*"A crisis is a terrible thing to waste".*

(Grenadian Prime Minister Keith Mitchell to World Bank President Jim Kim during the World BankForum after Hurricanes 2017 )

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**Before the (next) storm**

Debt Relief as a response to Natural Disasters in the Caribbean

**In September 2017 the Caribbean islands of Barbuda and Dominica were hardest hit by hurricanes Irma and Maria. Destruction was enormous and will impact on the islands’ development opportunities for years to come. International support was quick and helpful, but can not make up for the long-term effects, which are likely to last until the same islands and/or their neighbours will be hit by the next catastrophe.**

**Caribbean churches and civil society at large have therefore taken the initiative to call for a crisis response mechanism with the potential to secure the long-term viability of the islands’ economies.**

**This paper presents the economic and political analysis that stands behind the call from Jubilee Caribbean. It takes stock of existing proposals for adequate crisis responses to Caribbean small islands’ fiscal and external sustainability threats after natural disasters, specifically hurricanes. It demonstrates, how a pre-designed debt relief scheme can provide the essential safeguard for both, disaster relief as well as reconstruction.**

**To that end it takes stock of the merits and shortcomings of existing disaster relief proposals, which have been voiced more strongly after Irma and Maria.**

**It broadly outlines the logic and the functioning of a standing debt relief mechanism, which can be agreed upon by potentially affected states, development partners, creditors as well as International Financial Institutions. It discusses the strengths and weaknesses of the scheme from both debtor and creditor perspectives.**

**1.** **Disaster and Destruction in the Caribbean**

The Caribbean region is among the most vulnerable to natural disasters, particularly hurricanes, in the world. However, it is very difficult to assess, how much destruction an individual storm has brought to a specific island, and even more so to derive meaningful averages over a longer timeframe, as a basis for projections. What can be said, however, is that small states are regularly most affected by disasters in relation to there size and population - simply because a disasters is more likely to affect the whole territory of a nation, once it strikes. People have literally nowhere to flee.

For quite some time, losses through storms have been underestimated because only those, which have actually made landfall were considered in official statistics and because cumulative effects of recurring catastrophes were not taken into account. More recently, however, some analysts have tried to assemble all effects into a comprehensive stock-taking effort, including those of storms that have not made landfall but still have caused considerable destruction, and non-storm disasters such as heavy rainfall with subsequent flooding as well as earthquakes. Acevedo[[1]](#footnote-1), moreover, has added estimations of the consequences of various climate change scenarios. The results are staggering and go beyond what have so far been common perceptions of losses.

We are using Acevedo’s calculations in this paper, because the common under-estimation of the effects of hurricanes coincides with the equally common negligence of those cumulative effects, which the withholding of timely and sufficient debt relief traditionally has had on indebted sovereigns. World Bank and IMF as the masters and commanders of international sovereign debt relief efforts look back to a history of repeated over-estimation of countries’ future capacities to carry debt. As a consequence they have failed to reduce relative debt burdens.[[2]](#footnote-2) This notorious over-optimism has led to the serial restructurings, which have been the trademark of Paris Club debt rescheduling through the 1990s and early 2000s, before HIPC/MDRI provided at least the poorest countries with the necessary deep cuts into their unsustainable debt burdens.

**Box 1: Estimating different types of losses**

The effects of a natural disaster on the long-term economic viability of a nation depend on two parameters: (1) its extent, measured in economic losses related to a country's GNI, and (2) its frequency. From both parameters derive the actual losses, which every island statistically has to face.

These losses of economic output are like a headwind, against which a cyclist has to ride, demanding more efforts and calories burned for a given speed and distance, without rewarding him in any way for that additional efforts - like cyclists have it, when they fight their way uphill and in exchange can enjoy an effortless high speed downhill passage thereafter.

Average GNI losses as calculated by Acevedo are no perfect measure for assessing the medium-term consequences for a country's economic development, as they do not differentiate between losses to the productive capacities, which will have immediate and long-term decreasing effects on growth and losses to consumer goods and housing, which may be large in amounts, but can eventually be repaired provisionally with no other costs than the immediate damage in absolute terms.

Additionally there should be some assessment of the growth enhancing effects, which reconstruction efforts - particularly when externally financed through grants and/or concessional loans - can actually have.

Despite these shortcomings the average loss calculations by Acevedo appear like the most realistic assessments of economic disaster consequences we actually have and with those necessary reservations, can guide us to assess the need for remedies through debt relief.

Taken together, the under-estimations of natural disasters' destructive potential and the depressing consequences of unsustainable debt burdens, has put countries into what we can call a "debt trap": a situation were governments borrow in order to close budget gaps caused by the last natural disaster without being able to reduce debt burdens sufficiently before the next disaster strikes. The starting point of the proposal outlined here is therefore the attempt to not again err on the wrong - but, if in doubt, rather on the more generous - side. Acevedo’s calculations are helpful to that end.

Disasters and hurricanes combined have in any country in the Eastern Caribbean[[3]](#footnote-3) caused damages of 5.7 per cent of GDP every year on average. Worse still, this indicator is expected to rise to 6.5% in a »no climate change« scenario and to 7.1% and 7.7% in the “mean” and “high” climate change« scenarios, respectively.[[4]](#footnote-4) However, variations in loss probability are very large, with Antigua and Barbuda (8.4 % historical / 12.9% with high climate change) in the high range, Dominica (15.0% / 23.8%) in the extreme range, and St. Vincent and the Grenadines and Barbados clearly below average (see table ).

Still for our discussion whether and, if so, how, debt relief can be an appropriate answer to the kind of catastrophes suffered by the region, it needs to be recalled that we are not seeing constant outflows of resources like the averages may suggest, but occasional life-taking and extremely destructive episodes in one year, which may be followed by a longer or shorter period during which an individual island is being spared from major destruction at all. Therefore it is important to look at the intervals in which hurricanes cause major damage, even if the averages have already factored in the frequency.

