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A Special Focus on COVID-19 and the Commonwealth

Is Today's Pandemic Tomorrow's Debt Crisis?

COVID-19 and the Risk of Restricting Debt Relief for Small and Vulnerable Countries

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Introduction

The International Monetary Fund (IMF) has described the pending economic fallout from the coronavirus pandemic, known as COVID-19, as the worst economic crisis since the Great Depression.¹ Entire continents are now in some form of lockdown, with only necessary and basic services in operation. Only a few countries, such as Sweden, have dared to defy the prevailing scientific advice of mandatory confinement.

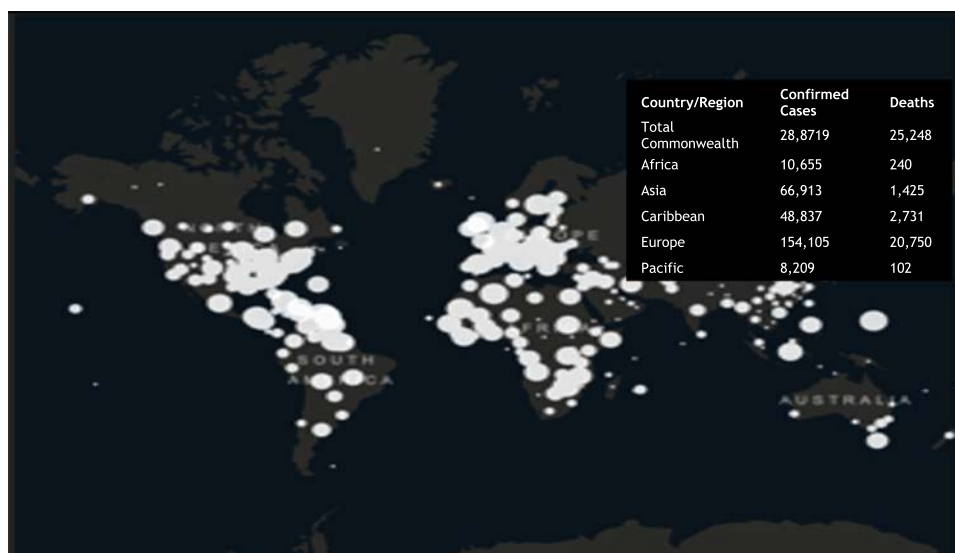
As of 28 April 2020, Johns Hopkins University reported that 3 million people across the globe had been infected and 207,815 people had died. The Commonwealth accounted for 9.6 per cent of all global infections and 12.1 per cent of deaths, of which the majority – 54.8 per cent of infections and 83.8 per cent of deaths – were in the United Kingdom: Other countries and regions in the Commonwealth seem to have been much less affected, although the impact is somewhat more significant when viewed as infections per 1,000 persons, given the small populations of a number of Commonwealth countries. There are countries such as Lesotho, Kiribati, Nauru, Samoa, Solomon Islands, Tonga, Tuvalu and Vanuatu, which have been fortunate enough not to record any infections at all, at least at the time of writing.

To assess the impact of COVID-19 on a biological basis alone, however, would be misguided. For many of the countries reported not to be as badly affected – mainly poor, small and other vulnerable countries – the real effects of the current pandemic will be felt during its aftermath. Notably, this point has been raised and acknowledged by the G20 group of countries who have agreed debt relief for 77 of the world's poorest countries for up to two years, and called on private sector actors to participate in the initiative. The initiative includes participation from the Paris Club and multilateral organisations.²

The IMF has answered the call with an announcement of debt service relief for 29 countries eligible for access to its Catastrophe Credit and Relief Trust (CCRT).³ Commonwealth countries eligible for the IMF's CCRT debt service relief include nine countries listed in Table 1 below. Of these eligible Commonwealth countries, only four are small states.

