High Level Advocacy Mission

A Time to Act: addressing Commonwealth Small States' financing and debt challenges

The Commonwealth

The Commonwealth

Background Paper

High-Level Advocacy Mission

A Time to Act: Addressing Commonwealth Small States' Financing and Debt Challenges

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Abbreviations and Acronyms

African Development Bank	AfDB
Agence Francaise de Developpement	AFrD
Asian Development Bank	ADB
Asian Development Fund	ADF
Caribbean Catastrophe Risk Insurance Facility	CCRIF
Caribbean Development Bank	CDB
Commonwealth Ministerial Debt Sustainability Forum	CMDSF
Central and Eastern European	CEE
Commonwealth Finance Ministers Meeting	CFMM
Collection Action Clauses	CAC(s)
Contingent Credit Facility for Natural Disaster Emergency	CCF
Counter-Cyclical Loan	CCL
Crisis Response Window	CRW
Debt Sustainability Analysis	DSA
Debt Sustainability Framework	DSF
Deferred Drawdown Option	DDO
Development Sustainability Contingent Credit Line	DSL
Development Grant Facility	DGF
Emergency Liquidity Facility	ELF
Human Development Index	HDI
Heavily Indebted Poor Countries	HIPC
Multilateral Debt Relief Initiative	MDRI
Immediate Response Mechanism	IRM
Inter-American Development Bank	IADB
International Development Association	IDA
International Bank for Reconstruction and Development	IBRD
International Finance Institutions	IFI(s)
Low Income Countries	LICs
Middle East and North Africa	MENA
Multi Investment Guarantee Agency	MIGA
Multinational Development Bank	MDB
Nigeria Trust Fund	NTF
Organisation Internationale de la Francophonie	OIF
Organisation for Economic Co-operation and Development	OECD
Official Development Assistance	ODA
Programme for Results Financing	PforR
Poverty Reduction and Growth Trust	PRGT
Regional Development Bank	RDB
Special Development Fund	SDF
Special Drawing Rights	SDR
Trade Finance Initiative	TFI

Executive Summary

Despite the debt restructuring operations undertaken by indebted Commonwealth small states, most continue to face high unsustainable debt burdens. This is particularly evident among the small Caribbean states where average public debt levels for the region amounted to 84.2 percent of GDP at the end of 2012. The existing mechanisms within the current international financial architecture have provided some debt relief but for the most part have only temporarily eased these states debt problems. This is because the debt problems of small middle-income countries have been treated largely as a matter of liquidity, requiring measures only to allay their immediate cash problems, rather than as a matter of solvency requiring more far-reaching measures to tackle the structural problems and inherent fragility that characterizes these countries.

One of the main difficulties faced by international financial institutions is that the debt problems of small states, who are mostly middle income, are related to private rather than official debt. Existing mechanisms, such as Heavily Indebted Poor Countries Initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI), have generally addressed the problems of countries heavily indebted to official creditors. Moreover, they have been confined to low-income countries despite equally unsustainable debt levels among the small middle income group.

Throughout this period of constrained financing, small states have been in need of more favourable access to concessional financial resources, but such requests have failed due to an insistence on eligibility by income classification. Owing to the depressed global economic environment, traditional donors face difficult resource constraints with some grappling with high debt burdens. And while some small states have benefited from the "small island exception", data shows that International Financial Institutions' (IFIs) financing, particularly during the 2007 global economic crisis, has been concentrated in only a select few countries, with financing not directed to the most indebted. Thus, small states have been stuck ~~-~~in a high debt-low growth cycle, which has been compounded by the increasingly high costs of private financing.

IFIs have developed a range of mechanisms to address these concerns but the situation in small states continues to worsen. As such, the Commonwealth Secretariat as mandated by its members, has proposed four policy options in an attempt to stimulate ideas for remedying small states' challenges.

- With small states confronting both high debt and a need for climate financing, the Secretariat proposes debt for climate change swaps as an innovative way of resolving their debt burdens while simultaneously catalysing fast-start financing for climate change.

- Additionally, in line with the rationale for more effective development financing, the Secretariat recommends adding a vulnerability consideration to the criteria for determining small states eligibility to use IFI concessional resources.

- The Commonwealth also proposes a broad application of counter-cyclical loan (CCLs) mechanisms and;

- The replacement of macroeconomic adjustment programmes with resilience building as the main conditionality for IFI lending to small states.

I. Introduction

1. Economic performance in Small states has been poor in the past two decades despite seemingly high levels of GDP per capita. This has been partly due to their size related challenges that have heightened their vulnerability to unexpected and uncontrollable external events. The global financial crisis and other adverse economic and environmental developments were instrumental in highlighting these weaknesses. Across the globe, small states are now some of the most indebted and in addition continue to face serious challenges, including an acute exposure to increased natural disasters, which have the potential to further increase administrative costs and public debt.

2. The situation in small states has become very severe as evidenced by a sharp increase in the frequency of sovereign debt restructurings and an increased probability of sovereign debt default. This has arisen due to the insurmountable liquidity constraints observed across a number of small states that have rendered the usual fiscal adjustment process unfeasible. Small states do not have favourable access to necessary development financing, nor is there an appetite among donors for debt relief, given donors own resource constraints and debt burdens. In fact, official development assistance (ODA) to small states has been on steady decline since the 1990's except in 2009-10 where there was a temporary increase in ODA to these countries, owing to the international financial response to the economic crises.

3. The Commonwealth Secretariat, mandated by its members to assist with the development of strategies to reduce small states' public debt and to improve their access to finance, has been engaged in analysis, research and both Commonwealth and international advocacy on these issues since the outbreak of the global economic crisis in 2007. Commonwealth Heads of Government, as well as Commonwealth Ministers of Finance and Environment have considered and made recommendations to address several financing and development challenges in the Commonwealth's 32 small states. This background paper draws on collective Commonwealth research and analytical material as well as other relevant and recent papers. Based on the research findings, the Commonwealth proposes four options for IFIs consideration and discussion, the main objective of which is to stimulate ideas for resolving small states' most pressing concerns.

4. The Secretariat's proposals have been drafted in consultation with Commonwealth small states' Ministers and with due consideration for IFIs constraints, including possible financial and political challenges. Consideration has also been given to ongoing efforts by IFIs to address these issues, reflected in the development and reform of existing financing mechanisms.

The background paper is organized as follows: sections II and III of the paper provides a brief overview of the characteristics of small states and their macroeconomic performance, while the next section focuses on the most pressing development challenges, comprising:

- High debt burdens, insufficient debt restructuring and the risk of debt default;
- Inadequate access to concessional resources;
- Debt overhangs, persistent weak growth and threats to human development; and
- Structural vulnerability and continuous exposure to external shocks.

Section V discusses the IFI mechanisms available to small states and the important criticisms of and challenges associated with these mechanisms. Finally, section VI outlines four Commonwealth proposals to help address the debt challenges of small states:

- Debt swaps for climate change adaptation and mitigation;
- Vulnerability as a criterion for access to concessional resources;
- Counter-cyclical Loans to mitigate debt accumulation and growth challenges; and
- Resilience building as a policy condition for IFI lending.

II. The Characteristics of Small States

5. **There is no commonly internationally agreed list of Small States but this group is usually defined as countries with populations of 1.5 million or less.** The definition has been recently endorsed by the IMF and World Bank, who in the past have defined Small States as countries with populations of less than 1 million. There are 52 Small States of which 32 are members of the Commonwealth. These Small States can be found in the Caribbean, Pacific, Africa, and Asia and European regions.

6. **In Small States, there are certain special characteristics that underpin their shared development challenges**:

- Small populations that impose diseconomies of scale in the production process and high fixed costs in the provision of public and private services.
- Their remoteness, particularly Pacific islands, which result in disproportionately high transportation costs and hurdles to regional integration;
- Narrow production and export bases that limit diversification and increases the susceptibility of small states to terms of trade shocks;
- A high degree of openness, which makes small states more vulnerable to economic shocks originating from their major trading partners;
- Underdeveloped financial markets which in combination with the above challenges precipitate disproportionate dependence on external aid and debt;
- High environmental vulnerability, including a proneness to natural disasters; and limited institutional capacity underpinned by skill shortages.

Table 1: Commonwealth Small States - Selected Indicators[1]

Country[2]	Geography	Population in millions (2011)	Income Classification	Degree of Openness[3]	Main Exports	Share of Top 3 Exports/Total Exports	Environmental Vulnerability
Africa							
Botswana*	landlocked	2.031	upper middle	0.90	Diamonds	86.43	Resilient
The Gambia*	Mainland	1.776	Low	0.76	Tourism	52.69	Vulnerable
Lesotho*	landlocked	2.194	lower middle	1.53	Diamonds	31.81	Vulnerable
Mauritius	Island	1.286	upper middle	1.20	Tertiary	38.21	Highly Vulnerable
Namibia*	Mainland	2.324	upper middle	0.97	Diamonds	36.4	Resilient
Seychelles	Island	0.086	upper middle	1.45	Tourism and Fishing	81.65	Highly Vulnerable
Swaziland	landlocked	1.068	lower middle	1.41	Sugar/Agri		At Risk
Asia							
Brunei-Darussalam	Mainland	0.406	high	1.10	Oil & Gas		Vulnerable
Maldives	Island	0.32	upper middle	2.14	Fisheries	89.2	Extremely Vulnerable
Caribbean							
Antigua and Barbuda	island	0.089	upper middle	1.05	Tourism	38.2	Vulnerable
The Bahamas	island	0.347	high	1.01	Tourism	58.56	At Risk
Barbados	island	0.273	high	1.00	Tourism	47.49	Extremely Vulnerable
Belize	mainland	0.357	lower middle	1.31	Agri & Fisheries	64.92	At Risk
Dominica	island	0.068	upper middle	0.90	Bananas	59.73	Extremely Vulnerable
Grenada	island	0.105	upper middle	0.74	Nutmeg & Tourism	41.64	Extremely Vulnerable
Guyana	mainland	0.756	lower middle	2.04	Agriculture	59.05	Resilient
Jamaica*	island	2.709	upper middle	0.85	Tourism	55.34	Extremely Vulnerable
St. Kitts and Nevis	island	0.053	upper middle	0.73	Tourism	73.27	Highly Vulnerable
St. Lucia	island	0.176	upper middle	1.14	Tourism	40.49	Extremely Vulnerable
St. Vincent and the Grenadines	island	0.109	upper middle	0.83	Agriculture	48.84	Highly vulnerable
Trinidad and Tobago	island	1.346	high	0.92	Oil & Gas	60.84	Extremely vulnerable
Pacific							
Fiji	island	0.868	lower middle	1.06	Sugar & Tourism	39.92	Highly vulnerable
Kiribati	island	0.101	lower middle	0.86	Fishery	54.65	Extremely Vulnerable
Papua New Guinea*	island	7.031	lower middle	1.03	Mining & Oil Production		At Risk
Samoa	island	0.184	lower middle	0.91	Fishery	74.9	Highly Vulnerable
Solomon Islands	island	0.552	lower middle	0.73	Timber & Fisheries	87.66	Vulnerable
Tonga	island	0.105	lower middle	0.78	Agriculture	47.22	Extremely Vulnerable
Tuvalu	island	0.01	upper middle		Copra & Handicrafts		Extremely Vulnerable
Vanuatu	island	0.245	lower middle	0.95	Agriculture & Eco-Tourism	76.84	Vulnerable
Europe							
Cyprus	island	1.117	high	0.87	Maritime & Tourism	31.71	Vulnerable
Malta	island	0.419	high	1.86	Tourism	64.48	Extremely Vulnerable

[1] Source: Environmental Vulnerability Index developed by United Nations Environmental Programme (UNEP) and the South Pacific Applied GeoScience Commission (SOPAC); World Bank Small State Data Bank; IMF Wold Economic Outlook
[a] No information for Nauru and therefore excluded from table
[b] Public debt data are estimates for 2012
[c] No EVI data for Dominica is available. However, based on its size and location in relation to its comparators, it is considered to be highly environmentally vulnerable.
[d] Share of top 3 exports/total exports from UNCOMM Trade.
[2] Some countries (*) with populations above the 1.5 million threshold are included in the category of small states due to their shared development challenges with other small states.
[3] Measured as total imports plus total exports as a ratio to a country's GDP.