On average all Caribbean countries are hit by a hurricane in less than ten years.[[5]](#footnote-5) Regarding the OECS+1 countries the individual probability of a hurricane striking looks a follows:

**A tropical storm or hurricane strikes every**

St. Lucia < 6 years

Dominica < 7 years

Antigua & Barbuda < 7 years

St. Vincent & Grenadines < 8 years

St. Kitts & Nevis <10 years

Barbados <10 years

Grenada <11 years

Dominica has suffered its share of disastrous storms for statistical 15 years in 2015 with tropical storm “Erica”, (destroyed an estimated 90% of GDP) and hurricane “Maria” 2017 (estimation 220% of GDP). Can it realistically expect to be spared for (at least) the next 11 years? Unfortunately not. Given that the growth reducing effects of "Erica" and "Maria" are to be felt even beyond the next eleven years, Dominica is facing an accumulation of negative growth shock effects - without any chance to escape from this specific form of a debt trap.

Estimations about the losses from each disaster in terms of GNI loss vary across different analyses - and necessarily so, because in the immediate aftermath of the event serious calculations of private and public property losses necessarily meet with almost insurmountable technical and logistical problems.

Given the fact that we are talking about highly vulnerable economies, which tend to have been deep in debt before the storm struck, we therefore need to build strategies on the farthest reaching assessments, which take the broadest possible range of negative effects into consideration.

Different from the standard EM-DAT database, which registers confirmed damages after on-the-ground survey missions, Acevedo uses a different approach: He constructs a damage level from wind speed and other meteorological factors of any storm passing an island in 60 miles distance or less. The logic behind this approach is to avoid missing damages, which could not in time be verified in the difficult

circumstances immediately after a disaster.

Additionally, he has not only considered destructions of hurricanes which have made landfall, but all which have affected the islands directly or indirectly plus non-storm related disasters such as heavy rains and floodings as well as earthquakes.[[6]](#footnote-6) The result is an assessment of drastically higher annual GDP losses though disasters.[[7]](#footnote-7)

While the weighted average, which is large, driven by the relative heavyweights Cuba, Dominican Republic, Jamaica and Trinidad seem to indicate less vulnerability, the results for individual small islands in the Eastern Caribbean are outright frightening: Dominica, Grenada, Montserrat and St.Kitt & Nevis stand out with double-digit losses every year.

For our considerations it is important to note that the hurricanes fall on land into nations, which are already deep in debt. All OECS members plus Barbados, which we analyse here, have debts above the indicative threshold for Caribbean debt sustainability of 55% (see below): Still the immediate quantitative problem of Caribbean debt post- or pre-hurricane is not what needs to drive any crisis resolution. It's rather the character of the debt as a trap with no exit. Historically, Trinidad & Tobago has been the only country in the Caribbean, which has managed to substantially reduce its external debt burden without any form of debt restructuring.[[8]](#footnote-8)

This refers to a situation, where there is no immediate link between loan-taking and investment, but the former largely serves to plug holes in the sovereign’s current fiscal or external balance. Once this effect has crossed a certain threshold of indebtedness, it becomes a virtual trap. This effect is not different for a sovereign from what it constitutes for an Indian small peasant or a family business in the south of Germany. As a general rule there is no escape from this trap other than declaring insolvency and heading for a fresh start after debt relief.

But at which debt level does the trap actually snap?

Based on empirical studies in the Caribbean Amo-Yatey et alia[[9]](#footnote-9) have identified a Caribbean debt threshold, past which debt merely serves to refinance existing debt service, without much of an opportunity to leave the trap unless there is a serious debt reduction:

According to their calculations, public debt shows a decreasing marginal growth effect beyond a debt/GNI ratio of 30% and is actually causing the economy to shrink beyond 55%.

As we have seen above, any of the OECS members as well as Barbados has a debt-to-GNI ratio clearly above the 55% threshold. This means that even absent regular new external shocks, countries would find it extremely difficult to return to a sustainable growth path under their present debt burdens.

It should be noted that the indicative target empirically defined for the Caribbean is not unique for this kind of vulnerable economies. It is in fact not too far away from the debt limit, which the European Union has defined for their highly developed members or those established for the Low Income Developing Countries which are strong performers regarding their governance and economic structure by the Wold Bank and the IMF.

**2. Existing options for disaster relief: useful but not sufficient**

Disaster Relief Financing is needed for both, immediate emergency relief and medium-term reconstruction. These two purposes are not identical and may require different financing instruments.

Emergency relief, of course, needs to cover the immediate rescue and survival operations, without which lives may be lost and long-term negative effects may be much larger than actually unavoidable. This kind of relief should normally come in the form of grants, and be it for no other reason than that this help will be needed within hours and with absolutely no time to negotiate anything like payment terms.

Aid to reconstruction is different from this. In middle income countries like those of the Caribbean it normally comes in the form of loans. Therefore it needs to take the actual fiscal and balance-of-payment situation of the affected country into account and design support in a way, which balances the maximum present support with a minimal negative impact on debt sustainability and hence long-term development. Existing foreign and domestic debt of the country as well as medium-term sustainability including with additional reconstruction loans is a key parameter in that regard.

In the last chapter we have seen the debt-growth-nexus, which Amo-Yartey et alia have conservatively calculated for Caribbean islands: Given the threat of a permanent debt trap, the authors have tried to provide a more realistic picture of what a sustainable debt can be in the Caribbean context. They have focussed on the need to provide fiscal space in the face of recurring natural disasters and the character of the islands as small and less diversified economies. The "natural debt limits" which they subsequently compare individually with each island's 2011 debt indicators, demonstrate the extreme over-indebtedness. At the same time it provides an indication of what amount of debt relief would be necessary in the case of a renewed external shock, if islands were to receive a comparable chance for a fresh start as - say - the Heavily Indebted Poor Countries through the 1996-2005 HIPC/MDRI debt relief initiative, which eliminated up to 90% of existing debt stocks.