This paper investigates whether, in light of the pandemic and its potentially large negative impact on small and other vulnerable countries, the decision by the G20 and the IMF to restrict debt relief only to the income poor (by multilateral standards) risks debt crises. Through debt sustainability projections and an assessment of small states' risks, including

Figure 1. Global COVID-19 infections and deaths



Map from John Hopkins University (<https://coronavirus.jhu.edu/map.html>) and Commonwealth Secretariat Coronavirus Response Centre (www.commonwealth.int).

those from natural disasters and market concentration, the paper finds that there is a positive probability of both increased and broad-based debt sustainability issues. In addition, when combined with the tumultuous outlook for the global tourism industry, the risk of debt crises post-2020 is seen to be significant. In this regard, the paper makes a number of recommendations on how the global community could seek to arrest this problem before it spirals out of control.

Economic impact of COVID-19 on small states

It doesn't require the most astute economist or statistician to figure out that the economic fallout from the COVID-19 pandemic will be severe. All across the world people are confined, meaning that almost all business has ground to a halt. Social distancing measures are at the core of that. Accordingly, the IMF in its April 2020 World Economic Outlook (WEO) predicted

Table 1. Eligible Commonwealth countries and amounts of IMF debt service relief^a (SDR millions)

Eligible Commonwealth countries	GNI per capita (\$US)	6-month debt service relief	Eligible Commonwealth countries	12-month debt service relief
Sierra Leone	490	9,756,085.00	Sierra Leone	42,521,770.00
Mozambique	460	7,947,266.91	Rwanda	36,545,668.80
Tanzania	1,020	7,502,858.97	Malawi	23,974,660.00
Rwanda	780	5,847,300.00	Tanzania	13,553,747.21
Malawi	360	5,257,460.00	The Gambia	5,789,265.00
The Gambia	710	1,532,452.50	Mozambique	2,867,927.64
Solomon Islands	2020	43,382.44	Solomon Islands	249,449.03
Uganda	620	–		–
Nauru	12,060	–		–

that global economic activity would decline by 3 per cent, with advanced economies declining on average by 7 per cent by the end of 2020 (IMF, 2020b).

Using the WEO data, the IMF expects Commonwealth small states to experience the greatest economic contraction of all Commonwealth states.

On average, real output in Commonwealth small states will decline by 3.1 per cent, meaning that these countries are due to lose 8.6 percentage points in potential GDP growth by year end. This compares with contractions in potential GDP growth of 8 and 4.9 percentage points for Commonwealth advanced countries and other developing countries, respectively.⁵

All but a few Commonwealth small states⁶ will be in the red come 2020. Growth declines will range from 12 per cent in Belize to 1 per cent in Tuvalu, mainly due to the disruption to the global tourism industry.

Tourism is the small states' main business and accounts for up to 50 per cent of GDP – and the majority of employment opportunities – in countries such as Grenada, Maldives, and St Kitts and Nevis.⁷ UNCTAD estimates that on average, tourism comprises 30 per cent of the GDP of small island developing states (SIDs), amassing US\$30 billion per year.⁸ That is why, when comparing the IMF WEO projections with the World Tourism Organization's forecasts, the outlook for small states, though dire, still seems fairly optimistic. The World Tourism Organization predicts that global tourism arrivals will contract by between 20 and 30 per cent, but there are views which assert that the drop could be as high as 60 per cent.⁹

Another relevant and major determinant of Commonwealth small states' economic outlook is natural disaster.

Natural disasters cannot be predicted with any degree of certainty, which means it is hard for the IMF's predictions to take them into account, but in light of the frequency with which