7. According to the World Bank's income classification, which is based on a GDP per capita criterion, the majority of Commonwealth Small States are middle and high income countries. Only the Gambia is classified as a low income country. Across the regions, the Caribbean comprises the region with the majority of upper-middle and high income countries while countries in the Pacific are mostly lower-middle income.

8. As a result of this middle-high income distribution among Small States, the majority of these countries are not eligible for IFI concessional resources or debt relief. This is despite being extremely susceptible to both environmental and economic shocks. There is a small island economy exception available to micro states, which has benefited Dominica, St. Lucia and St. Vincent and the Grenadines but not all small states are aided.[4]

III. Macroeconomic Performance in Small States

9. Small states have managed to attain relatively high levels of income when compared to other developing and developed country counterparts. Since 1980, GDP per capita levels in small states have been above that observed for Developing Asia, Emerging Economies and in Sub-Saharan Africa. The average for small states has been more than twice that for developing Asia, Emerging Economies as well as Sub-Saharan Africa. The only region or group that has had a higher level of GDP per capita, relative to the OECD average, has been Central and Eastern European (CEE) countries (Figure 1).

10. However, small states' GDP growth performance has been progressively declining, pointing to the presence of longer-term structural impediments. On average GDP growth has declined in every single decade since the 1980s. Indeed, by the post 2007 period average per capita GDP growth had reduced from an annual average in 1980 of around 4%, to below 2% per annum. In contrast, average growth in developing Asia during the same period was almost 4 times as large as that for small states and has been rising in each period since, while Emerging Economies, Middle East and North African (MENA) countries as well as Sub-Saharan Africa and CEE countries all had higher rates of GDP growth in the post 2007 period relative to small states.

11. Among small states, the growth performance has been heterogeneous. Commodity exporters and particularly, oil producers have generally out-performed

[4] Mirco States are defined as countries with populations of less than 200,000 people. They include: Kiribati, Maldives, Marshall Islands, Micronesia, Samoa, Tonga, Tuvalu, Vanuatu, Dominica, Grenada, Cape Verde, St. Lucia, and St. Vincent and the Grenadines. Micro States that benefit from the small island economy exception are granted access to World Bank IDA and IMF PRGT resources even if their gross income surpasses GNI eligibility thresholds. This exception was introduced in 1985 to reflect the view that micro states face a range of challenges that are typical of low income countries (LICs) (IMF, March 2013).[4]

those not endowed with natural resources. In addition, the most vulnerable states have scored much lower rates of growth on average, at least when looking at the period between 2000 and 2012.

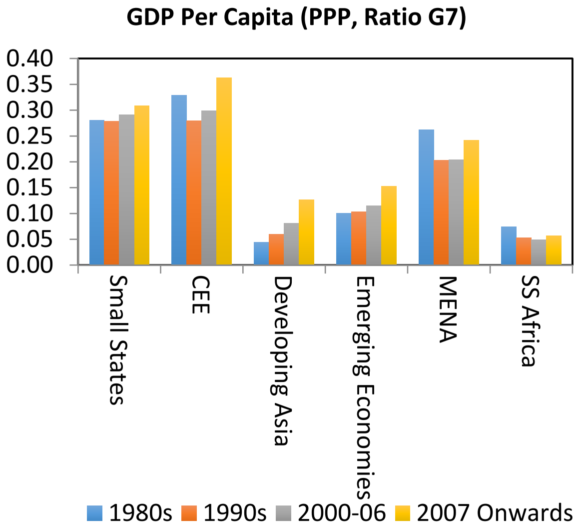
12. When GDP growth is disaggregated by region, the data shows contractions across most small states in 2009, reflecting small states susceptibility to exogenous shocks. The decline in output was deepest in the Caribbean, where average GDP growth was negative by almost 4%, followed by similar declines in Europe and the Asia and Pacific regions. The only region to experience growth in that period was Sub-Saharan Africa but output growth there slowed from above 4% in 2006 to just around 1% in 2009.

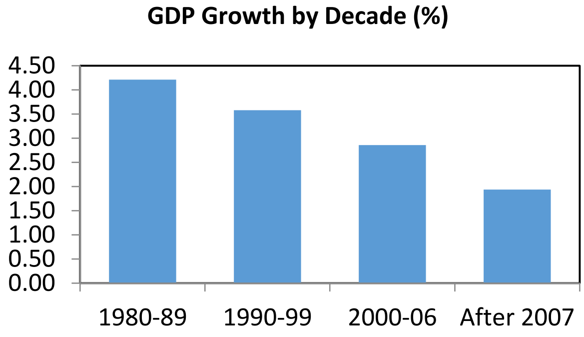
13. In addition to the weak growth trend in the 2000s, output performance has been very volatile. Average volatility in small states has been fairly high, particularly in the Asia and Pacific countries. This observation is consistent with IMF research which found that output volatility significant in small states, particularly in micro states and that volatility in the terms of trade, external demand, fiscal policy pro-cyclicality and small states openness to OECD countries were major determinants (IMF, February 2013). Similarly, growth slowdowns have been frequent. Notably, growth slowed in almost 20 countries in 2012, just 5 less than in 2009.

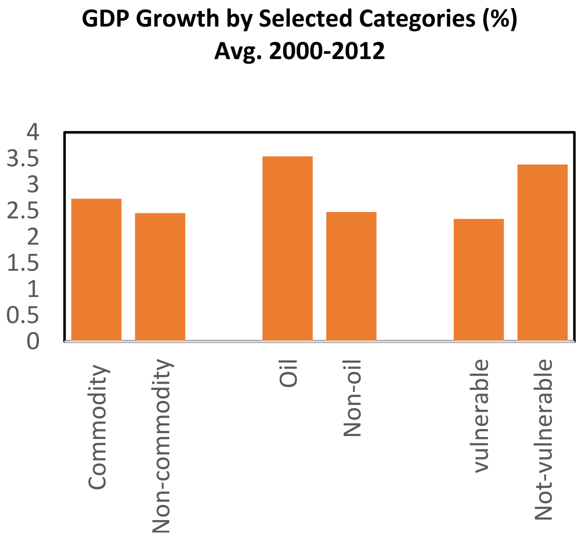
14. Like most developing countries as well as the G7, fiscal deficits in small states have expanded post 2006. In 2006, the average fiscal deficit to GDP ratio for these countries was less than 1%. Since then, however, average fiscal deficits in small states rose to just under 5% of GDP in 2009, about 4.5% in 2010 and 2011 and approximately 2.4% in 2012. The only country grouping that has had a greater deterioration in their fiscal deficit to GDP ratio has been the G7 group of countries, in which the ratio declined to 10% in 2009, and remained above 7% in 2010, 2011 and 2012.

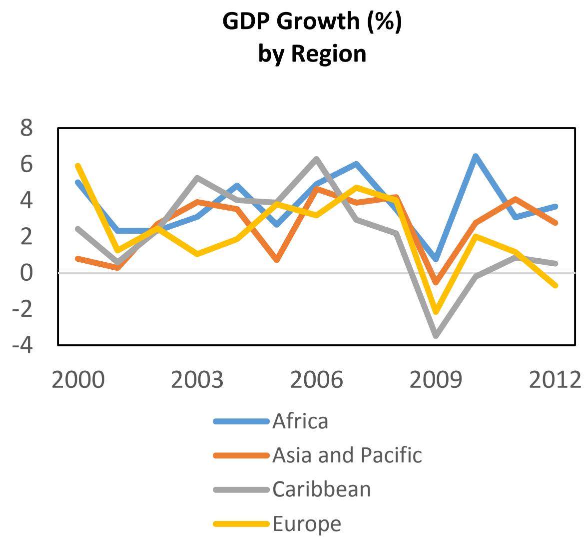
15. In addition to the deterioration in fiscal accounts, most small states also experienced a deterioration in their external current account balance in the post 2007 period. In the 1980s, 1990s as well as the 2000-2006 period, the average current account deficit in small states was approximately 6% of GDP. Since 2007, however, the external current account deficit has declined on average to 11% of GDP, but as high as 30% of GDP in some countries. The deterioration of the external current account balance was a combination of shocks to both the import and export side of the current account. On the import side, many small states have been severely affected by rising petroleum prices with imports of oil representing more than 20% of total imports in most countries. On the export side, the concentrated production of most small states along with the deterioration in the economies of the countries that purchased these goods and services has resulted in a significant decline in export demand (Also see IMF, 2013).

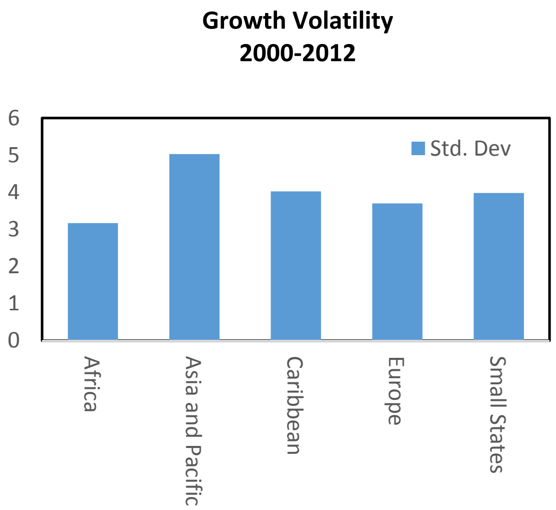
Figure 1: Overview of Small States Growth Performance[5]

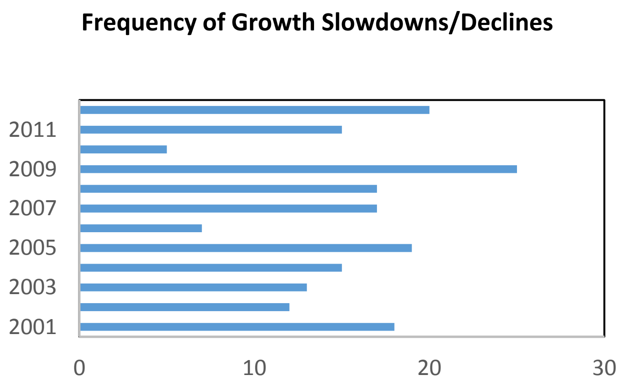






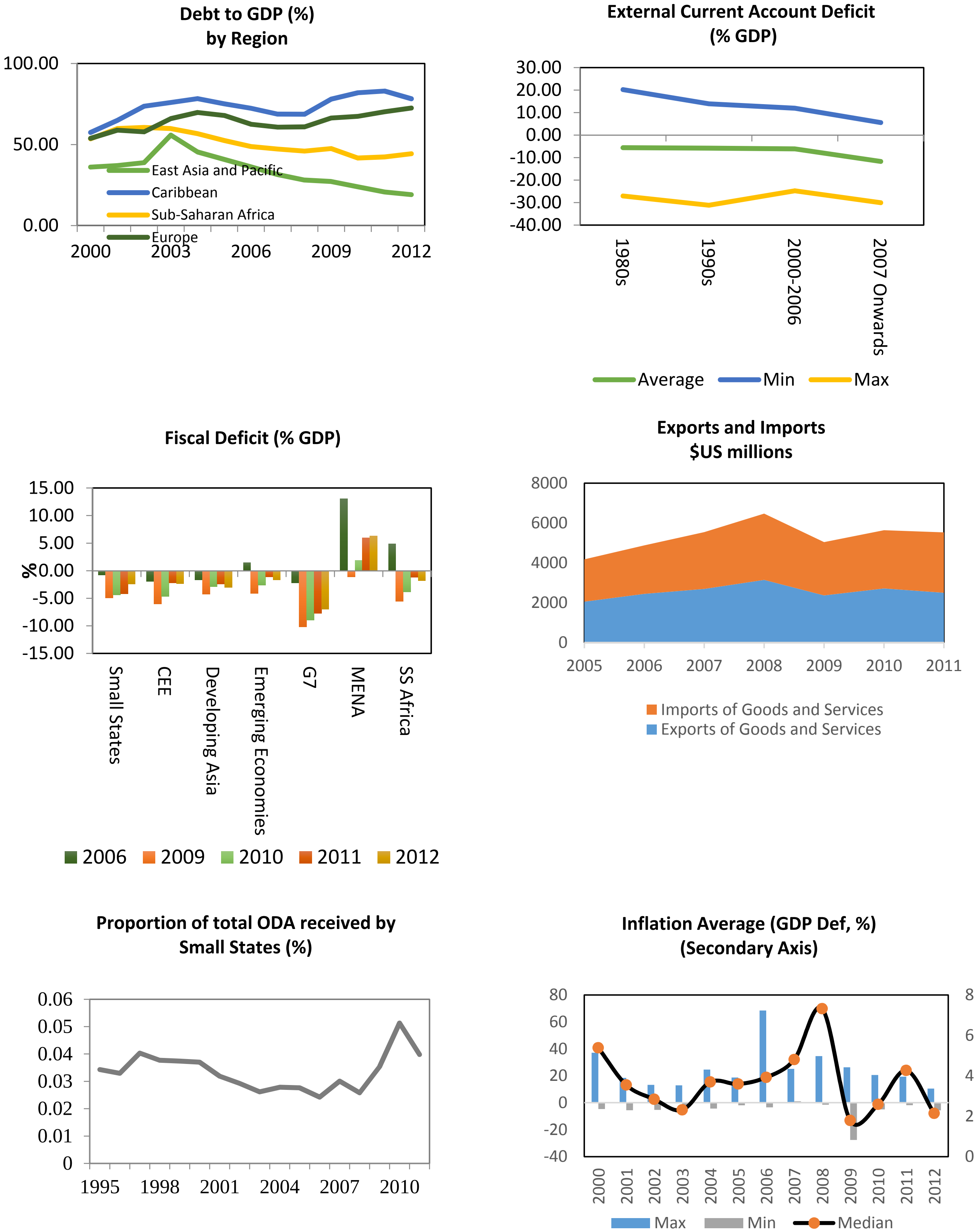






[5] Sources: Moore *et. al* (2013) and the Global Financial Database.