In conclusion it shows that the co-incidence of existing high debt levels and an annually recurring threat of extraordinary destruction requires an even more ambitious approach than may be needed in other vulnerable and even in poorer environments.

We hold that given the huge discrepancies between the existing debts and the “natural debt limits” such a cautious approach can not be implemented through restraint in external financing, because this would actually lead to a halting of badly needed external support.

Rather it is suggested to provide for an ex-post safety net that allows the vulnerable debtor country to restructure loans, which have been provided to overcome a catastrophic situation and/or kick-start the economy, but through a more recent external shock have been transformed into an obstacle to economic revival.

We shall outline in chapter (3) below how such a re-transformation can actually be achieved with the help of a debt relief mechanism. This mechanism, in turn, needs to be fair and transparent in order to function at all and to meet with the necessary acceptance on the creditor side.

Before outlining the key elements of such a mechanism, we shall take a look at relief instruments, which are either being discussed or already implemented at present.

How do development partners respond to emergency situations? And which are the strengths and weaknesses of each individual instrument?[[10]](#footnote-10)

Option 1: Emergency Relief

The mobilisation of resources for immediate relief (often with a blurred distinction to the needs of mid-term reconstruction) is what normally comes after a "Maria"-like disaster. Depending on media presence, political or social importance of the affected country and the visibility of the catastrophe, bigger or smaller amounts of money can be mobilised this way.

However, given the remote location of the Caribbean islands and the limited public awareness to their fates, amounts tend to be small in the region. In a September 2018 stock-taking draft paper[[11]](#footnote-11) the OECD-DAC found that out of the relief requests for Haiti, Cuba and victims of hurricane Irma between 38% and 73% remained unmet. In the case Irma immediate disaster relief covered 0.4% or the estimated damages.

Option 2: Private or semi-public insurances

In times of a general "private-before-public" prevalence, private insurance schemes are a logical instrument to be considered. However, given the high degree of vulnerability and the huge relative amounts of destruction, commercial insurances have for long not been considered as an appropriate option. Swiss Re has recently tried to market a private scheme; however their strategy of flattening payment profiles over a longer timeframe risks to become obsolete, if climate change indeed raises the frequency of hurricanes, as Dominica seems to have experienced in 2015/7.[[12]](#footnote-12) The establishment of a valid private-sector insurance scheme would require a broader than regional coverage, as hurricane and earthquake risks are normally regionally clustered, which will make an evening-up of affected and non-affected countries difficult. As Avinash Persaud, special adviser on economic recovery post-Hurricane Maria to Dominica put it: *Climate change cannot be addressed by private insurance. Insurance worksbest, when risk is uncorrelated, diversified ad random and you can spread the risk over timeand acreoss disasters. But what does climate change tell us? That disasters are of increasing intensity and of rsing correlation."[[13]](#footnote-13)*

As a consequence of the likely impossibility to design a private market-based insurance scheme for states, the World Bank has established the Caribbean Catastrophe Risk Insurance Facility (CCRIF) with the support of some major donors in 2007. The CCRIF is available to all Caribbean and Central American countries regardless of their income status. Pay-outs are made quickly after a disaster, as they are based on an independent statement regarding the severity of the disaster and not on the basis of actual losses. However, absent huge increases in subsidies, amounts tend to be small in relation to the losses, which need to be covered. Dominica after hurricane Erica received a US-$ 2.3m pay-out from the CCRIF, which was certainly useful, but does not come anywhere near the financing needs for bringing the country back to a pre-crisis stage. After the extreme 2017 hurricane season pay-outs to the region amounted to the following:

Antigua & Barbuda US-$ 6.8m

Anguilla US-$ 6.5m

St.Kitts & Nevis US-$ 2.8m

Dominica US-$ 19.3m

The strength of the CCRIF is clearly the speed of disbursements. Amounts, however, shall remain limited, due to the limited capital held by the CCRIF (just above US-$ 100m). Despite the severe hurricane seasons in 2015 and 2017 the pay-ins to the CCRIF have been more than double the amounts of the pay-outs.[[14]](#footnote-14) This makes the CCRIF not look like a resource-efficient instrument with regard to a medium term recovery of affected countries - at least not as long as not more public resources are mobilised in order to make the facility more cost-effective - which would in some way undermine its character as a traditional insurance and bring it closer to emergency relief.

Option 3: Access to emergency loans from multilateral sources

The World Bank has special contingent disaster financing instruments for middle-income, i.e. IBRD-eligible and IDA-eligible countries. The former have so far not been used by any of the Caribbean islands and would - at a LIBOR+0,5% rate - probably have severed the debt situation if they had ever been drawn upon. The "Catastrophe Deferred Drawdown Option(CAT DDO) would through lending at IDA rates have avoided that danger, but have so far not been used by Caribbean middle income nations qualifying under the small island exemption.[[15]](#footnote-15)

The Caribbean Development Bank offers up to US-$ 0.2m as emergency relief grants and up to US-$ 0.75m as immediate repose loans to each of its members.

The IMF has two facilities for members in emergency situations, the Rapid Financing Instrument (RFI) for all members and the Rapid Credit Facility (RCF) for Low-Income Countries; both provide quick disbursing capital post-crises, but only the latter does so at concessional conditions. Out of the OECS+1 countries Dominica, Grenada, St.Lucia and St. Vincent and the Grenadines qualified for the RCF under the small island exception. In Antigua & Barbuda, Barbados, St. Kitts & Nevis new post-disasters loans from the RFI would therefore necessarily add to an already tense debt situation of the country in question – moreover with additional multilateral debt, which, if needed, will be the most difficult category to restructure.