Figure 2. COVID-19's comparative economic impact on Commonwealth countries

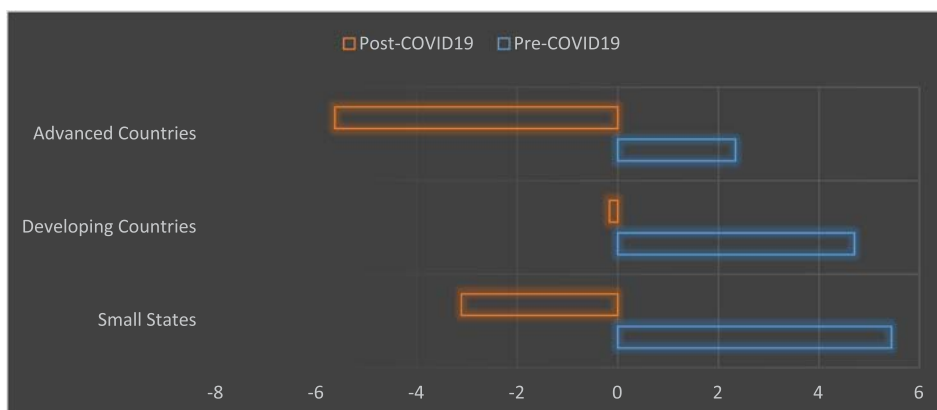
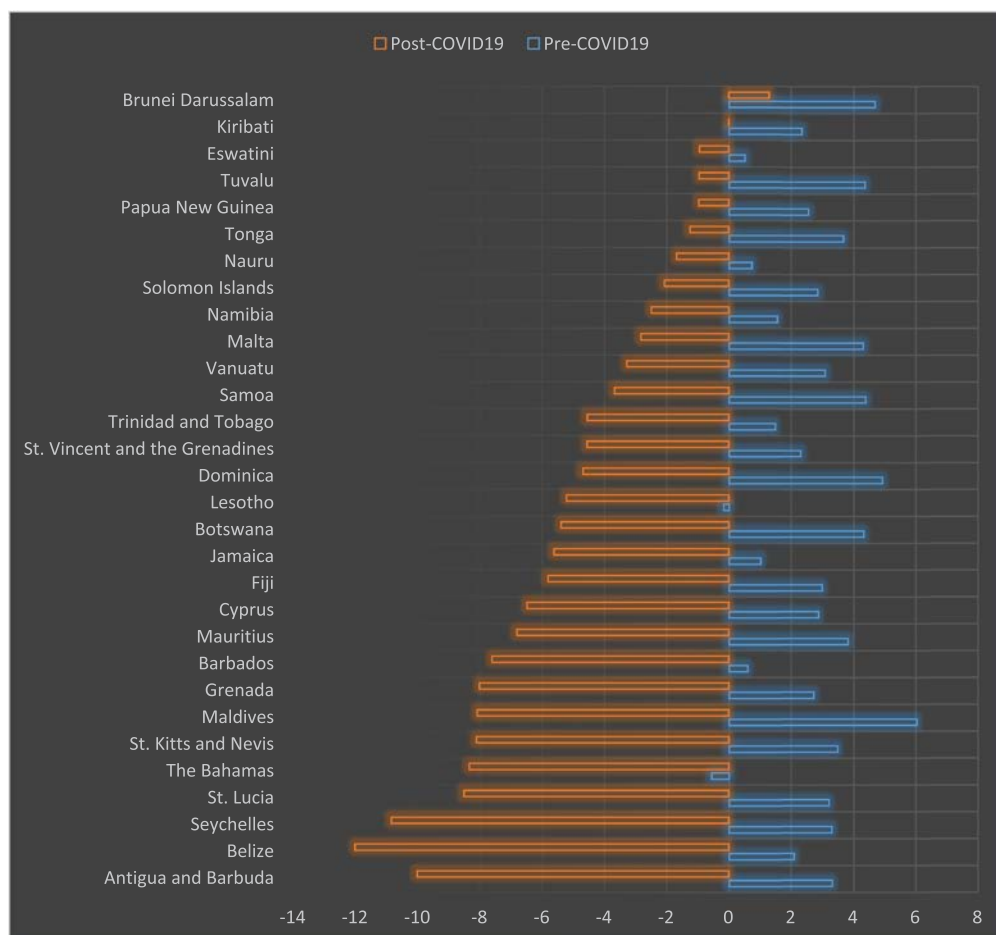