Figure 2: Other Key Macroeconomic Indicators for Small States[6]



[6] Sources: Moore *et. al* (2013), Commonwealth Secretariat (2013) and the Global Financial Database

16. Small states have witnessed reduced levels of official development assistance (ODA). ODA to small states as a ratio of total ODA declined steadily between 1995 and 2008, before sharply increasing in 2010 and in 2011. However, in that same period the proportion of total OECD-DAC assistance allocated to small states declined from roughly 5 % to 3.98 % and the percentage of total ODA received by small states with the highest public debt levels (i.e debt higher than 60% of GDP)[7], decreased. Generally, ODA flows to small states have not been allocated evenly but instead flows have typically been concentrated among a smaller sub-set of small states, including Haiti, Papua New Guinea, St. Vincent and the Grenadines, Solomon Islands and Timor-Leste. This has necessitated other small states to look for alternative financing streams, the latter which have been primarily commercial.

17. Given these developments, debt among small states has substantially expanded, especially for those countries in the Caribbean. Prior to the global financial crisis, public debt levels appeared to have been on a slight decline but thereafter, debt burdens quickly rose due to several factors including: the economic crisis and consequent weak growth, countercyclical fiscal policies that increased government expenditure and other domestic factors including the realization of large contingent liabilities.[8]

By contrast inflationary pressures in small states have remained fairly subdued. The world oil and food price crisis pushed average price increases in small states as high as 7.8% in 2008 but with the fall in aggregate demand following weak global output in 2009, price increases sharply receded and have since remained very low.

IV. The Pressing Development Challenges

A. High Debt Burdens, Insufficient Debt Restructuring and Risk of Debt Default

- *Debt burdens are high or near distress levels in a majority of Commonwealth Small States*

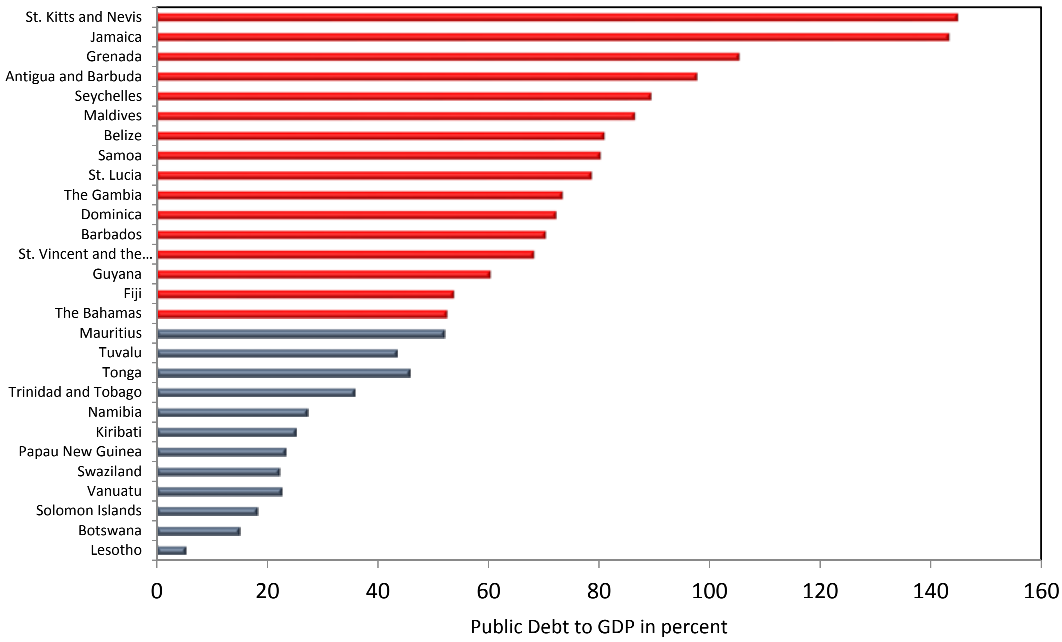
18. The debt burdens in Commonwealth Small States have grown rapidly within the last decade, particularly in the Caribbean and are now at unsustainable levels. As can be seen in Figure 3, of the 32 countries classified as

[7] Antigua & Barbuda, Barbados, Belize, Cape Verde, Guyana, Dominica, Guinea Bissau, Grenada, Jamaica, Maldives, St. Kitts & Nevis, St. Lucia, St. Vincent and the Grenadines

[8] The slight decline in debt observed across small states just prior to the world economic crisis can be attributed to fiscal consolidation efforts and debt restructurings between 2000 and 2007.

Commonwealth small states, 21 countries had debt-to-GDP ratios of over 50 percent and 14 had debt-to-GDP ratios exceeding 60 percent at the end of 2012.

Figure 3: Commonwealth Small Developing States - Public Debt to GDP 2012[9]



Source: International Monetary Fund - Regional Economic Outlooks and various country reports

19. Conversely, over the same period, small low-income countries, mostly in Sub-Saharan Africa, have seen their debt levels fall by more than half, the outcome inter alia of the Heavily Indebted Poor Countries debt initiative (HIPC) and the Multilateral Debt Relief Initiative (MDRI). In contrast, a significant sub-set of small middle-income countries have seen elevated debt levels over the period. While public debt to GDP levels fell by almost one-half in African small states and by one-third in Pacific small states, debt levels rose by 3 percent in Caribbean small states over the 2000-2012 period.

20. On average, Asia-Pacific Commonwealth small states have relatively moderate levels of public debt, with average public debt-to-GDP of 44.3 percent. Asia-Pacific small -states rely heavily on official development assistance to finance their budgetary and balance of payments requirements. For much of the decade, the main donors have been Australia, New Zealand and the United States and public debt remained relatively contained as flows were substantially in the form of grants. However, with the ascent of China as a major economic power, aid has increasingly been forthcoming from this source.

21. While, the Asia-Pacific small states are 50 percent less indebted than their Caribbean counterparts, a growing number of these countries are at high

[9] This includes the debt of public sector entities.

risk of debt distress. The most recent debt sustainability assessments undertaken by the IMF indicate that four Asia-Pacific countries – Kiribati, Maldives, Tonga and Tuvalu –are at a high risk of debt distress.

- *There has been an increase in the frequency of debt restructuring*

22. Since the start of the 2000s, as a result of steady debt accumulation, 7 of 32 Commonwealth small states have restructured their debt. All of these small states are tourism-dependent economies, with the exception of Belize, which is a commodity exporter. Most are extremely or highly vulnerable to natural disasters and all are very open economies and highly exposed to external economic and financial shocks.

23. Despite the generally successful implementation of debt exchanges in these Commonwealth small states and subsequent declines in debt ratios, debt albeit lower remains at unsustainable levels in all 7 countries. An analysis of the post-exchange outcomes (excluding St. Kitts and Nevis[10]) indicates that while public debt to GDP fell in 4 of the seven small states that had debt restructuring operations, in the year immediately after the debt exchange, after two years public debt to GDP levels had again risen in half the group.

Table 2: Small States Public Debt to GDP Pre and Post Debt Exchange

	Year	3-year Pre-Relief Average	Year-3	Year-2	Year-1	Restructuring Year	Year+1	Year+2	Year+3	3 year Post-Relief Average
Antigua and Barbuda	2010	**90.7**	93.3	76.9	102.0	**90.6**	93.4	97.8	n.a.	**95.6**
Belize	2007	**96.9**	100.1	98.4	92.2	**88.6**	79.4	82.5	84.6	**82.2**
Dominica	2004	**111.6**	92.7	111.4	130.8	**116.0**	108.1	95.7	90.9	**98.2**
Grenada	2005	**111.7**	112.3	102.2	120.6	**110.3**	116.5	111.0	83.7	**103.7**
Jamaica	2010	**127.5**	115.0	126.2	141.2	**143.0**	140.0	143.3	n.a.	**141.7**
Seychelles	2010	**138.0**	146.0	139.5	128.6	**82.5**	77.8	64.6	n.a.	**71.2**
St. Kitts and Nevis	2012	**155.6**	148.5	163.9	154.3	**144.9**	n.a.	n.a.	n.a.	

Source: International Monetary Fund

- *When analyzing small states' debt dynamics a high probability of debt default emerges*

24. The conclusions of Moore *et. al* (2013) suggests that debt will rise further in a number of Commonwealth small states. Using a structural time

[10] St. Kitts and Nevis is excluded as two years have not yet elapsed since it underwent a debt exchange.

series approach debt in a number of Commonwealth small states fail the non-accelerating debt criterion. Debt expansion is projected to occur in the Caribbean and in Sub-Saharan Africa, while much less so in the Pacific and Europe. In the expansion cases, the debt increases are expected to be the result of an acceleration of permanent expenditure over permanent revenue.

Further, the risk of debt distress in Commonwealth small states seems fairly high. In order to assess the potential need for debt assistance, a panel tobit model with data for 22 small states observed over the period 1989 to 2011 was employed to estimate the probability that a debt rescheduling takes place. In general, most small states considered were classified as has having a medium to high risk of debt default (see Table3). *However, these results should be viewed with caution* as the methodology employed in Moore et. al (2013) is a purely technical exercise that does not take into account countries policy commitments or actions. In essence, these forecasts emphasize the point that in the event of more adverse shocks, public debt, despite small states pursuit of fiscal consolidation and other debt reduction policies, is likely to increase in 2014 and beyond.

Among the indebted small states, approximately 30 cents in every dollar owed by these countries is attributable to a multilateral lending agency. While the actual dollar value of the group's debt is a small proportion of the overall portfolio of most international lenders, the authors suggest that the potential risk to multilaterals is not negligible. In general though, the indebted small states owe most of their debt to domestic and external private creditors.

B. Inadequate Access to Concessional and other Financial Resources

- *Concessional finance has not been forthcoming, especially for the higher middle-income small states*

25. Since the 1990s and the graduation to middle income status, a majority of Commonwealth small states have not had access to concessional resources. As the IMF and World Bank continue to base eligibility on income thresholds, a majority of small states continue to be excluded from IDA and PRGT resources, whereas access to these institutions non-concessional resources has been limited by small states' relatively small quotas. Both institutions have included a vulnerability criterion to prevent premature graduation from IDA and PRGT facilities but have not found vulnerability suitable for determining eligibility to use their concessional resources.

26. As a result of the decline in concessional finance, Commonwealth small states have had to rely on commercial instruments, particularly bonds. This has increased the indebtedness of small states to private creditors and has complicated the debt restructuring process. Not only is public debt in small states heterogeneous (multilateral, bilateral and private debt) but private creditors to small states are very fragmented, due to the widespread use of bonds.

Consequently, debt restructuring has become more difficult given the associated inter-creditor equity and negotiation issues. Moreover, with growth in some domestic capital markets, some small states have relied heavily on domestic debt and this too has had several implications for debt restructuring operations, including potential negative impacts on the domestic financial system.

