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GRAY/09/3375

August 31, 2009

Statement by Mr. Geadah and Ms. Choueiri 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 a well-thought out set of papers on introducing greater flexibility in debt limits and concessionality requirements, given the diverse characteristics of low-income countries (LICs) and the substantial changes in their financing in recent years. We also thank the staffs of the Fund and the Bank for reviewing the debt sustainability framework (DSF) with a view to render it more flexible, given the DSF's importance in the proposed approach. We are in broad agreement with the staff proposals and will confine our remarks to a few key issues.

Debt Limits in Fund-Supported Programs

2. Many LICs have strengthened their macroeconomic management and reduced their debts burdens, and have managed to broaden the sources of official financing in recent years. Nonetheless, many LICs continue to have fragile debt situations, while their development and financing needs remain large, which have been complicated by the current global crisis. Recourse to external concessional resources, including grants, remains important for these countries. It is therefore imperative that the proposed new guidelines avoid creating the impression that less donor concessional financing is needed. The Fund should emphasize this message in its external communication of the new guidelines. Staff rightly indicate that the new approach to concessionality should not be perceived as an invitation for donors to reduce their concessional financing, *and we would welcome their views on possible safeguards in this regard*. We support the call for close attention to the quality and intensity of the dialogue with donors and look forward to regular updates on donor concessional financing as the new guidelines are implemented.

3. Fund policies on external financing and debt have played an important role in preventing the build-up of unsustainable debts in LICs, while allowing for needed external

financing. While the current policy has allowed for the flexible implementation of external debt limits, we agree with staff that there is scope to ensure more systematic and consistent implementation of this flexibility (as reflected in the March 2009 discussion) by establishing debt limits on the basis of members' debt vulnerabilities and macroeconomic and financial management capacity. The proposed guidelines for debt limits in Fund-supported programs would provide room to all LICs, except the most vulnerable, to pursue more flexible borrowing strategies. The systematic link to debt sustainability analyses (DSAs) provides added analytical strength to the new framework.

4. With regards to the proposed two-step approach to measure capacity, the suggested use of sub-Country Policy and Institutional Assessment (CPIA) and Public Expenditure and Financial Accountability (PEFA) indices to carry out a preliminary identification of higher-capacity countries seems sensible given the indicators' relevance and relatively broad coverage. However, the second step involving the use of all relevant information, including qualitative assessment, to refine the assessment of capacity, entails a subjective element. Accordingly, we welcome the intention to conduct an annual stock-taking exercise to assess the need for changes in the classification based on new information, including evidence provided by the authorities.

5. Our preference is to review of the experience with the new approach after one year of implementation given the number of conceptual and technical innovations embedded in the approach.

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

6. The debt sustainability framework remains a key instrument in allowing LICs to conduct pro-growth policies without re-building unsustainable debt levels. We agree with the proposal to recognize adequately the impact of public investment on growth, and we support enhancing the Bank-Fund investment-growth analyses that underpin the debt sustainability analyses.

7. It also makes sense for the debt sustainability framework to take into account remittances, particularly when these are relatively large in comparison to exports or GDP. Given data limitations in this regard, there is useful scope for Fund involvement in strengthening statistics on remittances.

8. The paper indicates that with the present set of thresholds, small changes in the CPIA score may entail large changes in the threshold levels for some countries, with possible implications for ratings. We therefore support staff's proposal in Option 1 to increase the inertia in the changes in policy-dependent debt thresholds relative to changes in countries' CPIA scores.

9. We agree with maintaining the current rule for setting the discount rate, and join Mr.

Al-Azzaz in calling for a better understanding of the links between the recent decline in dollar-based interest rates and the risk of debt distress in LICs.

10. We also agree that the external debt of state-owned enterprises that can borrow without a public guarantee and whose operations pose limited fiscal risk for the government be excluded from public and publicly guaranteed external debt for the purpose of the debt sustainability analyses.

11. We support the proposal to streamline debt sustainability analyses.