressure.

Prioritize the External Framework for External Borrowing Decisions

The key question is not only whether a loan is concessional or whether it improves the public debt path in present-value terms. The key question is whether the borrowing will strengthen the country's capacity to generate the foreign exchange needed to service the debt. External loans are more defensible where they finance investments that expand export capacity, reduce import dependence, strengthen resilience to external shocks, or otherwise improve the balance-of-payments position over time. Where this link is weak, additional external lending may worsen external vulnerability even if it appears concessional. In those cases, grants or other forms of non-debt finance may be more appropriate.

Use Both Instruments in Debt Restructuring Design

For debt restructuring, both instruments are also needed, but for different reasons. The public DSA should help assess the fiscal burden of debt and the adjustment path required to restore public debt sustainability. It should clarify the scale of fiscal effort that is realistic,



the debt-service profile that can be sustained, and the risks posed by domestic refinancing pressures. The external DSA should assess whether the country's external obligations are compatible with its capacity to generate foreign exchange over time. In restructuring contexts, this distinction is crucial. A restructuring may appear to restore public debt sustainability while leaving external vulnerabilities unresolved. Conversely, a restructuring focused only on external flows may fail to address domestic debt-service pressures or fiscal risks.

This distinction also matters for the design of the restructuring envelope. The first analytical question should be as follows: What combination of debt relief, reprofiling, new financing, and policy adjustment is required to restore fiscal and external viability? That question should be answered through transparent stock and flow indicators grounded in fiscal and external realities. Gross financing needs, debt-service-to-revenue, interest-to-revenue, debt-service-to-exports, reserve adequacy, and realistic end-of-program debt-stock projections are likely to be more useful for this purpose than NPV indicators alone. NPV-based metrics may still be useful later in the process, especially for assessing comparability of treatment among creditors (Rivetti, 2022). But they should not be the main anchor for determining the overall scale of debt relief needed.

Use a Simplified Public DSA for Fiscal Rules and Fiscal Anchors

For fiscal rules and fiscal anchors, policy-makers should rely on a simpler public DSA rather than the full complexity of the LIC-DSF. Fiscal anchors need to be transparent, stable over time, easy to communicate, and clearly linked to policy instruments under the control of government. They must be understandable not only to debt managers and IMF/World Bank staff, but also to finance ministries, parliaments, fiscal councils, supreme audit institutions, investors, and the public. In practice, this points toward simple indicators such as total public debt, gross financing needs, debt service, and interest payments relative to revenue. It does not point toward complex present-value indicators, changing debt-carrying-capacity thresholds, or hybrid signals that combine fiscal and external risks in ways that are difficult to interpret.

This is not a minor technical issue. Domestic fiscal frameworks depend on credibility and communication. If a fiscal rule is built around an opaque indicator that few domestic institutions can reproduce or explain, it will be less useful as an anchor for policy. NPV-based indicators are particularly poorly suited for this purpose because they depend on discount-rate assumptions, financing terms, and the projected composition of borrowing. They do not map cleanly onto the fiscal choices that governments actually make: how much to spend, how much to raise in revenue, how much to borrow, and at what cost. A simpler public DSA would therefore be more useful for domestic policy-making, parliamentary oversight, fiscal council analysis, and public accountability.

This does not imply that complexity or granularity should be ignored. Rather, they should be concentrated on areas that are genuinely macro-critical and that generate material fiscal risks requiring assessment within the budgetary process and the broader institutional ecosystem of debt management. From this perspective, broader debt coverage remains important, particularly because significant vulnerabilities may emerge outside the traditional public and



publicly guaranteed debt perimeter, including through private external liabilities, contingent liabilities, state-owned enterprises, or non-guaranteed debt exposures. But identifying and assessing these risks necessarily requires country-specific institutional judgment and detailed balance-sheet analysis, making them difficult to incorporate into a purely mechanical framework or standardized indicator system.

Strengthen Domestic Capacity to Engage With DSAs

Finally, policy-makers should use the revised LIC-DSF as a basis for more active engagement with the IMF, the World Bank, creditors, and domestic institutions. They should not treat DSAs as external documents prepared for them. Countries should develop their own capacity to interpret, challenge, and complement LIC-DSF assessments. This means asking the following questions. What is the framework actually diagnosing? Is the main risk fiscal or external? Which indicators are driving the rating? Are the baseline projections realistic? Are the financing assumptions credible? Are external risks outside the public sector being captured? What would change under alternative assumptions? And what policy response follows from the diagnosis?