Table 3: Debt Projections and Assessment of the Possibility of Debt Default

Small States	Income Classification	Total public sector debt >100% of GDP by 2017	Total public sector debt >60% of GDP by 2017	Risk of Debt Distress
East Asia and Pacific				
Kiribati	Lower middle	No	No	Low
Papua New Guinea	Lower middle	n.a.	n.a.	Low
Samoa	Lower middle	n.a.	n.a.	Medium
Solomon Islands	Lower middle	No	No	Low
Tonga	Lower middle	n.a.	n.a.	Medium
Vanuatu	Lower middle	No	No	Low
Caribbean				
Antigua & Barbuda	Upper middle	Yes	Yes	High
Bahamas, the	High income	No	Yes	Medium
Barbados	High income	Yes	Yes	Medium
Dominica	Upper middle	No	Yes	High
Grenada	Upper middle	Yes	Yes	High
Jamaica	Upper middle	Yes	Yes	High
St. Kitts & Nevis	High income	No	Yes	High
St. Lucia	Upper middle	Yes	Yes	High
St. Vincent & the Grenadines	Upper middle	No	No	Medium
Sub-Saharan Africa				
Botswana	Upper middle	No	No	Low
Lesotho	Lower middle	No	Yes	Moderate
Mauritius	Upper middle	No	No	Low
Namibia	Upper middle	No	No	Low
Swaziland	Lower middle	No	No	Low
Europe				
Malta	High income	No	Yes	Moderate

Source: Moore *et. al* (2013) calculations

- *On top of reduced concessional resources, IFI shock financing has been inadequate*

27. Overall lending by multilateral and regional development banks to small states grew very strongly as a response to the global financial crisis. Total MDB and RDB [11] annual lending to small states increased from $1.1bn in 2007 to $4.0bn in 2009, an increase of $2.9bn or nearly a quadrupling of lending.

28. However this apparent overall positive response was concentrated in a select few countries. The large aggregate increase in financing had a high concentration, with the 5 largest recipients receiving 74% of funds. These

[11] Defined as the World Bank, the African Development Bank, the Asian Development Bank, the Inter-American Development Bank and the Caribbean Development Bank.

countries were Botswana[12], Jamaica[13], Mauritius, Papua New Guinea and Gabon. Consequently there was relatively little active financing response during 2007-09 for most small states as some countries got major funding (e.g. Jamaica, Botswana) but others got negligible amounts or none.

29. Moreover, the positive countercyclical response was driven largely by the RDBs rather than by the IMF and World Bank. RDBs increased lending by $2.5bn. The AfDB increased incremental lending by $2.2bn and the IADB by $0.4bn with an increase in lending to small states from 4.2% to 8.0% of total lending. However, there was a decrease of $0.1bn for small states at the ADB.

C. Debt Overhang, Persistent Weak Growth and Threats to Human Development

- *There is sufficient empirical evidence to conclude that the debt overhang in small states has negatively impacted growth*

30. The IMF (2013) reported that the increase in public debt and other macroeconomic factors are likely to have contributed to slowing growth, although some factors may have been structural. A number of empirical studies have tested this relationship with most confirming the validity of the debt overhang hypothesis. However, there are considerable differences in opinion as to the point at which debt begins to negatively affect growth. Pattillo et al. (2002; 2004) found an inverted U-shared relationship between these variables and argued that a ratio above a certain threshold would depress growth performance both through reduced investment and lower factor productivity, as well as the expectations of higher taxes to repay debt and the crowding out of private sector investment. A similar conclusion was also found by Kendall (2006) who investigated the relationship between growth and debt in a sample of Caribbean countries and found that adebt/GDP ratio exceeding 54 percent was likely to slow down growth. Reinhart and Rogoff (2009) suggest that growth becomes negative at a ratio beyond 90 percent.[14] Based on the calculations of Greenidge K. , Craigwell, Thomas, & Drakes (2012) the Caribbean has relatively

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[12]Botswana received an AfDB $1.5bn Economic Diversification Support Loan ("EDSL") with the objective of creating competitive conditions for accelerated private sector growth, economic diversification, and poverty reduction. This was a stimulus package responding to the global financial and economic crisis and the country's need to reduce dependence on its mineral revenues. The EDSL aims to promote fiscal sustainability by assisting the Government to implement the 2009/10 budget.

[13] Jamaica received funds from both the World Bank and the CDB. The World Bank projects included a $100m IBRD Fiscal and Debt Sustainability Development Policy Loan and smaller funds for extending conditional cash transfer programs. The CDB financed a number of infrastructure projects such as the North Coast Highway Improvement Project, the Norman Manley International Airport improvements and the Kingston Metropolitan Area Drainage Project.

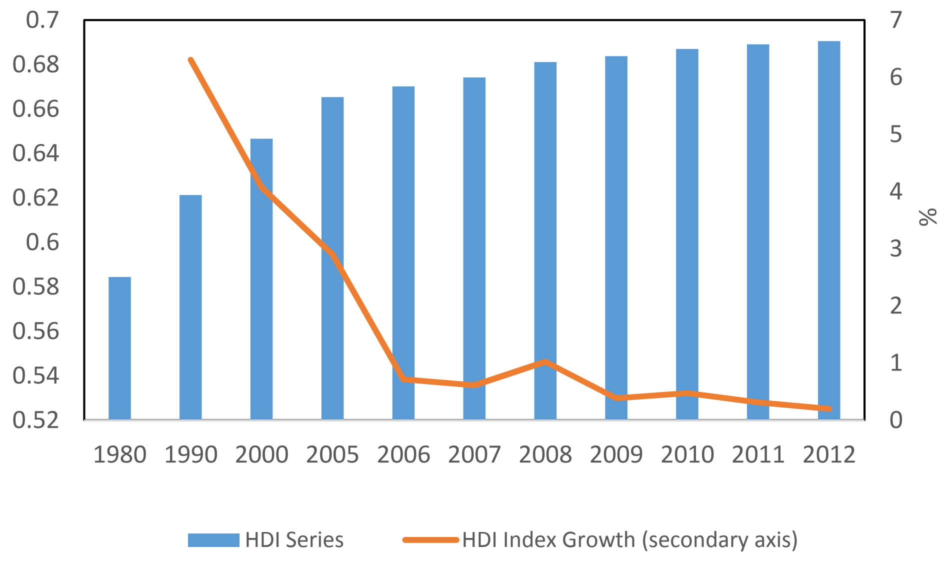
[14] This study has recently been criticised due to mistakes in the data. See The New York Times of April, 16, 2013 "A Study that Set the Tone for Austerity is Challenged" available at: http://economix.blogs.nytimes.com/2013/04/16/flaws-are-cited-in-a-landmark-study-on-debt-and-growth/. See also Nersisyan and Randall, 2010).

lower thresholds for debt and growth impacts in comparison to other regions. In particular, the authors find that as the debt levels in the Caribbean increase beyond 30 percent of GDP the effects on economic growth are positive, however, beyond this point, and up to debt levels of around 55 or 56 percent of GDP, the impact of the debt on the rate of economic growth becomes negative.

- *Disentangling causality between debt and growth may be difficult but data shows that human development improvement is weakening*

31. Although the results of a negative impact of debt on economic growth are debatable, there are signs that the high debt-low growth debacle in small states is beginning to impact these countries' human development. The UN HDI captures countries wellbeing in one estimate by combining sub-indexes measuring education attainment, life expectancy and income. Figure 4 illustrates that although the average HDI for small states has been increasing, human development in small states has been growing at a significantly slower rate when compared to the period before 1990. During the early 1990's and mid 2000s small states HDI growth slowed tremendously and it has slowed further since 2008, reaching the lowest growth rate of HDI in small states to date. According to the IMF (2013), infant mortality fell by much more for larger states than for small states between 2000 and 2010 and the HDI improved more for larger states, over the same period, than for smaller peers.

Figure 4: Human Development in Small States



Source: U.N Database

D. Structural Vulnerability and Continuous Exposure to External Shocks

- *Various external shocks in the past decade have re-highlighted small states vulnerabilities and structural weaknesses, i.e the "lack of resilience".*

9/11 Terrorist attacks

32. The 2001 September 11 terrorist attacks in the United States precipitated a major downturn in economic activity among small states. With the United States the predominant tourism source market for many small states, the Caribbean especially, the weak demand for the tourism product and the precipitous drop in tourist arrivals from the United States as well as Canada and the United Kingdom, led to sharp contractions in small states growth rates and a concomitant rise in average public debt.

Table 4: Performance of Commonwealth Indebted Small States and post-September 11 2001 Attacks

	Year immediately prior to attack	Year of terrorist attack (2001)	Year immediately after attack
Public debt/GDP (%)	95.4	**105.9**	123.9
Real GDP (annual average)	4.8	**0.1**	1.0
External current account balance/GDP (%)	(14.4)	**18.8)**	(19.6)
Overall fiscal balance/GDP (%)	(8.8)	**(9.7)**	(13.1)

Source: International Monetary Fund

Food-fuel crisis

33. A second wave of global shocks in the latter half of the decade also severely impacted small states. Counter-cyclical policies were adopted in almost all indebted Commonwealth small states in response to the food-fuel price crisis except in the Seychelles, so as to offset the sharp contraction in economic activity arising from the global economic slowdown. Only in the Seychelles did public expenditure fall - due mainly to a programme of fiscal reforms implemented in 2008 to stave of an impending debt crisis.

Table 5: Performance of Indebted Small States Pre and Post Global Food-Fuel Financial Crisis

	Year-2	Year immediately prior	Year of food-fuel-financial crisis (2008)	Year immediately after	Year +2
Public debt/GDP (%)	122.4	117.5	**101.8**	109.0	105.1
Real GDP (annual average)	4.7	5.3	**2.4**	(3.8)	(0.5)
External current account balance/GDP (%)	(17.7)	(22.7)	**(25.3)**	(20.5)	(15.8)
Overall fiscal balance/GDP (%)	(4.3)	(4.4)	**(2.9)**	(5.9)	(-3.4)

Source: International Monetary Fund

Natural disasters

34. Natural disasters have also contributed significantly to the high levels of indebtedness in small states. As an immediate response to natural disasters, small state governments have increased spending to aid recovery, rehabilitation and reconstruction efforts. Typically, these unplanned for expenditures have been funded directly from the government's budget as overseas aid may take long to be delivered. Dominica's debt restructuring in 2003 was to some extent prompted by the severe imbalances in the external and fiscal accounts after Hurricane Iris, while Grenada's debt restructuring in 2005 was primarily a result of the devastating effect of Hurricane Ivan.

Table 6: Selected Natural Disasters in Small States (2000-2012)

Country	Year	Event	Cost and Damage
Antigua and Barbuda	2008	Hurricane Omar	Total damage - $54 million. Agricultural loss of $11 million.
	2010	Hurricane Earl	Total damage - $12.6 million. Fatalities – 1.
Belize	2001	Hurricane Iris	Total damage - $74.5 million. Fatalities - 22
	2007	Hurricane Dean	Total damage - $97 million. Significant damage to agricultural sector.
Dominica	2001	Hurricane Iris	
	2007	Hurricane Dean	Total damage - $162 million. Fatalities – 2.
Grenada	2004	Tropical Storm Earl	Moderate damage, flooding
		Hurricane Ivan	Catastrophic damage. Total damage equivalent to approximately 200 percent of 2004 GDP. Fatalities – 39.
	2005	Hurricane Emily	Significant damage. Total damage - $110.4 million. Fatalities – 1.
Jamaica	2002	Hurricane Lili	Total damage - million. Fatalities – 4.
	2004	Hurricane Ivan	Severe damage.
	2005	Hurricane Emily	Total damage - $65 million. Fatalities – 5.
	2007	Hurricane Dean	Severe damage. Total damage - $300 million. Fatalities – 3.
	2008	Hurricane Gustav	Total damage - $210 million. Significant damage to road infrastructure. Fatalities – 15.
	2010	Tropical Storm Nicole	Total damage - $238.6 million. Fatalities – 13.
	2012	Hurricane Sandy	Total damage - $100 million. Fatalities – 1.
Maldives	2004	Tsunami	Total damage equivalent to 62 percent of GDP
St. Lucia	2002	Hurricane Lili	Total damage - $20 million. Fatalities – 4.
	2007	Hurricane Dean	Total damage - $18 million. Agricultural sector - 75% of crops lost. Fatalities – 1.
	2011	Earthquake	
St. Vincent and the Grenadines	2002	Hurricane Lili	Heavy damage to agricultural sector. Total damage - $20 million. Fatalities – 4.
Samoa	2009	Tsunami	Heavy damage estimated at 10.5percent of GDP
Seychelles	2013	Cyclone Felleng	Total damage - $30-$40 million[15]. Fatalities - 6

Sources: UNDP, Caribbean Catastrophic Risk Insurance Facility (CCRIF)

[15] Estimates from the Government of Seychelles.

