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**Statement by Mr. He and Ms. Lin 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**
**August 31, 2009**

One of the most significant challenges facing the LICs is to meet their development objectives while maintaining a sustainable debt position. Lack of adequate financing has persistently stood in the way of the LICs to enhance growth and reduce poverty. In this context, we share the concern that the Fund's Debt Sustainability Framework (DSF) and the debt limit imposed on the LICs, if not refined appropriately, would continue to unduly constrain the ability of the LICs to finance their development goals, particularly given the shortfall of highly-concessional resources.

We welcome the increased flexibility embedded in the matrix of concessionality options in response to the changing financing landscape and the diverse and still-evolving needs of the LIC members, and the refinement of the DSF in line with its experience. However, indicators and thresholds presented in the operational guidance should not be used as rigid yardsticks, but as indicative guideposts. When assigning the ratings, a delicate balance needs to be struck between a mechanical use of classification and a judgmental approach based on each individual country circumstance.

While quantitative indicators could serve as a good starting point in defining a country's capacity to manage public resources, the proposed rating system, including the selection of sub-CPIA and PEFA indicators and the establishment of threshold, needs further consideration.

- First, the measurement of the LICs' capacity to manage macroeconomic and public financial management should factor in growth performance and potential, rather than narrowly focusing on policy, institution, as well as budgetary management, as reflected in sub-CPIA and PEFA indicators. In fact, no other indicator is more robust than economic growth to gauge one country's stewardship in managing its macroeconomic development and its debt repayment ability. A possible proxy for this could be average growth rate over the past several years or growth potential over the medium term.

- Second, the threshold used to identify higher capacity should be set at a reasonable level. We note that the staff intends to use 75 percentile of the PRGF-eligible countries in terms of sub-CPIA and PEFA scores in order to match the mean of IDA "Blend" countries. We are concerned that an overly stringent benchmark could adversely affect the classification of LICs in terms of their capacity, and hence reduce the number of countries that should have deserved lenient concessionality requirements.
- Third, the inclusion of PEFA in the methodology for assessing LICs' capacity might risk overburdening the LICs with limited resources. As indicated in the paper, this framework was newly established and its data on a number of PRGF-eligible countries are not yet available. The use of PEFA as a guidepost would compel these members to undertake this assessment—an additional burden for LICs.

Turning to DSF, we welcome the staff's recognition of the need to pursue a multipronged approach to improve the analysis of the public investment and growth nexus underpinning DSAs and make this research operational and incorporated in DSAs as much as possible. In light of China's development experience, we have long believed that debt-financed public investment can generate growth and therefore adequate revenues needed to repay the debt even in the case of reverse-concessionality (including tax incentives for FDI) and bring enormous positive externalities, including by improving investment environment, creating employment, facilitating productive factors flows, and importing advanced managerial skills. The linkage between public investment and growth should be further explored in order to improve the Bank-Fund analysis in debt sustainability.

We agree with staff that other analytical and operational issues of the DSF need to be revisited in light of its accumulated experience and recent development of global economy.

- To ease the "threshold effect" of current operational rules of the DSF, we can go along with Option 1 aimed at introducing greater inertia in the policy-dependent debt thresholds as this option is not only effective, but easy to communicate with member countries and donors.
- We support adjusting the discount rate to 4 percent in new DSAs based on the current rule. However, given the huge uncertainties in the market interest rate movement, we hope that the rule-based approach could be refined, where appropriate, to limit the movements in PVs that do not properly reflect LICs' debt burden.
- To further enhance members' scope to borrow, we endorse excluding from the PPG external debt in DSAs the debt of those SOEs that can borrow without a public guarantee and whose operations pose a limited fiscal risk for the government.
- It is also desirable to streamline the DSAs so as to free up resources for more urgent and critical work, including improving the quality of DSAs.