Figure 3. IMF growth forecasts for Commonwealth small states



they have occurred in the past five years, small states have a higher than normal expectation of being affected. On this note, in Table 2, the probability of natural disasters for small states is calculated using data from 1900 to 2019.¹⁰ The probability of disaster was obtained by dividing the total number of disaster occurrences per country by the total number of disasters for that country's respective region (see Appendix I). Clearly, not all countries are at equal risk, with the country most at risk being Maldives, with a 43 per cent probability. The most at-risk region is Africa where, for example, the probability of being affected by a natural disaster – which according to EM-DAT includes storms, floods, wild fires, extreme temperatures and drought – is as high as 39 per cent (Namibia). However, all small states have at least a 10 per cent chance

of being impacted in 2020. Should this risk be realised in the current environment of economic decline, high debt and crashing tourism figures, the prospect of wide-scale debt crises among small states cannot be ignored.

Debt burdens in the Commonwealth's small states are already fairly elevated, despite good progress in addressing debt sustainability issues in recent years. As depicted in Table 1, the Caribbean in particular is highly leveraged with some debt burdens surpassing 100 per cent. Across the group the average debt burden is only 60 per cent, having fallen from an average of 80 per cent only three years previously. This improvement has come through governments' fiscal efforts and the rebound in the global economy. And while the debt burdens in the Pacific region are smaller, the risk to this region's

Table 2. Factors affecting small states' economic outlook post-COVID-19

Small states	Losses in potential GDP	Current debt ratios	Probability of natural disasters	Main sectors	Market concentration
Antigua and Barbuda	-13.3	88.3	0.07	Tourism	38.2
The Bahamas	-7.8	60.5	0.14	Tourism	58.56
Barbados	-8.2	117.3	0.06	Tourism	47.49
Belize	-14.1	92.6	0.11	Agriculture and Fisheries	64.92
Botswana	-9.7	12.8	0.30	Diamonds	86.43
Dominica	-9.6	91.3	0.08	Agriculture	59.73
Fiji	-8.8	50.2	0.26	Sugar and Tourism	39.92
Grenada	-10.7	56.1	0.04	Agriculture + Tourism	41.64
Guyana	-32.9	57.2	0.06	Oil + Agriculture	59.05
Jamaica	-6.6	94.1	0.29	Tourism	55.34
Lesotho	-5.0	37.9	0.30	Diamonds	31.81
Maldives	-14.1	61.4	0.43	Tourism + Fisheries	89.2
Mauritius	-10.6	67.5	0.11	Tourism	38.21
Namibia	-4.0	51.6	0.39	Diamonds	36.4
St Kitts and Nevis	-11.6	59.5	0.05	Tourism	73.27
St Lucia	-11.7	71.6	0.10	Tourism	40.49
St Vincent and the Grenadines	-6.9	71.4	0.11	Tourism	48.84
Seychelles	-14.2	54.5	0.03	Tourism	81.65
Trinidad and Tobago	-6.0	49.8	0.07	Oil + Gas	60.84
Vanuatu	-6.4	52.2	0.21	Agriculture + Tourism	76.84

debt sustainability is as acute as in other regions, principally because of the climatic shocks they are likely to face. The same can be said for small states in Africa facing the risk of commodity price volatility.¹¹

Small states' debt sustainability post-COVID-19

To ascertain the risk to small states' post-pandemic debt sustainability in 2020, a simple debt sustainability analysis was undertaken using a debt dynamics equation (see Appendix II). Growth forecasts for small states are from the IMF April 27 WEO and figures for current debt ratios are taken from the IMF's WEO database.¹² The interest rate on debt is assumed at 5 per cent, in line with the IMF and OECD's discount rate assumptions.¹³ Note that this means the

estimations are highly conservative as this interest rate is used for assessing grant elements in concessional debt. Additionally, with no good information on countries' primary balances in 2018, small states' fiscal balances are used as a proxy and scenarios of higher fiscal ratios are included to account for the expectation of increased fiscal stimulus due to the coronavirus. Specifically, a bounds testing approach¹⁴ was utilised and small states' fiscal balances were shocked at rates of increase equal to 2 and 4 percentage points in 2020. The resulting debt ratios and increases are presented in Table 3.