From 2011 to 2016 amounts received through the RCF have been limited, namely:

Dominica US-$ 2m

St.Lucia US-$ 2m

St.Vincent & the Grenadines US-$ 9m

On the side of the World Bank the same four countries are eligible for IDA financing under the small islands exception. Dominica received broad support from IDA[[16]](#footnote-16), namely US-$ 65m for reconstruction and US-$ 50m grants from IDA's crisis response window.[[17]](#footnote-17)

There is, however, an additional ethical argument against any insurance solution to disaster risk. As the contribution of the affected islands to climate change is actually negligible, expecting them to insure themselves, amounts to making the victims pay for a damage caused by someone else.

Option 4: "Catastrophe Bonds"

A so far untested innovative option is the issuing of "Catastrophe Bonds". For this instrument the nominal value, the coupon or the repayment period vary with the economic success of the issuer. “Success” is normally understood to equal GNI growth. In the case of a natural disaster the payment obligations could be reduced either as a function of a GNI reduction, which at a certain level, would automatically trigger the reduction or extension of payment obligations, or such a reduction could be decreed by a competent international body even before a GNI-effect can be technically determined.

This form of state-contingent liabilities can be a strong anti-cyclical instrument and contribute to the alleviation of the payment burden.[[18]](#footnote-18) Private issuers have known the instrument before as a form of risk-hedging. However no sovereign catastrophe bonds have been issued so far.

The IMF has put state contingent debt instruments (SCDIs) of this kind at the centre of its crisis response efforts ahead of a small states conference in November 2018, and also the OECD hails the merits of counter-cyclical loans as an option to inject additional liquidity in the case of a disaster: As part of a broader risk management approach, counter-cyclical loans featuring a moratorium period following the triggering of an index linked to a disaster can provide a far more valuable injection of liquidity than ex-post-contribution.Thesame, is, of course, also true for a debt restructuring exercise, which we shall discuss in the next chapter.

Option 5: Building Fiscal buffers

As an additional option the IMF discusses the building up of fiscal buffers for countries under possible stress from natural disasters. This would serve as a kind of self-insurance through substantial savings. While at first sight, putting money aside for a rainy (in fact: a stormy) day seems just logic and reasonable, it shows again, like in the case of the insurance options discussed above, that there is a huge mismatch between the scale of buffers which could actually make a difference in case of a hurricane and the amounts which already critically indebted countries would be able to set aside regular, giving their historical growth performance. In the case of Dominica the IMF found in April 2017 - i.e. between the hurricanes Erica and Maria - that the overall prospects of the island to set aside the calculated necessary amount of 1.5% of GNI out of the CBI inflows are bleak. The CBI[[19]](#footnote-19) inflows, as one of the few substantial external inflows are volatile themselves and potentially subject to sudden stops.[[20]](#footnote-20) As IMF[[21]](#footnote-21) (2019, p.54) put it: *Realistically most of the ECCU economies themselves are unlikely to generate significant fiscal space that would be sufficient for building the recommended resilient public investment and insurance buffers, given the already significant adjustment efforts, that are assumed in the scenarios.*

Beyond their quantitative inadequacy, fiscal buffers would mean that resources would have to be invested in a most liquid way, in order to be available overnight, if necessary. And they would have to be detached from the real economy of the country itself, in order to not become affected by the same catastrophe against which it is meant to provide a safety-net. This means that a poor and vulnerable country would have to provide investment capital for safer places, rather than using its own resources in order to boost domestic growth.

Option 6: Existing debt relief schemes

In principle an indebted sovereign can seek a restructuring of its unsustainable external debt from his bilateral creditors, once the debt situation has become critical due to a natural disaster. The Paris Club of official creditors, the London Club of private banks and a debt exchange offer to sovereign bond holders would be the instruments for each bilateral creditor group respectively.

None of these fora and instruments is known for providing a rapid solution, however. Arrangements with bilateral private or official creditors normally take their time. Particularly sobering has been Dominica’s recent experience with the Paris Club after hurricane Erica in August 2015: At first the country had tried to cope with the situation by its own resources. In November 2015 it became clear that these would not be sufficient to restore growth and economic viability. Consequently the government asked the Paris Club secretariat for support. Given that France and Britain were the only Club members with (modest) claims on Dominica, the secretariat told the government to negotiate directly with its creditors. The French and British governments (the former also acts as Club secretariat) then told Dominica that no bilateral agreement would be possible without a previous Paris Club arrangement. End-2016 Dominica then heard from the French treasury that the Club was unable to provide any relief without an IMF program in place. At that time Dominica did indeed have an on-going RCF program, which implied both disbursements and (limited) conditionality. However, this was not considered to be sufficient and ultimately no relief from either of the two creditors was provided.

These Caribbean experiences mirror those of other debtors in the global south, which through the last three decades have time and again found access to timely and sufficient relief blocked by their creditors' arbitrary decisions in fora, which were designed and run by those same creditors.

