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Statement by Mr. Nogueira Batista and Mrs. Joseph 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

1. We thank staff for the set of papers and appreciate the work involved to bring this issue to the Board since the last discussion in March 2009.

2. We acknowledge that external financing is critical to the development process of member countries and more so to low-income countries (LICs). In many instances, it is the only way that LICs can finance infrastructural projects that require large funding and are essential for sustainable economic growth. The execution of these projects is frequently constrained by institutional and absorptive capacity, limited access to financial markets, and varying levels of debt vulnerabilities. According to staff, financing sources - international financial institutions and donors - that are available to this category of members have relied increasingly on the debt sustainability framework (DSF) and debt sustainability analyses (DSAs). It is extremely important therefore that the overhaul of the DSF and DSA reflect increased flexibility not only on paper but also in operation.

Review of Some Aspects of the LIC Debt Sustainability Framework

3. We support the inclusion of the growth-investment nexus in DSAs. We acknowledge the difficulties involved in evaluating this relationship, an issue that was discussed by the Board in 2006. Many factors affect the transmission channels between investment and growth, according to staff's assessment of recent empirical literature. These include governance, the type of public projects and the quality of public financial management. Consequently, Directors' recommendation that a country specific approach be used is useful and should be pursued. In 2006, this chair supported the need for a country-by-country analysis of this issue as it relates to debt sustainability and we continue to do so. We believe that the authorities' views should be given due weight, particularly where the country is assessed to have a higher macroeconomic and public financial management capacity.

4. We see merit in the formal inclusion of remittances in order to increase the flexibility

of the DSF and DSA. Staffs note that while flexibility exists in the current framework to consider remittances, it has seldom been used. They also acknowledge that workers' remittances have become an increasingly important (non-debt creating) source of external resources for LICs. Studies have also found that these flows are also less volatile than official aid flows, FDI and exports. Moreover, they appear to be an enduring phenomenon. Staffs cite lack of adequate data as a major limitation to a re-estimation of the thresholds to include remittance, as the necessary historical data from 1970-2002 covering 132 countries may not be available. While this may be a current impediment to the inclusion of remittances, we urge staff to pursue work in this area. In the meantime, where remittances are large, we suggest that they be given due consideration, sufficient to influence countries' risk ratings, particularly as the framework is moving toward greater flexibility and the use of a country-specific approach. Under this new scenario, we are mindful that declines in remittance flows, as has recently occurred in some LICs, would also affect a country's risk rating.

5. Staffs indicate that "a few members are likely at risk of seeing their debt distress risk ratings deteriorate." Staffs' simulations suggest that only five members rated as being at moderate risk of debt distress would experience small and temporary breaches of their respective thresholds. Moreover, no member appears to be at risk of having their ratings move from low to moderate. In light of the above, we can agree to the continued use of the present rule on the discount rate.

6. The exclusion of state enterprise debt from DSAs should increase the overall flexibility of the latter. This exclusion seems reasonable. When incurring debt, a state-owned enterprise (SOE) and the project for which the funds are to be used would have been subject to a rigorous evaluation on the part of those providing the financing. The specific considerations, outlined by staffs to guide assessments of SOEs, whose operations pose limited fiscal risk, would be based partly on judgment, an element that we would prefer to minimize. In addition, these considerations must be judged against some benchmarks, which are not mentioned in the report.

7. Staffs admit that DSAs are highly resource-intensive. We agree that they can be streamlined in the manner recommended by staff. In the same vein, we urge the continued training of members in the methodologies underpinning the DSFs and DSAs, so that they can effectively participate in the setting, and evaluate the validity of risk ratings, which are so critical for access to external financing.

Debt Limits in Fund-Supported Programs - Proposed New Guidelines

8. We reiterate the view made in our statement in March that as a rule, no LIC in a Fund-supported program should be subject to more stringent debt limits under the proposed reform than they are currently. In March, we gave broad support to the concessionality options matrix with some reservations. We had expressed concern about imposing nominal limits on concessional borrowing and we note that this proposal has been removed.

9. We had also expressed some uncertainty about the appropriateness of setting debt

limits in present value (PV) terms. Staff had pointed out that the implementation and monitoring of a PV target are more demanding and the PV of debt is more sensitive to the timing of projected disbursements. Staff suggests that both options – using disbursements or contracting – are available. It is not clear on what basis the choice between these options would be made.

10. We can go along with staff's proposal for a two-step approach to assessing higher-capacity countries. Objective criteria using quantitative indicators with broad coverage of LICs should minimize the level of judgment and improve uniformity of treatment.

11. We agree with staff that there should be a review of these decisions in two years, especially to evaluate their impact on LICs' access to concessional and nonconcessional financing. This review is especially important as the new guidelines represent a significant departure from the current guidelines.