LIC policy-makers should use the revised LIC-DSF actively, but selectively.

It should be treated as an improved tool for public debt analysis, not as a universal framework for every debt sustainability question. Its signals should be interpreted alongside a separate external assessment, especially when balance-of-payments pressures, foreign-exchange liquidity, and external rollover risks are central to the country's vulnerability. Used in this way, the revised LIC-DSF can become more useful, not less: one instrument within a broader diagnostic toolkit that gives policy-makers clearer and more actionable signals.

Conclusion

The ongoing review of the LIC-DSF is important and timely. The debt landscape facing low-income countries has changed significantly since the framework was first designed. A framework designed for a world in which concessional public and publicly guaranteed external debt dominated can no longer be expected to provide all the answers on its own.

The proposed reforms are therefore welcome. A revised LIC-DSF that better reflects domestic debt vulnerabilities, country heterogeneity, overall public debt indicators, long-term risks, and data quality would be a meaningful improvement. But the central lesson of this brief is that methodological improvement is not enough. The LIC-DSF is not just a model. It is an operational tool used for debt management, multilateral lending decisions, and debt restructuring. Its usefulness depends not only on whether it measures risk more accurately but also on whether it provides the right signal for the right policy decision.

This is where the core limitation remains. Public debt sustainability and external sustainability are connected, but they are analytically distinct. Public debt sustainability concerns the government's capacity to mobilize fiscal resources, manage refinancing pressures, and stabilize



public debt over time. External sustainability concerns the economy's capacity to generate the foreign exchange needed to meet external obligations without persistent balance-of-payments stress. These two constraints interact, but they do not call for the same indicators or the same policy responses. A single framework that blends them may become more sophisticated, but it will still risk producing ambiguous signals.

The practical response is not to reject the revised LIC-DSF. It is to use it more deliberately. Low-income country policy-makers should treat the revised framework primarily as a public DSA. They should pair it with a separate external DSA, use both instruments together for debt management and debt restructuring, rely primarily on the external DSA when assessing external borrowing and lending decisions, and use a simpler public DSA when designing fiscal rules and fiscal anchors.

This approach would also clarify the role of different indicators. Present-value metrics may remain useful in creditor negotiations, especially when assessing comparability of treatment. But they should not be expected to do everything. For domestic fiscal policy, debt management, and the design of restructuring envelopes, more transparent stock and flow indicators are often more operationally useful: total public debt, gross financing needs, interest-to-revenue, debt-service-to-revenue, debt-service-to-exports, reserve adequacy, and realistic debt-stock projections. These indicators are easier to communicate, more directly connected to policy choices, and more useful for building domestic accountability.

A two-instrument approach would also help avoid a common policy mistake: responding to external vulnerability with purely fiscal tools. When a country's main constraint is foreign-exchange liquidity, reserve adequacy, export capacity, or exposure to global financing conditions, fiscal consolidation alone may not restore sustainability. It may even weaken growth and reduce the economy's capacity to generate foreign exchange. Conversely, when the main problem is fiscal, external indicators alone cannot substitute for a serious assessment of revenue, expenditure, interest costs, and refinancing needs. Better diagnosis is essential because different problems require different policy instruments.

The implications extend beyond methodology. Even a technically improved LIC-DSF will remain operationally insufficient if the broader financing architecture creates incentives to delay action. When DSA risk signals determine access to grants and concessional loans, the framework can unintentionally affect the timing of restructurings, the behaviour of creditors, and the willingness of institutions to recognize losses. If the system rewards delay, then better indicators alone will not solve the "too little, too late" problem. A fit-for-purpose framework therefore requires not only better analysis but also institutional incentives that translate diagnostic signals into timely and effective policy action.

In short, the revised LIC-DSF may become a better tool. But it should still not be asked to do all jobs at once. Its greatest value will come from using it as part of a broader diagnostic toolkit: a simplified public DSA to assess fiscal dynamics and public debt risks; a dedicated external DSA to assess balance-of-payments and foreign-exchange constraints; and a clearer institutional framework that ensures DSA leads to better borrowing decisions, more credible fiscal anchors, more effective debt management, and timelier debt restructurings.



The objective should not be to build an ever more complex single framework. It should be to give policy-makers clearer, more usable, and more policy-relevant diagnostics. For low-income countries navigating increasingly complex debt vulnerabilities, that clarity is not a technical luxury. It is a condition for better policy decisions.

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