Interestingly, in the past a very specific form of debt relief has been made possible in order to help poor countries overcome specific external shocks. This option related to the most hard-nosed debt category in any sovereign's portfolio, namely debt owed to the IMF.After the Ebola Crisis in West Africa the IMF was quick in contributing to the financing of the fight against the pandemic by re-financing current debt service of affected countries to the Fund out of its own resources. This allowed the scheduled debt service to be used for additional public health efforts. The Catastrophe Containment and Relief Trust (CCRT) was the specially created instrument for that purpose. While its actual functioning in West Africa was quite close to what we are suggesting in the next chapter, it failed to become a comprehensive global instrument, reliably available to countries under special threat of disasters: When shortly after the setting up of the CCRT Nepal suffered from a devastating earthquake wih more than 8000 dead, the Fund's technicians found that the overall economic damage was below the accessibility thresholds. No further efforts by other disaster-hit nations have been made to turn IMF debt service into a local crisis response.[[22]](#footnote-22)

Finally, debt-for-nature-swaps have been amply discussed with a special focus on the ex-ante financing of disaster resilience. Transforming regular debt service into the financing of disaster mitigation is in fact the right place for this instrument. It can indeed be an effective instrument for development financing, including through a mild debt relief effect. However, debt conversions are certainly no instrument to either provide immediate post-disaster liquidity nor for restoring medium-term debt sustainability. For the former they are too complex to negotiate in any short time-frame. For the latter they are by definition too small, because development financiers undertake them normally tailored to the projects that are to be financed and not to the debtor's sustainability.[[23]](#footnote-23)

The sobering CCRT experience illustrates, why a post-catastrophe debt relief scheme for critically indebted sovereigns needs to be designed in a way that allows for an impartial assessment of the debtor's situation and an impartial decision making, too. We shall come to this after a brief look at the merits of debt relief as a disaster response in general.

**4. Debt Relief as a crisis response: the dimensions and the logic**

If existing support instruments turn out to be either insufficient as a disaster response or risk to plunge recipient countries deeper into debt, we need to look for an additional alternative in order to hedge the risks which Caribbean small islands undergo because of natural disasters. We suggest to externalize a substantial part of the risk through an option for a catastrophe-triggered debt relief scheme.

Debt relief has the potential to provide immediate access to resources, which are already in the hands of the authorities and thus do not have to be mobilised through lengthy pledging exercises. Resources will normally have been earmarked for debt service in the national budgets. And they would be mobilised for emergency relief and reconstruction only in cases of obvious and undeniable need. That way the scheduled debt service would assume the role of the "fiscal buffer" discussed above.

Such a scheme would imply two debt relief operations, which would respond to two dimensions of the crisis: namely

* a **moratorium** which would make any resource schedules to flow from the government to external creditors immediately available for emergency relief and
* a pre-designed **framework for restructuring** the entire stock of existing public external debt in a way which provides enough fiscal space for medium-term reconstruction under the premise that the country should not find itself in another debt distress situation when confronting the next natural disaster within the statistically averaged timeframe.

How would it work?

A stylized process beginning on day 1 after a hurricane and involving both dimensions would consist of the following sequence of steps:

1. A country affected by a hurricane requests debtor protection from a pre-defined competent institution.
2. An assessment based on available information leads to a preliminary moratorium if warranted in a very short timeframe of between two days and one week.
3. A period (normally 6 months) is being defined during which no debt service is being paid and no legal action against the debtor can be taken.
4. A creditor committee is set-up during the 6 months period, which will start negotiations on a medium-term debt restructuring.
5. Negotiations with representatives of all creditors are chaired by an impartial mediator and lead if necessary to a restructuring agreement with all creditors.

Obviously a key element for the functioning of the scheme is the neutral and competent institution that would have the capacity to declare a moratorium and lead a restructuring process. There is more than one option, who could actually fulfil this role:

* An existing intergovernmental institution with competence in assessing hurricane damages and/or managing debt
* A newly created body, which is created for this particular purpose.

It is essential that the institution must not be unduly dependent on any of the potential beneficiaries of the scheme. Neither must it be a creditor to them. Given these two prerequisites, options could include

* a small group of experts based at the Eastern Caribbean Central Bank (ECCB) but at arm’s length from its decision making bodies;
* a leadership group of UN bodies in a distant place like New York or Geneva with the resources and information access to quickly gather all relevant information and release a decision within less than 24 hours after a hurricane strikes.

Regarding procedure, the scheme foresees that an independent body confirms that the conditions for an immediate moratorium are met. The technically competent body affirms that a predefined threshold — e.g. for hurricane damages — has been breached, which would then automatically trigger the moratorium and provide the legal, political and technical basis for the subsequent debt relief process; its calibration, however, would still have to be the result of a due debt sustainability analysis.[[24]](#footnote-24)

Linked to the assessment, *whether* debt relief is necessary is then the definition of the *amount* of debt relief. This again needs to be done by an institution that is entirely independent of the debtor/beneficiary and any of its creditors. This can be the »Debt Workout Institution« described in the UNCTAD Roadmap and Guide to Sovereign Debt Workout[[25]](#footnote-25), or any other body, agreed upon by the parties. Particularly in the case of a regionally defined initiative, it may also be a regional institution provided that extra-regional parties trust in its impartiality and independence.

What would be the dimensions of resources, which could be mobilized through the scheme?

If we talk about halting countries debt relief and making the outflows in the short term in their entirety available for emergency relief and in the medium term partially for reconstruction, what are the amounts, we are talking about? Debt service payments by the OECS members in the fiscal years 2015 and 2016 were:[[26]](#footnote-26)

|  |  |  |
| --- | --- | --- |
| **Country**  | **2015 [US-$]** | **2016 [US-$]** |
| **Dominica** | **23.269.000** | **26.772.000** |
| **Grenada** | **27.599.000** | **34.950.000** |
| **St. Vincent and the Grenadines** | **33.549.000** | **32.036.000** |
| **St. Lucia** | **68.342.000** | **42.226.000** |
| **Antigua & Barbuda** | ***30.000.000*** | ***30.000.000*** |

At first sight, these figures are not dimensions above the amounts mobilised f.i. through the CCRT as discussed above. However, we are talking about annual outflows, which could make annual two-digit million amounts available over a multi-year timeframe, if necessary.