V. Available Mechanisms for Addressing Small States Challenges and Important Caveats

A. International Mechanisms and Support

- *International Financing and other support mechanisms offered to small states are plentiful*

<u>The International Monetary Fund</u>

35. As regards the international financial architecture, the IMF's role is central to ensuring small states' macroeconomic and balance of payments stability. Small states eligibility for IMF mechanisms can be divided into two groups namely (a) market-access countries and (b) low-income countries (LICs).[16] The mechanisms offered by the IMF are both for short-term and long-term balance of payment adjustments.

The Poverty Reduction Growth Trust
The low-income IMF member countries, in addition to those with small economy exceptions, are eligible for access to the Poverty Reduction Growth Trust (PRGT). This framework came into effect in 2010 as a result of the 2009 reform aimed at increasing concessional resources provided by the Fund to its poorest members, by introducing more flexibility and more alignment to the needs of individual low-income countries (IMF, 2013f). The IMF, like the World Bank, also introduced a vulnerability consideration in its graduation criteria to safeguard against LICs premature PRGT graduation. Market access countries on the other hand, are financed through the Funds' non-concessional window at SDR market rates. These non- PRGT facilities were also reformed post 2009 to increase flexibility and to reduce ex-post conditionality (See Appendix Tables 1&2 for a list of these facilities).

The Joint World Bank–IMF Debt Sustainability Framework
The joint World Bank – IMF Debt Sustainability Framework (DSF), which was established in 2005, assists LICs in obtaining development finance from donors while keeping the risk of unsustainable future external and public sector debt levels to the minimum (IMF, 2013a; IMF and World Bank, 2012). It contains the Debt Sustainability Analysis (DSA), under which a debt projection and proneness to external (as well as policy) shocks, is conducted. This is done together with an analysis of the quality of institutions and policies, which contribute to the indicative thresholds of debt burden, as well as borrowing strategy

[16] The market-access Commonwealth small states are Antigua and Barbuda, Bahamas, Barbados, Belize, Botswana, Jamaica, Malta, Mauritius, Namibia, Seychelles, St Kitts and Nevis, St Vincent and the Grenadines, and Swaziland, whereas that LICs are Dominica, Grenada, Kiribati, Lesotho, Maldives, Papua New Guinea, Samoa, Solomon Islands, St Lucia, Tonga and Vanuatu (IMF, 2013c)

recommendations to limit debt burden distress. The Fund introduced a DSA for market access countries in June 2002, which was later reformed in 2011. The DSA for market access countries has improved on the standard analysis and now includes more realistic stress tests, simplified tables and graphical presentation and country tailored alternative scenarios (IMF, 2005).

Capacity Building

In addressing capacity building needs of member countries, the IMF offers training and technical assistance (TA). The IMF runs the Institute for Capacity Development offering workshops and distance-learning programmes (IMF, 2013g). The Fund also has eight Regional Technical Assistance centres designed to assist member states in institutional as well as human capacity development needed for poverty reduction and growth policies implementation. Three of these centres cover most small states.

Countries' Economies Surveillance (Article IV)

The IMF monitors its members' financial and economic policies in order to facilitate global economic cooperation by identifying possible stability risks and giving advice on tackling them effectively (IMF, 2012). About a fourth of small states are on an extended consultation cycle, in comparison to only about two percent among larger countries. This is mostly due to their proneness to exogenous shocks which is one of the grounds for granting a longer surveillance cycle (IMF, 2012).

The World Bank

36. The World Bank's role can be seen as complementary to that of the IMF as its main goal is to provide loans and mechanisms for poverty eradication. The portfolio of development-facilitating instruments available to all World Bank members is available to small states, but the Bank offers the 'small island exception' within the International Development Association (IDA) schemes.

International Development Association (IDA)

Middle-income countries typically do not have access to finance from the International Development Association, the World Bank's concessional window. One of the priorities of IDA16 is strengthening the capacity of IDA countries to deal with exogenous natural or economic shocks. To address the impact of such crises, a separate *Crisis Response Window (CRW)* was created. In case of natural disasters, the CRW assists with events that are exceptionally severe and in economic crises, the CRW targets those caused by exogenous shocks that affect a number of countries.

International Bank for Reconstruction and Development Loans

All thirty-two Commonwealth small states are members of the World Bank and twenty-two of them[17] are eligible for the World Bank borrowing under IBRD. IBRD

[17] Except for The Bahamas, Barbados and Malta.

provides loans, advisory and analytical services, risk management products and guarantees.[18] It is designed for middle income and creditworthy low income countries and offers loans on highly-competitive market terms. IBRD flexible loans maximum repayment period is 30 years and the grace period is up to 17.5 years. Graduation from IDA and IBRD is a flexible process, which takes into consideration constraints and "vulnerabilities" faced by developing countries. In this way, small states per capita income above the IBRD threshold does not automatically lead to graduation from IBRD. IBRD loans are of particular importance to small states, who are very often considered too risky for private sector investment.[19]

Other World Bank Mechanisms Available to Small States[20]
In addition to the tools and initiatives tailored specifically for small states, small states can also use all other services from the Bank portfolio, including the following:

Programme for Results Financing (PforR): PforR is a relatively new achievement-based lending and support product, approved in January 2012. Disbursements are conditional upon results being achieved. Additionally, the programme focuses on building stronger institutions, as well as making sure that Bank financing is put to good use taking into account the environmental and social impacts.

Multilateral Investment Guarantee Agency (MIGA): This World Bank Group offers guarantees (political risk insurance) to increase developing countries' attractiveness for FDI. The World Bank Guarantee Programme focuses on lessening political risk for lenders associated with investment in developing countries. This programme operates on a 'lender-of-last-resort' basis, while sourcing funds from the private sector.

Development Grant Facility: DGF finances the generation of new ideas and paths towards solving development problems through joint cooperation of different players, as well as national and local stakeholder participation.

B. Regional Mechanisms and Support

- *Generally, regional mechanisms are not as plentiful and not as largely financed but appear to be better targeted to small states' needs*

<u>Regional Development Banks</u>

40. Regional development banks play a crucial role in the international finance architecture. They provide long-term financing to both low and middle

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[18] http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/EXTIBRD/0,,contentMDK:21116492~menuPK:3126966~pagePK:64168445~piPK:64168309~theSitePK:3046012,00.html .

[19] See Appendix 1 regarding the finance instruments of the World Bank and the IMF for addressing small states development issues.

[20] See Appendix 1: Table 6 for mechanisms offered by IFC and MIGA.

income countries who do not have adequate access to private funds. However, not all Commonwealth small states have access to the various financing facilities provided by the various regional development banks.

At the IADB, six commonwealth small states have access to their concessional financing facilities. There are twelve small states who have access to the CDB's facilities, five have access to those at the AfDB and nine have access to ADB facilities. Some Caribbean small states have access to both the IADB's facilities as well as to the CDB's (See Appendix: Table 3 and 4).

There are various types of concessional facilities that are of a similar nature within each of the RDBs. These facilities are made available with the aim of promoting economic and social development whilst strengthening development results by targeting needs, placing resources where they are likely to be effective, and giving member countries an incentive to perform well. The CDB, AfDB and ADB all have specialised Funds that provide concessionary financing. The CDB's Special Development Fund (SDF) allocates its single largest source of concessionary resources. Through the SDF the CDB allocates money to specific funds such as the Basic Needs Trust Fund (BNTF) and provides technical assistance through its Caribbean Technological Consultancy Services Network. However, the Banks' credit rating was recently downgraded and this may put extra strain on the institution to raise necessary resources.

The IADB has introduced a number of innovate instruments, which is of particular interest to many of the Commonwealth's small states. To name a few, the IADB's Contingent Credit Line for Natural Disasters provides borrowing member countries with resources to cover urgent financing needs that arise immediately after a natural disaster. The country limit for these would be $100 m. or 1% of GDP, whichever is less. In addition the Board approved a deferred draw down option which allows countries, on payment of an upfront premium, to draw on the resources of policy based loans, as and when they require these funds. In addition to this, the IADB introduced its Contingent Credit Facility for Natural Disaster Emergencies (CCF) and Emergency Liquidity Facility (ELF). A detailed breakdown of these facilities is provided in the Appendix: Table 5.

The AfDB has well targeted mechanisms to assist African small states. In addition to the participation of Sub-saharan Africa in the HIPC initiative, the AfDB assistance can be attributed to Sub-Saharan Africa's improved stability and performance. One of its notable facilities is the Emergency Liquidity Facility. In 2009, the AfDB established a US$1.5 billion Emergency Liquidity Facility (ELF) as part of a global response to the financial crisis. ELF aims at providing financial support to eligible clients in exceptional cases. Given the urgent nature of the financing needs to be addressed by the ELF and the need for a fast-tracked process, proposals for the use of the resources are considered by the Board within ten (10) working days. The rapid dispersion of funds is of importance and relevance to small states when taking in to consideration their exposure to climatic disruptions.

C. Other Important Mechanisms

- *There are various other mechanisms available to small states outside of the mainstream international and regional purview*

41. Small states have benefited from several mechanisms that have been created to address specific issues such as debt forgiveness, natural disaster management, energy price inflation and so on. Some mechanisms are fairly new and some have been provided by non-traditional donors like China and Venezuela.

The Paris Club
The Paris Club provides for middle-income countries to restructure on *standard "Classic" terms*. These terms, the least generous of the menu of terms extended by the Paris Club offer no upfront debt reduction but instead typically extend debt maturities over 12 years with a 5 year grace period. A lowering of interest can be negotiated with Paris Club creditors on a bilateral basis. Lower middle-income countries receive only marginally more favourable terms from the Paris Club under the *Houston terms*. These also only contemplate a rescheduling of payments over a longer period accompanied generally by lower interest rates. The Paris Club also offers debt relief on non-standard terms to middle-income countries under the *Evian approach*. This approach is loosely comparable to the HIPC debt as it seeks to provide a treatment which restores long-lasting debt sustainability to the beneficiary country rather than merely interim cash relief. The Paris Club *Evian Approach* therefore hinges critically on debt sustainability analyses (DSAs) undertaken by the IMF. The Paris Club stresses however that debt reduction will only be considered in "exceptional cases" and only as clearly indicated in a thorough analysis of the country's debt sustainability.

South-South Cooperation/Concessional Flows
Commonwealth small states have generally benefited from China's emergence as a major international donor. As aid flows from traditional Western donors have dwindled, concessional financing from China has helped to fill gaps in the external accounts and ease the debt service burden of some small states. The Caribbean region benefited from an US$530 million economic assistance package from China over a three-year period ending in 2010. In addition, China has funnelled aid of some US$30 million to the Caribbean through the Caribbean Development Bank (CDB) and an additional US$350 million in aid through the Inter-American Development (IADB).The main benefits of Chinese aid are the highly concessional terms on which they are offered. Terms include long repayment periods – 25 years or more - and low rates of interest, ranging from between 1 percent and 3 percent. Moreover, aid packages are sizeable, in contrast to development aid often received from the multilateral financial institutions.

Collective action clauses

Collection action clauses (CACs) have become the principal means of overcoming the hurdle of holdouts by a minority of bondholders. CACs allow a super-majority of bondholders to agree to a debt restructuring that becomes binding on all holders of a particular bond issue. This helps to facilitate a more orderly and prompt restructuring of unsustainable sovereign bond debt. The inclusion of collection action clauses in bond agreements has contributed significantly to the orderly restructuring of private bonded debt for some small states. Belize, Grenada, St. Kitts and Nevis and the Seychelles have all used collective action clauses to complete their exchange transaction after facing holdouts in the range of 3-16 percent.

