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Statement by Mr. Mirakhor on Review of Low-Income Country Debt Sustainability Framework and Implications of the Multilateral Debt Relief Initiative (MDRI) (Preliminary)
Executive Board Meeting 06/37
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The Debt Sustainability Framework (DSF) has become a useful tool for assessing and monitoring countries' debt burden and sustainability, and for informing Fund program design, the financing decisions of development partners and countries' own borrowing strategies. For these purposes, the analytical framework seems appropriate and may not require any major changes for now. Admirably, staff paper recognizes the importance of not applying the framework mechanically and taking individual country circumstances into account. It is crucial that this highly appropriate stance is complemented with a sober resistance to the anxious views that post-MDRI countries will rush to accumulate unsustainable, nonconsessional debt as they have in the past. This view tends to ignore changes that have taken place in LICs. There is ample evidence that these countries are now keenly aware of the critical importance of sustained macroeconomic stability to growth and the threat that unsustainable debt accumulation could pose to that stability. In no small measure, this recognition and the accompanying effort to maintain stability are due to the hard work and contribution of the Fund and the World Bank in LICs over the last decade. It is, however, equally important to acknowledge that in many of these countries accelerated growth, required to achieve the MDGs, is constrained by lack of sufficient financial resources. Also, currently the prospects for mobilizing additional nonconcessional resources, required to achieve the needed progress, are not encouraging. Moreover, the evolution of many high-growth developing countries demonstrates that economic progress would not have been achieved without, inter alia, efficient mobilization of domestic resources and access to external savings. Therefore, dogmatic position against access to nonconcessional resources needs to be attenuated with realistic and sound consideration of the total resource envelope to accelerate growth and achieve MDGs. The legitimate concern for debt sustainability should, therefore, be translated into a proactive role for the Fund and the World Bank to help LICs to rapidly develop their domestic capital markets and to learn how to successfully and wisely access international capital markets. For this approach, the new arrangement combining ICM and MFD must assume a central role.

To safeguard debt sustainability, it is also crucial that Bretton Woods institutions, as well as development partners, help LICs establish efficient and dynamic debt management units to monitor the progress in nonconcessional resource mobilization. This would minimize the risk

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of overborrowing and, combined with a well-designed, transparent, and widely disseminated debt sustainability analysis, the framework would also minimize the risk of returning debt distress. Like other Directors, we see no justification for a rush to lower debt threshold, particularly, in view of the paper's position that the DSA framework should not take a "one-size-fits-all" approach, but be fully developed, taking into account "country-specific features and risks." While there is validity in the notion of a debt threshold, determining a new threshold based on a strong empirical analysis and devoid of arbitrariness, selectivity, and non-uniformity of treatment will require considerable time and effort. Clearly, the situation where blanket ceilings are imposed on LICs' borrowing, ignoring the necessity of intended projects for accelerated growth and removing structural bottlenecks, imposes severe constraints on these countries' growth potential and is not helpful. As rightly noted by Messrs. Meissner/ Meyerhoefer and Mr. Sigurgeirsson/Ms. Roos Isaksson, additional borrowing for productive investment could contribute to higher growth and enhanced debt-servicing capacity.

Debt Sustainability Assessments (DSAs) should continue to be customized to "country-specific features and risks." The use of indicative debt burden thresholds based, in part, on policy and institutional qualities seems to remain appropriate. The current standardized ranking of debt distress would also appear to serve well the purpose of facilitating consistency in treatment and comparability as well as signaling to IDA and other donors. Staff rightly point to the need to supplement the classification with additional information, where necessary, including regarding vulnerabilities associated with domestic debt and capacity to meet debt service obligations. For borderline cases, more finely calibrated ratings may be warranted. Staff suggest to issue DSAs as stand-alone documents. The merit of this approach is that DSAs would then be separately available to development partners and creditors for determining country risks and making their financing decisions. In that case, additional outreach activities to disseminate data and analytical information would be helpful. For purposes of program design and policy advice, however, even if reported separately, DSAs would be more meaningful if they were integrated into overall macroeconomic frameworks.

Consensus seems to have developed within the Fund and the Bank that domestic debt should receive equal attention in staff analysis. While public debt DSAs have been commonly presented with those of external debt in staff reports, it would be useful to take it "more systematically into account" under the DSF and to develop a "more integrated approach." An important challenge would be how to deal with data inadequacies and inconsistencies across countries for purposes of comparability underlying the importance of rapid progress in establishing an efficient debt management unit in these countries. Further analytical work on domestic debt and its management would be desirable. Staff's proposal to enhance domestic debt analysis and the understanding of the link between fiscal expenditures and growth is, therefore, welcome. This should ensure a better assessment of debt risk with due consideration of "the quantity and quality of public spending, returns to investment, and macroeconomic impact of aid flows." While there is certainly room for further improvement in the framework of Bank-Fund collaboration in preparation of DSAs, the joint DSA benefits from an appropriate division of labor and represents a useful vehicle for ensuring consistent signaling to development partners and creditors.