Still, beyond the quantitative aspects, there are some additional advantages of halting debt service over the mobilisation of fresh money:

* We are talking about resources that are already in the country. The authorities could use them without having first to consult with anybody. They could be spent in line with the country’s own relief and development priorities without any external interference.
* The amounts are perfectly calculable; planning for an emergency budget under the difficult circumstances of day 1 after a hurricane would be possible. The same can not be said about even officially pledged support from development partners, which in the past have sometimes been inflated by the inclusion of already pledged resources or the deviation to non-priority areas, which could damage long-term development perspectives.
* The amounts could be used without any risk-buffer deductions because they would be offset by payments otherwise made to external creditors; no contingency calculations in order to deal with potential technical or political delays in pay-outs from donors or foreign exchange conversion risks are necessary.
* The amounts could not be tainted with the often substantial discrepancies between pledges at donor conferences and actual disbursements which have been notorious for the international donor community, particularly when natural disasters had a high degree of media visibility but were kicked off the screens by the next disaster elsewhere in a short timeframe.

**5. Would such a debt relief scheme be feasible – technically and politically?**

A scheme like the one proposed above would not be innovation from scratch. Most of the elements, which constitute it, have in one or another way already been applied in sovereign debt management and/or disaster relief:

* **Hurricanes have already been considered as reasons for reduced debt payments.** Private and official creditors have been including "hurricane clauses" into their debt rescheduling agreements with individual debtors; notably have private bondholders and the government of Taiwan (the single most important bilateral creditor of the time) done so in their agreements with Grenada in 2015. Both clauses have allowed for moratoria and subsequent concessional reschedulings in the case of future hurricanes.[[27]](#footnote-27)
* **Capital markets are able to deal with contingent risks.** Sovereign bonds with contingency clauses, such as coupons indexed to the issuer’s GDP have been marketed through the last years.[[28]](#footnote-28) While still marginal in quantitative terms, they show that risk sharing does not automatically lead to market exclusion.
* **Debt moratoria have been used to (co-) finance disaster relief and first-phase reconstruction.** After the 2004 Indian Ocean tsunami the Paris Club itself has suggested moratoria for Sri Lanka and Indonesia and implemented them even against reluctance on the Indonesian side – without any of the negative consequences feared for by the Indonesian authorities and their creditors, such as impaired access to capital markets, ever materializing.
* **Even for creditors moratoria and orderly debt restructuring often provide better results than disorderly defaults.** This important lesson from debt relief history[[29]](#footnote-29) contradicts creditors who tend to insist on continued debt service payments even in situations of obvious bankruptcy; while individual unscrupulous creditors may be successful in securing larger repayments, for the majority of creditors a messy default resulted in smaller redemption rates than an orderly process with a perspective to restore the debtors sustainability in the medium term.
* **Targeted debt relief has already been implemented for groups of countries in special need.** The IMF/WB's Heavily Indebted Poor Countries' (HIPC) initiative has demonstrated that far reaching debt relief for countries in a specific debt distress situation can be possible on a broad basis. While far from perfect in its design and implementation, the HIPC/MDRI initiatives have provided most of the beneficiaries with a fair chance for a fresh start. In our context the most important aspect of HIPC has been that it was possible to design a scheme for a limited number of countries, while a global consensus for a generalized debt relief option for sovereigns at large was clearly out of reach.
* **Legal protection under a multilateral but not universally accepted scheme can be formally or informally organised.** The World Bank, the IMF and the African Development Bank have created several instruments to assure compliance of HIPC arrangements, even when they were formally in no legal position to impose anything on any non-co-operative creditor. From moral suasion through offers of debt buy-backs to the creation of the AfDB's legal support facility. It also needs to be recalled that in reality it is costly for a non-co-operative creditor to enforce payments - and the more so, the broader the international consensus for a multilateral debt relief agreement is. On a more formal basis, three European jurisdictions - Belgium, France and the UK - have limited the enforceability of loans held by vulture funds. These legislations could serve as models for immunizing a disaster-hit country's assets from seizure.

Box **Could the IMF make itself useful by endorsing a debt restructuring in post-catastrophe SIDS?**

While debt restructurings generally can be unilateral or multilateral in character, an agreed-upon arrangement between all the parties has obviously the highest potential to spare the debtor form any disruptive litigation. As the normality in sovereign debt restructurings lies somewhere between the two extremes "unilaterally declared and enforced" and "multilaterally agreed among all stakeholders", there is a relevant challenge to make an agreement between the debtor and a sub-group of creditors binding on everybody. In our context we assume that a Caribbean nation has unilaterally declared a moratorium after substantial destruction through a category 5 hurricane and that a subsequent restructuring with all but one of its multilateral creditors, about half of its official bilateral creditors and none of its private creditors has been reached. What role could the IMF play in endorsing such an agreement?

There are three possible ways to endorse - two already existing ones and one that would require internal reforms in the IMF itself.

1. **The IMF can indirectly exert pressure on creditors by conditioning its own rescue (and bailout) financing on participation of other creditors in a restructuring.** IMF funding of a debtor's fresh start greatly enhances the possibility that old creditors recover a larger share of their existing claims. This provides an incentive to comply with (normally un-rivalled) IMF calculations about a necessary haircut. This is an entirely informal mechanism, which builds exclusively on economic incentives.
2. **The IMF's Articles of Agreement explicitly allow for restrictions on hard-currency outflows.[[30]](#footnote-30)** This instrument is intended to support outflow restrictions in the face of liquidity shortages, not the resolution of solvency problems. However, there is no reason why an IMF-endorsed outflow restriction could not be used to immunize the debtor against litigation from creditors, which have been subjected to a comprehensive debt restructuring. Capital controls have been a key element in the successful crisis strategy in Iceland.
3. **The IMF could create the option to make a debt restructuring binding on all its members on the basis of its own Articles of Agreement.** Once this option has been established as an amendment to the Fund's Articles of Agreement, it would either directly become enforceable law in all member countries, or it would trigger the relevant domestic law reforms. Three-fifth of IMF members (presently 183 countries) representing at least eighty-five per cent of voting powers are necessary for any amendment to the AoA. This option was the legal cornerstone of the Fund's proposal for a Sovereign debt Workout Mechanism in 2001-2003, which was abandoned, when the US government of the time rejected the SDRM as an option altogether.

