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Statement by Mr. Moser and Ms. Tartari on Debt Limits in Fund-Supported Programs--Proposed New Guidelines; Review of Some Aspects of the Low-Income Country Debt Sustainability Framework
(Preliminary)
Executive Board Meeting 09/91
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It is encouraging to see that existing practices related to the debt sustainability framework already allow for flexibility, and that pragmatic changes can adequately improve the guidelines. We continue to support the Fund's policy that nonconcessional external financing should be avoided in low-income program countries, with exceptions granted on a well-founded case-by-case basis.

Debt Limits in Fund-Supported Programs

1. We underline the importance that debt limits focus on debt sustainability and concessional financing, and we agree with the proposed options matrix. However, we request that **the concessionality requirement be increased to a minimum of 50 percent for vulnerable countries, combined with the absence of nonconcessional borrowing for countries assessed as being at debt distress.**

2. We agree with the introduction of the two-step approach and hope that such an approach would motivate LICs to undertake PEFAs. On the Sub-CPIA index, **we encourage staff to include the sub-component "efficiency of revenue mobilization."** Debt, by definition, needs to be repaid, and without sufficient revenue this is not possible.

3. We welcome the annual stock-tacking exercise and its communication to the Board. We think, however, that ad-hoc reconsideration on a case-by-case basis should be weighed against the cost incurred by the Fund. While we see merit in keeping the thresholds unchanged from one year to the next, we think there should be a new assessment every three to five years to better reflect relative country performance.

4. As to donor incentives, if the most advanced LICs prefer concessionality requirements to be made more flexible they should then expect more non-concessional loans. The recipient and donor countries should deal with this in a responsible manner with increased transparency to address cross-subsidization issues and to guarantee long-term fiscal sustainability.

Debt Sustainability Framework

5. The DSF remains a key instrument to guide macro-economic policies towards sustainability as manifested in the significant increase of its use. Now, when many developing countries are facing severe financing gaps leading to increased debt, it is questionable whether making the DSF more flexible and mitigating some of its pro-cyclical bias in the short run would be beneficial. In the medium to long run, this could well lead once more to excessive accumulation of debt by LICs.

6. The link of the **investment-growth nexu**s is worth exploring. However, we think that, first, IMF resources should better be targeted at more central elements of the resource-intensive DSF and leave other international organizations (e.g., World Bank) to contribute to this debate. Second, deficits and borrowing do not per se reflect productive investment, and past experience even with debt-financed public investments is not overly encouraging. Further, staff mentions five factors influencing the benefits from debt-financed investment, but the analysis fails to account for the inclusion of maintenance costs, which can be significant. Finally, we continue to think that the base scenario in most countries' DSF relies on GDP growth assumptions that are too optimistic. Staff's analysis over 2004-2008 shows tentative evidence that growth was underpredicted, but this period was one of exceptional global growth. A different picture might emerge out of an analysis over a longer time period.

7. On remittances, we agree with staff's proposals. In particular, we think it is important that remittances be taken into account in countries where they play a meaningful role. We also support the recommendation not to alter the thresholds. We wonder, however, whether remittances truly tend to be counter-cyclical. Staff’s comments are welcome.

8. The use of CPIA scores is appropriate in the DSF. We take the point that a modification in a country score close to a boundary of policy performance category can lead to a significant change in the applicable debt distress thresholds. Thus, we agree with the added flexibility of **the policy-dependent thresholds as proposed in Option 1.**

9. We also support keeping the rule regarding the discount rate and to adjust its value in the new DSAs. For countries that have a relatively developed financial markets and a relevant part of non-concessional debt, an interest rate yield curve might be used to derive the PV instead of a constant discount rate. *Could the staff comment?*

10. The current definition of state-owned enterprise (SOE) debt is both widely used and adequate. We are not in favor of excluding the debt of those SOEs that can borrow without a public guarantee. We would like to hear from staff of concrete examples where SOEs that borrowed without public guarantee were allowed to default or went bankrupt without public support. In the same manner, we do not support the exclusion of SOEs whose operations pose a limited fiscal risk for the government. Indeed, even if the fiscal risk is limited, such costs might add up, push a country over the thresholds and generate negative debt dynamics.

11. We support the proposal to better reflect the authorities' views but we would propose **a clear separation between the staff's assessment provided in DSAs in the current format and the authorities' assessment provided in their memorandum of economic and financial policies.** The Board needs a clear understanding of the staff's independent assessment and calculations.

12. Since DSAs are critical to the IMF's contribution to economic policy formulation in LICs, updates should be conducted regularly. Especially, in the current global circumstances, it would be unwise to move to a three-year updating cycle. We indeed have noted large changes in country DSAs conducted over a three year span and propose therefore to **streamline DSAs on a two-year cycle.**