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Statement by Mr. Guzmán, Mr. Gramajo-Marroquin, and Mr. Jiménez 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

We thank staff for the proposal on new guidelines for debt limits in Fund-Supported Programs, which we consider as a solid basis for discussion.

As we stated in our gray in March, we regard the debt sustainability framework (DSF) as an extremely useful tool in assessing debt vulnerabilities. Moreover, like other directors, we believe this framework already entailed a certain degree of flexibility and room for maneuver for LICs, and it was useful as long as applied on a case-by-case basis. In view of the usefulness and flexibility of the established praxis, we advised against drastic changes and suggested to explore further if the proposed policy modifications set appropriate incentives for member countries.

In particular, we were concerned in March that the proposed measures could imply a rigid categorization of countries. Thus, we were in favor of maintaining an element of judgment in any statement on the institutional capacity of countries and, provided that this was recognized, DSAs had proven very helpful overtime.

Nevertheless, for the sake of consensus, we may support a different approach to add flexibility to debt criteria, including the introduction of a concessionality options matrix as suggested by staff. It should be noticed, however, that under this option the DSF might require further improvements. Otherwise, the mechanism risks being too strict or even blindfolded. As Mr. Rutayisire suggested in his gray, it may be required to account for progress achieved by member countries –e.g. track records of sound policy implementation and key macroeconomic and structural reforms—and not only base judgments on a mechanical use of indicators, as this may impose too strict borrowing limits and hinder the authorities' ability to implement pro-growth policies.

In other words, we support a balance between a rules-based framework and a case-by-case approach. Moreover, we consider that, from a forward-looking perspective, the new guidelines must not indefinitely confine a country in a given category. The system should contemplate incentives to improve their overall debt conditions and management capacity. We would ultimately expect that guidelines are to be applied with flexibility whenever an external debt performance criterion is established, as it is indicated in paragraph 8.a. Finally, we think that periodic guidelines reviews would be useful.

Also, regarding the issues for discussion related to the review of the DSF (SM/09/216), we are in favor of a revision in order to enhance its flexibility, provide a better assessment of debt-related vulnerabilities, and avoid unnecessarily constraining the ability of LICs to finance their developing goals, including the revision of a potential element of 'procyclicallity' in the framework.

It is reasonable that some variables related to public investment be taken into account when analyzing debt sustainability (as generally it is being done nowadays), but it is necessary to avoid being too optimistic on the impact of public investment on growth, as it may lead to new episodes of unsustainable debt. More research by the Fund and the WB is required in this regard. On the other hand, we fully support the inclusion of remittances in debt analyses when they may have a significant impact on debt sustainability. Regarding the external debt of state-owned enterprises, we believe that this is a complex issue, but we do not support the exclusion as it is always a state's responsibility not to let a public enterprise go bankrupt. Having said this, additional improvements to the framework may be necessary in the future.

Regarding the assessment considerations and the two-step approach proposed in the new guidelines (SM/09/215), we agree that there are many available and useful indicators to evaluate a members' specific capacity in the field of management of public resources. In fact, the list is extremely long, which raises our concern on how the staff plans to use all available indicators and on the weights to be assigned to each one of them for a proper, relevant assessment. Of particular concern is the uniformity of treatment among countries and the potential for a degree of arbitrariness. Nevertheless, the two-step approach suggested seems quite sensible to us.

We want to reiterate our March view that the World Bank's CPIA is a useful indicator in this regard –at least some of its components—given its relevance and coverage. Therefore, we see the 'sub-CPIA', together with the PEFA, as appropriate for assessing capacity. However, it would be desirable to have both indicators for all LICs or most of them, so that we do not abuse the gray area for lack of information. *We would like to hear from the staff what would be required in order to make both indicators available to all LICs and how long that endeavor may take?*

We can agree with the definition of “external” debt according to the currency of denomination criterion or the basis of the residency. However, this should closely follow the guidelines (in particular, paragraph 2) and allow for a reasonable degree of flexibility, given the fact that in some cases the use of one or the other can overstimate/understimate the weight of the foreign debt.

On the frequency of the assessment of capacity for program countries, we in principle agree with the annual assessment, although we would appreciate further explanation by staff on the advantages of doing these assessment that often. On the other hand, we totally agree on the individual reclassifications in between periods, on a case-by-case basis, if necessary.

The changes in the policy will very likely have implications on the provision of concessional financing by donors. We are particularly concerned by a potential perception of cross-subsidization among donors which may deter concessional lending. Nevertheless, we favor a close examination of the results of its implementation. A permanent dialogue with donors on the relevant issues may be extremely helpful.
We agree with a delayed effectiveness date for the decision, as it is proposed. In addition, we are of the view that implementation should be gradual and a thorough revision of the impact should be conducted within two years.

Finally, we want to make clear that, as the Supplement 1 states, no member should be subject to more stringent requirements under the revised guidelines than under the current framework, leaving room for more flexibility in cases where debt sustainability is not a serious concern.