Annex:

**STATEMENT FROM JUBILEE CARIBBEAN**

**A Call to the Governments of the Caribbean and the International Financial Institutions ahead of the next hurricane season: establish debt relief as an instrument for emergency support and reconstruction**

The 2017 hurricane season has been one of the most devastating in the history of the Caribbean. In the most affected of the Eastern Caribbean islands, Barbuda and Dominica, we have seen lives lost and destruction totalling more than twice the annual GDP.

All research points to the fact that the growing severity of hurricanes in the Caribbean is related to man-made climate change. This means that we in the Caribbean, like some other nations elsewhere in the global south, are least responsible for but most affected by climate change. The few dozen small Island States across the world, for example, have neither the size nor developmental history to have been major contributors to current climate change. Yet these small Island States are the most easily devastated by rising seas and harsher storms. Our brothers and sisters who inhabit these places are in peril, through no fault of their own.

Still, our nations are not only exposed to adverse weather phenomena. Moreover, we are small Island States with small and less diversified economies that have little capacity to withstand external shocks, with which poor but larger nations may be able to cope. This has been one of the reasons that we have never been able to sustainably escape from our debt traps. However, our external debt can be turned into an instrument of efficient support in the event of future catastrophes, if there is a proper mechanism to allow for moratoria and serious debt restructuring.

As Churches in the Caribbean we have witnessed the grief and despair of our people last September, and we are not prepared to enter the next hurricane season without at least being able to tell them that our authorities shall be able to use scarce resources for immediate relief and mid-term reconstruction rather than debt service.

We therefore call upon all those who bear responsibility for responding to any crisis in the next hurricane season and beyond:

* **Our own heads of State and Government** must unite and collectively demand the creation of an efficient debt relief option ahead of the next hurricane season through all available means, including the United Nations System and the Bretton Woods Institutions.
* **The IMF** must use its rule-setting power to endorse a full debt moratorium once a hurricane or any other serious disaster brings destruction beyond a pre-defined level and make sure that a serious debt restructuring of all external commitments shall be possible under due consideration of our peoples' human rights.
* The **ECCB** and the **CDB** must act as supporters of a comprehensive debt restructuring process once it is needed.

**We as Churches and broader Civil Society in the Caribbean** commit ourselves to support our authorities in their efforts towards global justice in every possible way, including through global advocacy with the help of the international community.

Debt relief has been provided before to countries in need, e.g., through the *Heavily Indebted Poor Countries Initiative* (HIPCI) under WB/IMF leadership or the IMF's *Catastrophe Containment and Relief Trust* (CCRT) after the Ebola crisis in West Africa. Through these initiatives, beneficiaries have been given the opportunity of a fresh start and found a way out of their debt traps. There is no reason why our people in the Caribbean, in contrast, should have to slide deeper and deeper into their debt traps after each hurricane season.

We urgently need a tailored *Heavily Indebted Caribbean Countries Initiative*, which will combine immediate relief and an efficient form of debt restructuring. We do not want to face the next hurricane season without a proper mechanism for relief in place.

