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Statement by Mr. Bakker and Mr. Friedmann 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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1. The proposal for the new Guidelines on Debt-Limits in Fund-Supported Programs and the proposal to update the Guidance Note on Applying the DSF translate well into practice the IMFC and G-20 leaders' request to review the flexibility of the Debt Sustainability Framework and enhance the flexibility within the DSF in Fund-supported programs. Hence, we broadly support the proposals and add the following comments.

Debt Limits in Fund-Supported Programs – Proposed New Guidelines

2. As we expressed in the March 2009 discussion, the large diversity in LICs' economic performance supports the decision to move to a framework that uses macroeconomic and public financial management capacity dimensions when deciding on countries' concessionality requirements. Given the scarce datasets that cover the entire LICs group, we find staff's two-step approach for dividing countries into two groups along the 'capacity' dimension very well-designed . We see merit in using both the sub-CPIA and the PEFA indices as a first step, since these indices carry a wide range of information on many aspects of countries' macroeconomic and financial management capacity. In the second step, we would prefer that focus will be put on assessing the 'capacity' of countries in the 'gray zone', while countries would be removed from the 'high capacity' classification to 'low capacity' or vice versa only in extreme cases.

3. We agree with staff that donors' concerns regarding possible cross-subsidization when the concessional requirements are stated on 'average borrowings' should be mitigated by the fact that such requirements are assigned only to countries within the 'high capacity' group. We should assume and be confident that countries with higher macroeconomic and financial management capacity use the flexibility afforded to them by the average concessionality requirement to route capital resources, both concessional and non-concessional, to projects according to availability and need. After all, the idea behind the 'average concessionality' requirement is to allow more flexibility for the authorities in raising capital, thereby increasing the countries' capital raising options. In that sense, non-concessional borrowing

should not be seen as cross-subsidized by concessional borrowing.

Review of Some Aspects of the Low-Income Country Debt Sustainability Framework

4. We agree that a reconsideration of aspects in the Debt Sustainability Framework is timely and support staff's recommendations for modifications in the framework.

5. Staff's comprehensive analysis on the public investment and growth nexus shows the difficulty in embedding this nexus analytically into the DSF. Indeed, it is true that increasing public debt to invest in the economy formally gets the same treatment as increasing debt for public consumption, and hence we agree that DSAs should report in more details the staff efforts to analyze the investment-growth nexus. However, this weak point in the DSF is overcome in two ways: a) by staff having different growth assumptions for different structures of public expenditure; and, b) by having different debt thresholds for different policy and institutional capacity. Thus, we believe that the fact that the public investment and growth nexus is not fully embedded in the DSF is not a major drawback of the framework.

6. Globalization, and, in particular, cross-border labor mobility, have made remittances (and also dividends) an important component in the balance of payments, especially in less developed countries. We realize that the lack of adequate data on remittances does not allow for re-estimation of the DSF thresholds and for formally taking into account remittances in the DSF. However, as remittances enhance a country's capacity to repay its debt and because it is agreed that, theoretically, remittances should be part of the DSF, we would suggest including the country's level of remittances in every DSA write-up, highlighting the relative importance of the remittances in the economy.

7. In our view, institutional framing should encompass all explicit and implicit public and publicly guaranteed debt with recourse to the budget. We however agree that a certain flexibility is warranted, and would value an objective operational guideline within which well-founded decisions can be made.

8. Staff recommends streamlining the DSAs by having full DSAs done only every three years and having annual updates in between two full DSAs. However, in our view, less rigorous DSAs could only be justifiable for countries with relatively low risk of debt distress. We would also suggest not implementing this recommendation before 2011. At the current juncture, as fiscal deficits and public debts are skyrocketing, full DSAs should serve as a tool to assess the amount of fiscal space a country has.

9. We see merits in better reflecting the authorities' views in the DSAs. Apart from receiving broad and more reliable data from the authorities and perhaps improving the underlining assumptions for the DSAs, asking for the authorities' views will likely make them more involved in the DSA process and, perhaps, increase the authorities' willingness to improve their DSA assessment.