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Concluding Remarks by the Chairman
Debt Sustainability Analysis and Analytical Aspects of
the Debt Problems of Heavily Indebted Poor Countries
Executive Board Meeting 96/13 - February 20, 1996

I will summarize briefly Directors' views and comments on the analysis in the two staff papers, before concluding with some observations on what is implied for the task now ahead of us, which is to develop specific proposals for action.

On the scope and nature of the debt problems of the heavily indebted poor countries, a number of Directors drew attention to the difficulties involved in coming to a firm judgment in this area. They noted that, at a theoretical level, there were several possible reasons to expect high levels of debt to adversely affect economic performance. How important these effects were, however, is difficult to determine and depends on country-specific circumstances. The empirical evidence is inconclusive. Speakers generally emphasized that sound economic management and persistence in implementing reforms were likely to be over-riding factors in determining both long-term economic performance and the ability of countries to service their debts. But it was also generally acknowledged that persistently high levels of debt may intensify the risks that countries face in an uncertain external environment and that may undermine confidence, potentially crowding out private investment and hindering economic growth. Moreover, there was broad recognition in the international community, as embodied in several debt reduction initiatives, including Paris Club procedures, that the opportunity for countries to "exit" from a continuous cycle of reschedulings can reap benefits for debtors and creditors alike.

Directors agreed that the methodology proposed by the staff for assessing debt sustainability was broadly appropriate and helped to clarify some of the key issues. While noting that the use of the indicators and quantitative thresholds inevitably involved important judgmental elements, most Directors believed that these were a useful tool when looked at in conjunction with the range of other factors set out in the staff paper. They broadly agreed with the proposed criteria for judging sustainability and with the list of countries classified as having unsustainable debt burdens. The situation of those countries classified as "possibly stressed" was more difficult to determine and more sensitive to changes in assumptions. Some Directors thought that the number of countries facing unsustainable debt burdens could be larger than that suggested by the staff, and it was agreed that the situation of the "possibly stressed" countries needed to be kept under close review. Some Directors believed that a more rapid improvement in the debt indicators should be required in order to classify a country's debt situation as sustainable. Others observed,

however, that countries that had pursued sound policies had been able to combine strong economic performance with high levels of debt service over periods substantially longer than the five-year horizon used in the analysis.

Several Directors observed that the staff had approached the debt sustainability analysis from a balance of payments perspective. In future work, they encouraged the staff to consider further the fiscal implications, especially the effects of external debt-service payments on government revenue and the structure of public expenditures. This view, however, was not shared by all speakers.

Also on methodology, a number of Directors commented that the scenarios on which the analysis and conclusions were based depended not only on strong and consistent policy implementation, but also on strong private sector responses. In most cases, the projections assume increased investment, buoyant export growth, and rising capital inflows from abroad. Again, however, opinions differed as to the appropriateness of these assumptions. Some suggested that they were excessively optimistic, while others noted that they were not out of line with the experience in those countries that had in fact adhered to adjustment and reform policies.

Notwithstanding these uncertainties, many Directors supported the staff's assessment that, for the majority of the heavily indebted poor countries, sound policies coupled with new concessional financing and debt relief under current mechanisms would be sufficient to achieve debt sustainability in the medium term. It was pointed out that efforts were needed, and some were already underway, to enhance current mechanisms, including the establishment of a self-sustained ESAF, an increase in the provision of official development assistance resources to multilateral institutions and to the poorest countries, more bilateral support under the Paris Club, and greater efforts on the part of non-Paris Club official bilateral creditors.

At the same time, however, it was recognized that for a number of highly indebted poor countries the burden of debt was likely to remain above sustainable levels over the medium term, even with strong policies and full use of existing debt relief mechanisms. For these countries it was also recognized that their reform and development efforts may be put at risk by continued high debt and debt-service burdens. There is a broad consensus that this is not a satisfactory situation, and that the Fund, together with the international community, needs to find ways to effectively assure countries with unsustainable debt situations that also help themselves that their efforts will not be undermined by an excessive burden of debt. In that context, some Directors considered that support from the Fund and the World Bank should rely on the Bretton Woods institutions' own resources, while others stressed the need to find a cooperative strategy involving a broader group of creditors.

This discussion suggests that there are six "building blocks" on which there is broad agreement, and on which we can base our future work.

First, we should target overall debt sustainability as an objective, on a case-by-case basis, focusing on the totality of the country's debt, rather than on the debt due to any single creditor group.

Second, we should envisage action only when the debtor has shown, through a track record of reform and sound policies, the ability to put whatever exceptional external support is provided to good use to achieve a sustainable outcome.

Third, we must build, as much as possible, on existing mechanisms, including, in the case of the Fund, through a continuation of ESAF-type operations.

Fourth, for the problem cases, additional action should be coordinated among all creditors involved.

Fifth, any action on relieving the burden of debt owed to multilateral creditors should be consistent with the financial integrity of the institutions, the constraints of their charters, and their preferred creditor status, to ensure that the institutions can continue providing member countries with financing on appropriate terms without being hampered by a special effort for this group of countries.

Sixth, new external finance for these countries should be on appropriately concessional terms, in order to support their efforts to pursue reform and establish a track record of good policies.

During the next few weeks we will have several informal meetings to try to develop from these six "building blocks," in coordination with the World Bank and the multilateral regional development banks, specific proposals for action to address the debt problems of the heavily indebted poor countries..