*05 March 2018*

1. S. Acevedo (2016): Gone with the Wind: Estimating Hurricane Climate Change Costs in the Caribbean. IMF Working Paper WP/16/199 [↑](#footnote-ref-1)
2. See most recently: IMF: Macroeconomic Developments in Low Income Developing Countries; March 2018, pt. 76 [↑](#footnote-ref-2)
3. In this paper we look specifically at the Eastern Caribbean region. Unless stated otherwise data refer to six sovereign OECS members (Antigua & Barbuda, Dominica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Grenada) plus Barbados. [↑](#footnote-ref-3)
4. S. Acevedo (2016): Gone with the Wind: Estimating Hurricane Climate Change Costs in the Caribbean. IMF Working Paper WP/16/199: 24. [↑](#footnote-ref-4)
5. Moody’s Investor Service: Caribbean Sovereigns: The Silent Debt Crisis; Feb.2nd 2016, p.9. [↑](#footnote-ref-5)
6. It needs to be noted that the Caribbean / Central American region is on average experiencing between 4 and 10 earthquakes per day. In the last 365 days it were 3322 with the strongest one having a strength of 7.6 on the Richter scale. The vast majority are, fortunately, un-dramatic and moreover the majority on the central American Isthmus and not affecting the small islands in the Eastern Caribbean. However, Acevedo has shown that a major earthquake like the one in Haiti in 2010 is possible any time. [↑](#footnote-ref-6)
7. Acevedo op.cit. p.19 [↑](#footnote-ref-7)
8. Munevar, D.: Climate Chance and Debt Sustainability in the Caribbean: Trouble in Paradise; UNCTAD Geneva November 2018 [↑](#footnote-ref-8)
9. Amo-Yartey,Ch., M.Narita, G.P. Nicholls, J.C.Okwuokei, A.Peter, T. Turner-Jones: The Challenge of Fiscal Consolidation and Debt Reduction in the Caribbean; IMF WP 12/276 [↑](#footnote-ref-9)
10. Additionally to the instruments discusses here the IMF also considers financing through Citizenship by Investment programmes as a relevant financing instrument. However CBI programs are volatile and may quickly be halted altogether by political decisions, on which the beneficiary states have not influence. Moreover IMF staff considers them a "missed opportunity", because CBI windfall inflows have nowhere led to a sustained build up of reserves. See: IMF: Eastern Caribbean Currency Union: Selected Issues; December 2018, p.37. CBI is therefore not considered as a relevant instrument here. [↑](#footnote-ref-10)
11. OECD-DAC Working Party on Development Finance Statistics: Financing Mechanisms to Fund Emergency Response and Reconstruction Following Disasters in Recently Graduated High Income Countries; Sept. 13th 2018, pt.80 [↑](#footnote-ref-11)
12. For an overview of the limitations of any private insurance cover see: Kousky,C. and R.Cooke (2012): Explaining the failure to insure catastrophic risks; in: Geneva papers on Risk and Insurance - Issues and Practice Vol. 37, p 206-227; [↑](#footnote-ref-12)
13. Quoted from Jubilee Debt campaign: Don't owe, shouldn't pay; October 2018, p.12 [↑](#footnote-ref-13)
14. Jubilee Debt Campaign: The CCRIF-SPC. forthcoming [↑](#footnote-ref-14)
15. Potential beneficiaries would have been St.Lucia, St. Vincent and the Grenadines, Dominica and Grenada. [↑](#footnote-ref-15)
16. https://www.worldbank.org/en/news/press-release/2018/04/13/world-bank-provides-us65-million-for-dominicas-post-maria-reconstruction The statement is unclear regarding the relationship between the 65m loan and the 50m grant, i.e. whether the 65m include the 50m or not. [↑](#footnote-ref-16)
17. The IDA-CRW does not look very different from the CAT-DDO discussed above. In fact the former's mandate is described as: *Expand financing to promote resilience through crisis preparedness and response, through an enhanced Crisis Response Window, including aligning governance arrangements for responding to economic shocks with the process in place for natural disasters and health emergencies.* The latter's mandate in turn says: *Expand instruments available for crisis preparedness and response, by introducing the Catastrophe Deferred Draw-Down Option (Cat DDO) for IDA countries in response to the demand for contingent financing mechanisms.* IDA-18 overview at http://ida.worldbank.org/financing/replenishments/ida18-overview (last visited on Nov. 5th 2018) [↑](#footnote-ref-17)
18. "Sovereign Cat Bonds can help governments borrow, improve welfare"; Artemis, Feb. 17th 2017 [↑](#footnote-ref-18)
19. Citizenship by Investment - a presently very fashionable approach in the Caribbean region, whereby governments raise funds beyond their normal tax incomes, through marketing their citizenships to rich investors, who are first of all interested in the privileges to enter the EU and the US visa-free rather than in Caribbean sunshine and good rum. Accordingly the IMF regularly warns against the volatile character of such funds - without discouraging countries, however, from using an instrument, which a European immigrations scandal or an angry tweet from the US President could eliminate overnight. [↑](#footnote-ref-19)
20. IMF: Dominica. Staff Report for the 2017 Art.IV Consultation; April 27th 2017; Annex 1 Debt Sustainability Analysis [↑](#footnote-ref-20)
21. IMF: Eastern Caribbean Currency Union: Selected Issues; December 2018, p.37 [↑](#footnote-ref-21)
22. Another problematic aspect of the CCRT for poorer countries is its under-funding; even worse, in order to finance the operations for Ebola-countries, the IMF's MDRI trust fund was emptied, which will endanger the remaining MDRI relief operations for the still outstanding HIPCs and the grandfathered countries, which could eventually still be considered. See: Kaiser,J.: Fragwürdige Großzügigkeit. Der IWF schafft Möglichkeiten zur Entschuldung von Ländern in katastrofischen Situationen; erlassjahr.de Fachinfo 51; Juli 2015 [↑](#footnote-ref-22)
23. The latest proposal to use debt-for-development conversion as an instrument for disaster mitigation and prevention has been made by the UN Economic Commission for Latin America and the Caribbean. See: ECLAC: Proposal on debt for climate adaptation swaps: A strategy for growth and economic transformation of Caribbean economies; Basseterre April 21st. 2016 [↑](#footnote-ref-23)
24. Such an assessment could also have important legal implications, because damages through *force majeure* events—such as hurricanes—are among the few factors that could trigger the *rebus sic stantibus* clause in loan contracts. See: M. Goldmann (2016): Putting Your Faith in Good Faith: A Principled Strategy for Smoother Sovereign debt Workouts, in: *The Yale Journal of International Law* *Online* Vol. 41 (2): 134; available at: https://campuspress.yale.edu/yjil/files/2016/10/H-Goldmann-Special-Edition-1zxbg5i.pdf (last accessed on 21.03.2017). [↑](#footnote-ref-24)
25. UNCTAD: Roadmap and Guide for Sovereign Debt Workout; Geneva 2015; section III.2.2. [↑](#footnote-ref-25)
26. World Bank: International Debt Statistics 2018; as Antigua and Barbuda is not reporting to the World Bank’s debtor reporting system, annual debt service there is only estimated. [↑](#footnote-ref-26)
27. A different "hurricane clause" has also been part of the 2015 agreement of Grenada with the Paris Club, This clause, however, does not say anything, except that Grenada could renegotiate after a next hurricane with the Club - which it could have done any way. [↑](#footnote-ref-27)
28. For instance they were included as one particularly attractive instrument during the Argentinian debt swap of 2005. More recently the Bank of England and the European Commission have been vocal in (more or less cautiously) propagating such "state-contingent instruments". See: Bank of England Workshop on GDP-linked Bonds: Making it happen; London Monday Nov. 30th 2015; and: Carnot,N. and S. Pamiet Sumner: GDP-Linked Bonds: Some Simulations on EU Countries; European Commission Discussion Paper 073 /December 2017. [↑](#footnote-ref-28)
29. Meyer,J., C.Reinhart, C. Trebesch: Sovereign Bonds since Waterloo; forthcoming, second preliminary draft on file with author. [↑](#footnote-ref-29)
30. Art. VI, Sec. 1, 3 [↑](#footnote-ref-30)