The Caribbean Catastrophic Risk Insurance Facility (CCRIF)

CCRIF is a risk pooling facility, owned, operated and registered in the Caribbean for Caribbean governments. It was established in 2005 and is designed to limit the financial impact of catastrophic hurricanes and earthquakes to Caribbean governments by quickly providing short term liquidity when a policy is triggered. It is the world's first and, to date, only regional fund utilising parametric insurance, giving Caribbean governments the unique opportunity to purchase earthquake and hurricane catastrophe coverage with lowest-possible pricing. CCRIF was developed through funding from the Japanese Government, and was capitalised through contributions to a multi-donor Trust Fund by the Government of Canada, the European Union, the World Bank, the governments of the UK and France, the Caribbean Development Bank and the governments of Ireland and Bermuda, as well as through membership fees paid by participating governments.

The Petrocaribe Fund

Another initiative to ameliorate the effects of external shocks has been the implementation by Venezuela of the Petrocaribe Fund, a financing arrangement to help cushion current account balances from oil price shocks. The initiative provides participating countries with concessional financing on fuel imports from Venezuela. Countries all receive loans with a 25-year maturity including a 2-year grace period at a 2 percent interest rate.

D. Reservations on Available Mechanisms[21]

- *In spite of the abundance of IFI mechanisms, small states are still facing hard pressed financing and debt challenges.*

International Monetary Fund

[21] Also see Comsec, 2012.

42. Although, since 2010, the IMF would seem to be assigning more importance to small states than before, it has still been criticised for not adequately taking local circumstances into account.[22] Although annual consultations with governments and central banks take place during the surveillance cycle (IMF, 2012), particularly in small states, the Fund's presence on the ground, in terms of getting to know the clients circumstances, would seem to be inadequate. The Fund's resident representatives cover a limited number of small states and in many cases their responsibilities are shared over more than one country. By working more closely with small states on the ground, the IMF can improve the effectiveness of its interventions in the interests of small states in general.

A problem often faced by small states is that they do not generally operate in a level playing field when they negotiate with international organizations. Broome (2011) contends that in their negotiations with the IMF for crisis management support, they have a weak voice. Referring to the case of Iceland, the author argues that this happens in spite of the fact that small states face higher stakes compared with larger economies and have a narrower policy choice at their disposal. On this issue, Panke (2012) adds that small states tend to possess less well-equipped delegations at the international negotiation table than big states. This can easily translate into difficulties in preparing positions for all items on the negotiation agenda and in developing negotiation strategies in great detail, which might inhibit small states from successfully influencing negotiation outcomes.

Griffith-Jones and Tyson (2010) assert that despite the reforms adopted by the IMF in 2010, the new facilities still pose problems. For example under the Standby Credit Facility, referred to above, countries with difficult access to international private capital markets may face additional conditionality due to the fact that this facility has lumped together external and domestic policy shocks for accessing significant IMF loans, even when the problem in small states mainly relate to external shocks. More fundamentally, the focus of the original IMF compensatory financing, namely of automatic provision of very rapid and significant liquidity for countries facing purely external shocks, has been aimed for low income countries.

Further, the economic measures accompanying Standby programmes have typically focused on the demand side, through a strong fiscal consolidation effort. While necessary, growth is often severely constrained as often capital expenditures are cut given the rigidities of the wage and interest bill. A growing concern is whether these policies provide the necessary impetus for growth recovery or instead lead to further economic compression.

[22] This shortcoming is implied by the IMF itself. The concluding sentence of the Key Points in IMF (2013d) states "The Fund could also consider additional ways to strengthen institutional capacity in small states and to better tailor some of its analytical tools to meet their needs." See also Jensen (2004) in this regard.

World Bank

43. In 2006 the World Bank Independent Evaluation Group published its report entitled, ***Making the Most of Development Assistance*** **(IEG, 2006). The report stated that due to the fact that small states receive substantial levels of other ODA, mostly as grants, the World Bank is a not one of the most attractive organisations for most small economies.** The most important reasons for this are the high transactions, supervision and processing costs in dealings with the World Bank due to capacity constraints in small states. The report also finds that small states had the highest drop-out rates before project approval as well as cancellations of approved products in comparison with other developing countries. The report remarks that unlike bilateral donors, the Bank rarely has a field presence in small states. In addition small projects in general have a lower rate of satisfactory outcome ratings, which indicates that the Bank may be ill-equipped in experience and procedures to undertake them.[23]

The Commonwealth Secretariat (2012) report also identified a number of weaknesses in the World Bank's support to small states. The report states that the concessional windows of the IDA are primarily designed to assist low-income countries, whereas many small states are middle income countries, and despite the eligibility exceptions, some face threats of graduation from such funds.
The Commonwealth Secretariat report, referring to Guillaumont (2010), also considers the "country performance" criteria used by the World Bank in its performance-based allocation system as being opaque and subjective. The same report also refers to the IDA Crisis Response Window (CRW) introduced in 2009 and the IDA immediate Response Mechanism (IRM) introduced in 2011, and contends that while admittedly these are welcome developments, the shock-response mechanism lacks the scale of funding needed to successfully combat exogenous shocks. Further, Robinson (2013) asserts that if the debt burden of highly indebted small middle-income states is to be tackled on a sustained basis, a wider application of the IDA 'small island' exception will be needed.

Griffith-Jones and Tyson (2010) assert that there has been considerable progress with regard to World Bank Financing, during and after the recent financial crisis, such as the significant countercyclical response of development banks' lending, including to small states, and the ongoing creation of specific crisis response windows. However, despite this overall positive situation for small states, World Bank financing has been concentrated in five select countries, which received 74 percent of funds.

[23] According to IED (2006) the Bank average for satisfactory project outcomes (exit fiscal 1995–2005) was 74 percent, but for projects with commitments under $20 million, the satisfactory rate fell to 66 percent. The majority of projects in small states had commitments under $20 million; the average commitment size for evaluated small states projects (exit fiscal 1995–2005) was $13 million. The average outcome rating for small-states projects under $20 million is identical to the average for all projects with commitments under $20 million.

Other Mechanisms

44. Paris Club relief that does not include extensive debt reduction is inadequate in addressing the needs of highly debt distressed countries. Small middle-income countries face the same challenge of repeated rescheduling as their low income counterparts faced pre-HIPC where their debt problems are treated as one of short-term liquidity rather than one of solvency. Those countries that have fared better in terms of improved growth and debt dynamics are confined to countries that have benefited from a deep debt reduction. Seychelles, a tourism-dependent small state, has more favourable post-restructuring indicators than its Caribbean peers, a consequence to some extent to the significant debt reduction accompanied by strong fiscal reforms.

The Seychelles benefited from a 50 percent principal reduction under Evian terms. It is the only country among the four small states that approached the Paris Club that has had its public debt to GDP drop as a result of Paris Club debt relief.

45. A major concern over south-south concessional flows is whether China will be as magnanimous in the event of a payment default and the need of a beneficiary country to restructure its debt and what rules it will apply in providing debt relief. A second concern with aid from China is the significant exchange risks that may arise in external debt portfolios as many Commonwealth small states have currencies pegged to the US dollar. The growing share of the Chinese Yuan in the unhedged external debt portfolios of Commonwealth small states increases the potential risk.

46. There are concerns about the effectiveness of Collective Action Clauses (CACs) versus a sovereign debt resolution mechanism due to the lack of comprehensiveness of CACs across different bond issues, possibilities of court actions, delays in reaching agreements and the necessity to negotiate with various creditors (bilateral, commercial banks and bond holders), separately. Jamaica, which has just undergone a second debt restructuring in three years, has not included collective action clauses in any of its agreement with external bondholders. A debt exchange could therefore be far more difficult for Jamaica to conclude given the sizeable share of private bonded claims in its external debt portfolio and the lack of CACs. Additionally, the recent decision by the New York court of appeal to enforce the "pari passu clause"[24] in the case NML vs. Argentina[25] has raised additional fears about the strength of such contractual agreements against hold out litigation.

47. A major limitation of the Caribbean Catastrophe Risk Insurance Facility (CCRIF) is the relative cost of insurance premiums related to different triggers levels for hurricanes and earthquakes. Given the high cost of insurance

[24] Prevents the debtor from legally subordinating the bonds in question to other debt.
[25] The decision could trigger new waives of holdout litigation in future debt workouts.

premiums for lower trigger levels, not all governments have full coverage for natural disaster events. Therefore, although insured, many Caribbean countries are still forced to fund their emergency expenditures with substantial amounts of debt. Another limitation is that CCRIF does not cover damage associated with rainfall. The losses to infrastructure caused by flooding or by landslides are not covered under the catastrophe fund. In many countries, these losses can be significant and cause substantial debt to amass. Petrocaribe funds also represent debt-creating flows and therefore further increase debt levels.

VII. Commonwealth Proposals for Discussion

- *In light of small states' pressing development challenges and the shortcomings of available financing and other mechanisms, the Commonwealth Secretariat has developed four proposals for IFIs consideration and discussion.*

A. Debt Swaps for Climate Change Adaptation and Mitigation

48. **The Commonwealth Secretariat is proposing debt swaps as an innovative way of circumventing small states debt challenges and to provide small states with urgent and necessary debt relief**. The Commonwealth's smallest and most vulnerable economies possess a unique set of structural characteristics which pose a special development challenge and combine to make them amongst the most vulnerable to exogenous shocks in the world. At the same time for these countries climate change is a real and escalating threat, making natural disasters more likely, frequent and deep, thus negatively affecting growth and reversing hard-earned development gains. In addition to this small states possess high and unsustainable public debt, which they are unable to reduce due to their large and unfeasible fiscal adjustments (IMF, 2013). Understandably, underpinning the reluctance for debt relief among IFIs and bilateral governments for indebted countries has been the limited international financial resources and domestic fiscal constraints.

In the Commonwealth proposal for a multilateral debt relief-for-climate swap (Comsec, 2012), the Commonwealth Secretariat illustrates that in spite of the resource constraints of IFIs, there is ample scope for innovative solutions to address small states debt challenges. The Commonwealth proposal has the potential to provide small states with significant debt relief and to assist them with unlocking pledged climate funding to finance climate change adaptation and mitigation projects. The benefits to donors are the following:

- *While there remains an ongoing need for additionality of resources to finance development in poor, small and vulnerable developing* *countries, in regard to this proposed mechanism there is no need for additional donor resources;*

- *The proposal can help reduce the climate finance implementation gap by quickly increasing the disbursement of pledged funds;*

- *Debt relief can be counted as ODA and so can help donors meet internationally agreed targets;*

- *Donors have flexibility in the design and hence the amount of debt relief provided***.**

The multilateral debt relief for climate finance initiative is essentially a variant of a debt –for-nature swap. There are three actors involved: **multilateral institutions**, **donor countries** and **small states debtor countries**. Specifically, the Commonwealth proposes that multilateral institutions gradually write off 100 percent of small states **multilateral concessional debt stock**, contingent on approval from donors and the annual payment in local currency by small states of existing multilateral concessional debt service into a trust fund over a period of 10-15 years. The trust fund would be governed by respective Central Banks and the funds would be used to finance climate change adaptation and mitigation projects.

Based on 2010 data and assuming 100 percent write down of small states multilateral concessional debt stock, the total cost of the initiative could range from an estimated $4.5 million (£2.8 million) to $4.5 billion (£2.8 billion) depending on donors' preferred eligibility criteria. In terms of feasibility within a solely Commonwealth context, for example, this is within the $5.78 billion of total climate funds pledged by UK, Canada and Australia since 2003. In line with this range of options, the multilateral debt relief initiative could translate into between $0.4 million (£0.25 million) and a maximum of $277.2 million (£174.3 million) worth of debt service ring fenced annually for climate change projects in beneficiary countries, respectively. Over the life of the debt swap (10-15 years), that would generate between $6.0 million (£3.8 million) to $4.2 billion (£2.6 billion) of small states climate financing.

Debt swaps are currently being used to relieve commercial debt in an innovative way by the Nature Conservancy. The Nature Conservancy model uses a combination of different resources, including official and impact capital, to buy commercial debt and to finance adaptation activities. The most recent negotiation has been with the Seychelles and there are other ongoing negotiations with indebted small states.

B. Vulnerability as a Criterion for Access to Concessional Resources

49. The Commonwealth Secretariat proposes that vulnerability be urgently added to the criteria for eligibility to access IFI concessional resources and official development finance. Small states are vulnerable because of their exposure to shocks and lack of resilience. Additionally, their vulnerability is structural rather than derived from policy choices. These facts have been confirmed in the past and recently, as described in Section IV (4), and have been the basis for the World Bank's "small island economy exception". Small states vulnerability to shocks has also been the basis for the IMF's inclusion of a small economy exception for access to PRGT resources and has been included as a criterion to determine graduation from PRGT resources in an effort to safeguard against premature and reverse graduation. Paradoxically, however, none of these institutions, however, have thus far considered vulnerability as a criterion for eligibility to use their concessional facilities.

