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Statement by Mr. Mozhin and Ms. Shabunina 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 a very comprehensive analysis of the new debt limits and a thoughtful review of the debt sustainability framework. We share the view that the unduly rigid constraints for the LICs' financing bear the risk of holding back their development prospects. At same time, we strongly believe that any changes in the existing framework should ensure that the new financing opportunities are used by the countries properly and do not lead to the accumulation of unsustainable debt.

At the time of the previous discussion we were critical regarding the proposed changes to the concessionality requirements for the LICs in Fund-supported programs and many of our earlier concerns still stand. We would like to underscore that we are not against the flexible approach to nonconcessional debt limits for the LICs per se. Our major concern is that the proposed framework can create a false sense of security stemming from the seemingly more rules-based approach and the resulting presumption of objectivity.

Therefore, we would like to caution against overestimating the level of objectivity of the new approach. Specifically, we note that the comprehensive methodology for measuring macroeconomic and public finance management capacity presented in the report relies on the CPIA ratings that are created on the basis of judgment of World Bank staff. Moreover, the aggregation of rating components to the sub-CPIA index naturally entails substantial loss of information. The assessment of debt vulnerability, though much less judgmental, is also sensitive to background assumptions.

It is true that the existing "single design for concessionality requirements" was criticized for a large number of waivers and exceptions arising due to country-specific circumstances. However, given the diversity of situations faced by the LICs, we feel that the new framework will not eliminate the need for exceptions when setting the debt limits.

Having said that, we recognize that, in order to comply with the principle of uniformity of treatment, our decisions on the degree of concessionality can not be entirely based on a case-by-case approach and that some system of quantitative metrics is needed. Therefore, we go along with the proposed matrix of concessionality options.

On operational issues, we would appreciate it if staff could clarify how breaking the debt limits will affect a country's classification within the matrix and what the respective implications from new conditionality would be.

We thank staff for a very informative analysis of the debt sustainability framework, which is addressing all the major points of earlier criticism. We agree with staff's conclusions on most of the issues.

- On the effect of public investment on growth in the DSA projections, we believe that additional information in the report on staff's derivation of the growth assumptions would be beneficial. However, considering the inconclusive results of the related academic research and the lack of a well-established formal approach, we do not think that a formal model should be incorporated in the DSA framework at this juncture.

- On remittances, we share the view, that given the current problems with data quality and availability, the best solution is to introduce more flexibility into accounting for remittances in the DSA projections for the countries where their share is high.

- On the threshold effect, we support the introduction of higher inertia to the reclassification of countries versus increasing the number of country classes in the DSF. The existing three-cluster DSF framework has proved to be successful among donors and country officials and increasing its granularity could adversely affect its usage.

- On the discount rate rule, we share staff's conclusion that the benefits of sticking to the rule outweigh the possible disadvantages.

- On the external debt of SOEs, a great caution should be exercised when defining which companies pose only limited fiscal risk to the sovereign balance sheet.

- On the streamlining, we would like to ask staff to specify how the "absence of the major changes in the debt sustainability outlook" will be determined. Overall, given that the current crisis is not yet over, we would prefer to postpone the discussion on streamlining until the next review.