This is surprising, despite obvious financing constraints. Small states are now ranked among the most vulnerable in the world, with some Caribbean countries for example within the top 5 most vulnerable to natural disasters; and have experienced a significant decline in performance over the past four decades in spite of relatively high per capita incomes. On top of this, these countries confront high and unsustainable debt, which has been partly the result of their inability to access to concessional funds.

Adding a criterion of vulnerability to IFI eligibility criteria would meet three principles of good aid allocation (Guillamont, 2010):

- *Effectiveness:* because the marginal effectiveness of aid is higher in vulnerable countries. Including vulnerability as an *ex ante* aid allocation criterion assists in providing a preventative and regular treatment of vulnerability to exogenous shocks, without the hazards or delays normally associated with compensatory *ex post* financing;

- *Equity:* because vulnerability is a structural handicap to be compensated for by equalizing opportunities; and

- *Transparency:* because it contributes to avoiding the multiplication of exceptions (caps, floors and special treatment).

Low Income Countries
Box 1. Criteria for Entry and Graduation from PRGT Eligibility[26]

Entry: A Fund member would be added to the list of PRGT-eligible countries if: (i) its annual per capita GNI is below the operational IDA cutoff (as defined); and (ii) the sovereign does not have capacity to access international financial markets on a durable and substantial basis.
Graduation:
Income Criterion: The country¡¥s annual per capita GNI: (a) has been above the IDA operational cutoff for at least the last five years (for which qualifying data are available); (b) has not been on a declining trend over the same period (comparing the first and the last relevant annual data); and (c) is currently at least twice the operational IDA cut-off.
Or:
Market Access Criterion: The sovereign has the capacity to access international financial markets on a durable and substantial basis.
And:
Absence of serious short-term vulnerabilities: In addition to meeting at least one of the above two criteria, the country should not face serious short-term vulnerabilities. The assessment of these vulnerabilities will require, in particular, the absence of risks of a sharp decline in income, or of a loss of market access (where relevant), and limited debt vulnerabilities, as indicated by the latest Debt Sustainability Analysis (DSA), and a confirmation that overall debt vulnerabilities remain limited, taking into account developments and prospects since such analysis.

Source: Eligibility to use the Funds Resources (IMF, 2013)

In this context, a criterion in the reverse of the absence of serious short-term vulnerabilities criterion (see Box 1), used by the IMF to determine graduation from PRGT funding could be added to entry criteria to use IFI concessional resources. If this were implemented, for example, countries that exhibited (i) and (ii) or (iii) serious short-term vulnerabilities, that is, those showing a high risk of a sharp decline in income, or a loss of market access, and significant debt vulnerabilities would be granted use of IMF and World Bank concessional resources. This would assist in preventing the rapid accumulation of debt witnessed in small states during 2009 and 2010 and it could also help to minimize the instances of untimely debt default, thus leading to more timely and orderly debt restructurings.

In terms of the impact on IFI concessional envelopes, the addition of a vulnerability criterion would not necessarily imply an increase in financial resources or a reduction in concessional resources for already eligible low income countries. As seen in the recent crises, not all countries have been affected equally by external shocks. In fact, LICs managed to weather the crises much better than their middle-income counterparts, for whom concessional finance is not extended. In this case, concessional resources would only have to be committed to the most affected vulnerable countries, which at any point is highly unlikely to include all LICs and all small states. To control access levels, IFIs would

[26] *From Eligibility to Use the Fund's Facilities for Concessional Financing (2010) and the Decision on Eligibility to Use the Fund¡¥s Facilities for Concessional Financing--PRGT-Eligibility Criteria (Decision No. 14521-(10/3), January 11, 2010.*

simply have to establish vulnerability thresholds for loss of income, debt and market access as has been done in the case of graduation.

C. Counter-cyclical Loans to Mitigate Against Debt Accumulation and Growth Challenges

50. Additionally, the Commonwealth proposes a broad based implementation of counter-cyclical loan mechanisms to reduce debt accumulation episodes and consequent growth challenges in small states. The Commonwealth Secretariat has studied the development of lending mechanisms that could help countries better cope with external shocks, without unnecessarily interrupting growth and development. Particular focus has been placed on counter-cyclical lending contracts, in which it is agreed ex-ante that debt servicing will automatically be allowed to fall, or become zero, in periods when external shocks (measured in a particular way, e.g fall in value of exports), hit a particular country (See Jones, 2010).

This study was driven by issues raised and discussed at a joint meeting of the Commonwealth Ministerial Debt Sustainability Forum (CMDSF) and Organisation Internationale de la Francophie (OIF) in April 2009 and by Commonwealth Ministers in October 2010, as well as the Ministers of the Francophonie meeting in April 2011 in Chad. Commonwealth Ministers recognised the need for new or modified lending instruments to help vulnerable countries cope with large unforeseen exogenous shocks and accordingly urged the international community to develop new instruments to promote the counter-cyclical management of debt service.

The Commonwealth asserts that in light of the continued sovereign debt crisis in Europe, and the slowdown of the world economy, it would be particularly important and timely to expand the battery of instruments that help developing countries, when they are hit by shocks, as well as increase their scale. Counter-cyclical lending if far more widely applied, would represent an important instrument that complements existing shock absorber mechanisms. The IMF, World Bank as well as the IADB have been studying the application of counter-cyclical/precautionary lending for some time but none of the instruments developed (IMF precautionary lending instruments and IADB counter-cyclical loans) deliver the type of assistance to meet the specific needs of small states. For example, the IADB precautionary mechanisms carry various commitment fees and are add to the debt stock during crisis episodes.

The idea of countercyclical lending has been applied in an innovative way since 2007 by the Agence Francaise de Development, (AFrD) via its Counter-Cyclical loan, the CCL. The CCL affords borrowing countries debt holidays through a fixed grace period of 5 years and a floating grace period, also of 5 years; the latter debt holiday on capital repayments can be used automatically if the debtor country choses to do so, allowing suspension of debt servicing by the debtor country if its merchandise exports fall by 5% or more in relation to the moving average of the previous five years.

The choice of merchandise exports as a trigger variable, (rather than total exports) is linked to the fact that this indicator is available at most with four months lag in the Global Trade Atlas, which implies that the debt service suspension holiday can be triggered quickly (Cohen et al., 2008); and speed is essential as it ensures genuine counter-cyclicality (see again, Te Velde and Griffith-Jones, op cit). Furthermore, the fact that mirror statistics (not based on the data of the country itself, but of its trading partners) are used ensures data objectivity. However, during Commonwealth-UNDP workshops in the Caribbean and Africa, AFrD revealed that they were investigating the use of different triggers, including natural disasters and prices.

These counter-cyclical loans provide unconditional, automatic (if requested by country and thus optional) debt service holidays, equivalent in cash terms to conditional new compensatory financing, for those countries that have borrowed previously. Lack of conditionality for debt holidays is seen as an attractive feature for developing countries, but the facility is only relevant for countries that have borrowed fairly significantly in the past.

Indeed, the AFrD report that there is relatively low demand for this type of loan from potential borrowing countries. The AFrD considers one reason to be the fact that its loans do not represent a significant share in total bilateral and MDB/RDB lending; and asserts that if all official concessional lenders created a CCL, borrowing through this instrument could become an important proportion of countries' debt, and debt holidays could become a valuable and desirable source of foreign exchange and fiscal expenditure savings in the event of shocks (Jones, 2010). Additionally, there is a knowledge deficit in developing countries with respect to the CCL, a fact that was also revealed in the Commonwealth-UNDP CCL workshops.

D. Resilience Building as a Policy Condition for International Financial Institution (IFI) Lending

51. **The Commonwealth's final proposal is for IFIs to pursue macroeconomic adjustment within a framework of resilience building and to let resilience building serve as the main policy conditionality for small states access to IFI resources**. Resilience building includes macroeconomic adjustment but would be accompanied by social, political and environmental reforms as well. Typically, the IMF has only focused on macroeconomic adjustment given its function but this approach has been widely criticised, as mentioned in section IV, for the negative effects on growth and development. Additionally, for access to international and bilateral aid, and in debt restructurings, most countries have had to agree to an IMF programme that does not give due consideration to the need to strengthen developmental elements. Resilience building, even though containing an element of

macroeconomic adjustment, is more politically palatable and could help to avoid issues such as debt restructuring "too little, too late". To design this type of reform, the IMF would need to collaborate closely with the World Bank and regional development banks, who are better placed to consult on social, political and environmental policies. To facilitate resilience building IFIs could consider supporting peer learning as they are many lessons to be learned and shared with respect to country experiences with macroeconomic adjustment, debt restructuring and building resilience, for example.

The Commonwealth Secretariat has been working on a resilience index for small states (Comsec, 2013). Briguglio *et al.* (2009) [27] defines resilience as a country's ability to cope with external shocks, that is, to the ability of a country to (a) recover quickly from harmful external economic events and (b) withstand the effect of such shocks. As illustrated in sections II and III, small states poor economic performance and debt issues have stemmed primarily from their exposure to external shocks or "lack of resilience". This is particularly why small states Ministers at CFMM in 2012 called for measures to improve their resilience and why the Secretariat's Small States arm has an entire work programme devoted to developing a resilience index for small states. Resilience building, as articulated by Briguglio *et al* (2006; 2009) would involve implementation of the following policies:

Macroeconomic stability

In the context of economic resilience, macroeconomic stability relates to the interaction between an economy's aggregate demand and aggregate supply. Briguglio *et al* (2009) proposed that the macroeconomic stability component of resilience can be measured by three variables, namely: (i) the fiscal deficit-to-GDP ratio; (ii) the sum of the unemployment and inflation rates; and (iii) the external debt-to-GDP ratio. These variables are available for a reasonably wide set of countries spread over a spectrum of stages of development, size and geographical characteristics.

Market efficiency

If markets adjust rapidly to achieve equilibrium following an external shock, the risk of being negatively affected by such a shock will be lower than if market disequilibria persist. Indeed, with very slow or non-existent market adjustment, resources will not be efficiently allocated in the economy, resulting in welfare costs, manifested, for instance, in unemployed resources and waste or shortages in the goods markets. These considerations have important implications for shock-absorbing resilience. Not many indicators of market efficiency are available which span a sufficiently wide range of countries. Following consideration of a number of possible suitable indicators, Briguglio *et al.* suggests the use of a component of the Economic Freedom of the World Index entitled 'regulation of credit, labour and business'[28] which is

[27] Briguglio, L., Cordina, G., Farrugia, N. and Vella, S. 2009. "Economic Vulnerability and Resilience: Concepts and Measurements." *Oxford Development Studies*, Vol. 373: 229-247.

[28] Economic Freedom of the World 2010 Annual Report, available at: http://www.freetheworld.com/2010/reports/world/EFW2010_BOOK.pdf.

aimed at measuring the extent to which markets operate freely, competitively and efficiently across countries. The index is designed to identify the effect of regulatory restraints and bureaucratic procedures on competition and the operation of markets.

Social development

Briguglio *et al* (2006; 2009) argue that social development is an essential component of economic resilience. This factor indicates the extent to which relations within a society are properly developed, enabling an effective functioning of the economic apparatus without the hindrance of civil unrest. Social development can also indicate the extent to which effective social dialogue takes place in an economy which, in turn, would enable collaborative approaches towards the undertaking of corrective measures in the face of adverse shocks. Social development in a country can be measured in a number of ways. Variables relating to income, such as its dispersion and the proportion of the population living in poverty, and the proportion of the population with low levels of education, could be useful indicators.

Good governance

Good governance is essential for an economic system to function properly and hence to be resilient. Governance relates to issues such as rule of law and property rights. Without mechanisms of this kind in place, it may be relatively easy for adverse shocks to result in economic and social chaos and unrest. Hence the effects of vulnerability to external shocks would be exacerbated. There are various indicators of political governance including the World Bank Kaufman Index[29] and the "Legal Structure and Security of Property Rights" component of the Economic Freedom of the World Index.[30]

Good environmental management

The environment can be an important source of vulnerability as it is associated with shocks of an adverse nature, principally by hazards, such as earthquakes, floods and sea-level rise. Management of such hazards (such as early warning systems, education, adaption schemes) would be conducive to resilience building. In this regard, the Yale University Environmental Performance Index would be useful for inclusion in a resilience index. Unfortunately, data on small states is generally absent in this index.

[29] Kaufmann, D., Kraay, A. and Mastruzzi, M. 2010. "The Worldwide Governance Indicators : A Summary of Methodology, Data and Analytical Issues." World Bank Policy Research.

[30] Economic Freedom of the World 2010 Annual Report, available at: http://www.freetheworld.com/2010/reports/world/EFW2010_BOOK.pdf.

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Appendix

Table 1: Summary of Key Features of the IMF PRGT Facilities

Facility	**ECF** Extended Credit Facility	**SCF** Standby Credit Facility	**RCF** Rapid Credit Facility
Function	Long term balance of payments problems	Short term balance of payments needs	Low-access, emergency funding
Replaces	PRGF (Poverty Reduction & Growth Facility)	Exogenous Shock facility (High Access Component)	Exogenous Shock facility (Low Access Component), Emergency Post-Conflict Assistance & Emergency Natural Disaster Assistance
Term	3 years	1-2 years	Outright disbursement
Repayment	5-10 years	4-8 years	5.5-10 years
Extendable	Yes	No	No
Repeatable	Yes	Limited to 2.5 out of any 5 years	Yes
Precautionary	No	Yes (Subject to maximum of 50% of quota)	No
Interest Rates*	0.25%	0.25% plus commitment fee	0.25%
Upper Credit Tranche	Yes	Yes	No
PRSP required	Yes	No	No
Limit on scale	Annual limit of 100% of quota; Limit of 300% cumulative basis; Limits decline with outstanding	Annual limit of 100% of quota; Limit of 300% cumulative basis; Limits decline with outstanding	Sub-limits of annually 25 & cumulative 75% of quota

(Source: IMF, Jones 2010) [31]

[31] In addition: the Policy Support Instrument ("PSI") continues to provide advice without lending.

Table 2: Summary of Key Features of IMF Non-PRGT Facilities

Facility	SBA Stand-By Arrangements	FCL Flexible Credit Line	PLL Precautionary and Liquidity Line	EFF Extended Fund Facility	RFI Rapid Financing Instrument
Function	Short-term balance of payments problems	Crisis prevention and crisis resolution	Crisis prevention and crisis resolution	Medium- and longer-term balance of payments problems	Urgent balance of payments need
Eligibility	All	Strong performers	Strong performers not eligible for FCL	All	All
Replaces	Not applicable	Not applicable	Precautionary Credit Line	Not applicable	Emergency Natural Disaster Assistance (ENDA) Emergency Post-Conflict Assistance (EPCA)
Term	12-24 months	1-2 years	6 months or 1-2 years	3 years	1-2 years
Repayment	3¼-5 years	3¼-5 years	3¼-5 years	4½-10 years	3¼-5 years
Extendable	Yes Up to 36 Months	No	No	Yes	No
Precautionary	Yes	Yes	Yes	No	No
Other Flexibility	Exceptional access; Front loaded access; Rapid access	Can draw at any time within a pre-specified window	Renewal of six-month PLL possible after a two-year cool-off period	Not applicable	No need for a full-fledged program or reviews
Interest Rates[32]	SDR interest rate	SDR interest rate	SDR interest rate	SDR interest rate	SDR interest rate
Other Costs	Commitment fee and service charge	Commitment fee, service charge and possible surcharge	Commitment fee and service charge	Commitment fee and service charge	
Upper Credit Tranche	Yes	No	Yes	Yes	Yes
Conditionality	Yes	No	Yes		
Limit on scale	200% of quota[33] for, and cumulative up to 600 % of quota	No cap on resources; request assessed on a case by case basis	250% of quota (6 months) 500 % of quota and a cumulative limit of 1000 % of quota (1-2 years)	200 % of quota annually and cumulative up to 600 % of quota.	50% of quota per year and 100% of quota on a cumulative basis

[32] Special Drawing Rights (SDR) interest rate is known as the IMF "rate of change". It is a market related interest rate that is revised weekly to take account of short-term interest rates in international money markets.

[33] *Quota subscriptions are a central component of the IMF's financial resources. Each member country of the IMF is assigned a quota, based broadly on its relative position in the world economy. A member country's quota determines its maximum financial commitment to the IMF, its voting power, and has a bearing on its access to IMF financing.*

Table 3: Small States Eligibility for International Financing Mechanisms

	World Bank (IDA)			IMF (PRGT)			EU	
Types of Funding	**IDA Crisis Response Window**	**IDA Immediate Response Mechanism**	**IDA only - Debt Reduction Facility**	**Extended Credit Facility**	**Standby Credit Facility**	**Rapid Credit Facility**	**Vulnerability Flex Mechanism**	**Food Facility**
Country								
East Asia & Pacific								
Brunei Darussalam								
Fiji								
Kiribati	√	√	√	√	√	√		
Nauru								
Papua New Guinea	√	√	√	√	√	√		
Samoa	√	√	√	√	√	√		
Solomon Islands	√	√	√	√	√	√		
Tuvalu	√	√	√					
Tonga	√	√	√	√	√	√		
Vanuatu	√	√	√	√	√	√		
Latin America & Caribbean								
Belize								
Dominica	√	√	√	√	√	√		
Grenada	√	√	√	√	√	√	√	
Jamaica								√
St. Kitts and Nevis				√	√	√		
St. Lucia	√	√	√	√	√	√		
St. Vincent	√	√	√	√	√	√		
Antigua and Barbuda								
Bahamas, The								
Barbados								
Trinidad and Tobago								
Guyana	√	√	√	√	√	√		
South Asia								
Maldives	√	√	√	√	√	√		
Sub-Saharan Africa								
Lesotho	√	√	√	√	√	√		√
Swaziland*1								
Botswana								
Mauritius							√	
Namibia							√	
Seychelles								
Gambia, The	√	√	√	√	√	√		
Europe								
Malta								
Cyprus*2								

Table 4: Small States Eligibility for Regional Financing Mechanisms

	IADB					CDB	AfDB					ADB
Types of Funding	**Development Sustainability Contingent Credit Line**	**Contingent Credit Line for Natural Disasters**	**Deferred Drawdown Option**	**Immediate Response Facility for Emergencies caused by Disasters**	**Contingent Credit Facility for Natural Disaster Emergencies**	**Special Development Fund**	**Emergency Liquidity Facility**	**Trade Finance Initiative**	**African Development Fund**	**Nigeria Trust Fund**	**Debt Sustainability and ADF Grant Eligibility**	**Asian Development Fund**
Country												
East Asia & Pacific												
Brunei Darussalam												
Fiji												
Kiribati												√
Nauru												√ (Blend Only)
Papua New Guinea												√
Samoa												√
Solomon Islands												√
Tuvalu												√
Tonga												√
Vanuatu												√
Latin America & Caribbean												
Belize	√	√	√	√	√	√						
Dominica						√						
Grenada						√						
Jamaica	√	√	√	√	√	√						
St. Kitts and Nevis						√						
St. Lucia						√						
St. Vincent						√						
Antigua and Barbuda						√						
Bahamas, The	√	√	√	√	√	√						
Barbados	√	√	√	√	√	√						
Trinidad and Tobago	√	√	√	√	√	√						
Guyana	√	√	√	√	√	√						
South Asia												
Maldives												√
Sub-Saharan Africa												
Lesotho							√	√	√	√	√	
Swaziland*1												
Botswana							√	√	√	√	√	
Mauritius												
Namibia							√	√	√	√	√	
Seychelles							√	√	√	√	√	
Gambia, The							√	√	√	√	√	
Europe												
Malta												
Cyprus*2												

Table 5: List of IADB and AfDB Facilities

IADB	Details	AfDB	Details2
Development Sustainability Contingent Credit Line	• Protect social programs or capital investment in the event of an economic shock. • U.S $6 billion available to their 26 borrowing member countries over the 2012-2014 period. • Maximum of $2 billion per year and with unused resources from one year carrying over to the following year.	**Emergency Liquidity Facility**	• ELF aims at providing financial support to eligible clients in exceptional cases. • Started off with a US$1.5 billion fund. • Proposals for the use of the resources are considered by the Board within ten (10) working days.
Contingent Credit Line for Natural Disasters	• Covers urgent financing needs that arise immediately after a natural disaster. • Country limit for these would be $100mn or 1% of GDP. • Deferred draw down option also available: allows countries, on payment of an upfront premium, to draw on the resources of policy based loans, when they require these funds.	**Trade Finance Initiative**	• A multiphase USD 1 billion Trade Finance Initiative (TFI) was created after the financial crisis.
Deferred Drawdown Option	• Allows countries to commit policy-based loans up front on payment of a premium, but to draw them down at a time of their choosing	**African Development Fund**	• Promotes economic and social development in 40 low-income African nations (77% of Africa's population) • Provides concessional loans and grants to the public and private sectors. • ADF loans are interest free and a repayable over long periods of time (50 years) with a 10 year grace period. • The loans only carry a service charge of 0.75 per cent per annum on outstanding balances, and a 0.50 per cent on undisbursed commitments. • Replenished every 3 years.

Immediate Response Facility for Emergencies caused by Disasters	• Funds available expeditiously for immediate support in the aftermath of a natural disaster.	**Nigeria Trust Fund**	• Objective is to assist the development efforts of the Bank's low-income regional member countries whose economic and social conditions and prospects require concessional financing. • Its initial capital of US$ 80 million was replenished in 1981 with US$ 71 million. In 2008, the Federal Republic of Nigeria and the Bank agreed to a ten-year extension of the NTF. • The capital at the end of 2010 was US$ 200 million (approximately UA 128.5 million). • NTF resources can co-finance operations with the ADB and the ADF, as well as fund stand-alone operations, in both the public and the private sector.
Contingent Credit Facility for Natural Disaster Emergencies	• Provides contingent funding in the event of natural disasters. • Existence of a Country Integrated Disaster Risk Management Program, and verification of occurrence of a disaster event of contractually agreed type, location, and intensity required.	**Debt Sustainability and ADF Grant Eligibility**	• The Joint World Bank-IMF's Debt Sustainability Framework (DSF) methodology is used to determine each country's: o Risk of debt distress o Applicable financing terms o Eligibility to grants

Table 6: World Bank Facilities

IBRD	IDA	IFC	MIGA
Middle-income country governments & Subnational entities with government guarantee	**Low-income country governments**	**Private Sector Clients**	
¤ IBRD Flexible Loan	• Credits, Grants • IBRD Flexible Loan for enclave operations	• IFC A-Loan • IFC B-Loan (third parties) • IFC C-Loan • Parallel loans/Participating loans • Equity Finance • Local Currency Loans • Subnational finance* • Trade Finance/Short-term Finance • Fund Investments	
¤ Deferred Drawdown Option (DDO)	• DDO for IBRD-IDA for blend countries	• Deferred Credit Line • Maturity Put Option	
• Partial Risk Guarantee (PRG) • Partial Credit Guarantee (PCG) • Policy-based Guarantee (PBG)	• PRG • PCG • PBG (IBRD-IDA Blend countries only) • IBRD PRG for enclave operations	• Full/Partial credit guarantee • Credit-linked guarantee • Mezzanine investments in securitizations • Risk sharing facilities • Guaranteed offshore liquidity facility	• Political Risk Guarantees for cross border financing (commercial loans and capital market transactions) • Coverage available: TR, Expro, BOC, WCD, NHSFO
• Cross currency swaps • Interest rate swaps • Interest rate caps and collar • Commodity derivatives	• IBRD Hedging products (IBRD-IDA Blend countries only)	• Cross currency swaps • Interest rate swaps • Interest rate caps and collars • Commodity derivatives • Swap guarantee • Carbon delivery guarantee	• MIGA Political Risk Guarantees available for hedging instruments including commodity swaps, interest rate and currency swaps

• Derivatives for natural disaster risk management • Catastrophe Deferred Drawdown Option (Cat DDO) • Insurance pools • Catastrophe bond	• Weather hedge • Catastrophe bond • Insurance pool	• Weather hedge	
• Asset management • Government debt and risk management • Asset-liability management • Capital market access strategy and implementation	• Asset management • Government debt and risk management	• Access to finance • Investment climate • Environmental and social sustainability • Corporate and SME advisory services • ALM and risk management advice	• Investment strategy related to political risk • Dispute resolution • Environmental and social sustainability

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