The impact of COVID-19 on the IMF's new forecasts could see debt ratios in Commonwealth small states rise by as much as 27 percentage points, with debt to GDP ratios rising to as high as 134 per cent in small states.

Table 3. Impact of the pandemic on small states' debt sustainability

Small states	Int. rate	GDP	Fiscal balance scenarios						Current debt ratio	New debt levels			Level change			Avg. level change
			(a)			(b)				(a)	(b)	(c)	(a)	(b)	(c)	
			(a)	(b)	(c)	(a)	(b)	(c)		(a)	(b)	(c)	(a)	(b)	(c)	
Antigua & Barbuda	5.0	-10.0	-4.1	-6.1	-8.1	88.3	107.2	109.2	111.2	18.8	20.8	22.8	20.8			
Bahamas	5.0	-8.3	-1.5	-3.5	-5.5	60.5	70.7	72.7	74.7	10.3	12.3	14.3	12.3			
Barbados	5.0	-7.6	2.9	0.9	-1.1	117.3	130.3	132.3	134.3	13.1	15.1	17.1	15.1			
Belize	5.0	-12.0	-1.6	-3.6	-5.6	92.6	112.2	114.2	116.2	19.5	21.5	23.5	21.5			
Botswana	5.0	-5.4	-2.6	-4.6	-6.6	12.8	16.8	18.8	20.8	4.0	6.0	8.0	6.0			
Brunei	5.0	1.3	-9.4	-11.4	-13.4	2.6	12.2	14.2	16.2	9.5	11.5	13.5	11.5			
Cyprus	5.0	-6.5	2.0	0.0	-2.0	101.0	111.5	113.5	115.5	10.4	12.4	14.4	12.4			
Dominica	5.0	-4.7	-3.3	-5.3	-7.3	79.8	91.3	93.3	95.3	11.4	13.4	15.4	13.4			
Eswatini	5.0	-0.9	-5.1	-7.1	-9.1	41.1	48.6	50.6	52.6	7.5	9.5	11.5	9.5			
Fiji	5.0	-5.8	-3.3	-5.3	-7.3	50.2	59.3	61.3	63.3	9.0	11.0	13.0	11.0			
Grenada	5.0	-8.0	4.9	2.9	0.9	56.1	59.1	61.1	63.1	3.0	5.0	7.0	5.0			
Guyana	5.0	52.8	-4.8	-6.8	-8.8	57.2	44.1	46.1	48.1	-13.1	-11.1	-9.1	-11.1			
Jamaica	5.0	-5.6	0.6	-1.4	-3.4	94.1	104.1	106.1	108.1	10.0	12.0	14.0	12.0			
Kiribati	5.0	0.0	-21.4	-23.4	-25.4	23.5	46.1	48.1	50.1	22.6	24.6	26.6	24.6			
Lesotho	5.0	-5.2	-5.2	-7.2	-9.2	37.9	47.2	49.2	51.2	9.3	11.3	13.3	11.3			
Malta	5.0	-2.8	0.6	-1.4	-3.4	42.5	45.3	47.3	49.3	2.8	4.8	6.8	4.8			
Maldives	5.0	-8.1	-4.6	-6.6	-8.6	61.4	74.8	76.8	78.8	13.3	15.3	17.3	15.3			
Mauritius	5.0	-6.8	-2.7	-4.7	-6.7	67.5	78.7	80.7	82.7	11.3	13.3	15.3	13.3			
Namibia	5.0	-2.5	-7.2	-9.2	-11.2	51.6	62.7	64.7	66.7	11.1	13.1	15.1	13.1			
Papua New Guinea	5.0	-1.0	-1.9	-3.9	-5.9	37.7	41.9	43.9	45.9	4.1	6.1	8.1	6.1			
Samoa	5.0	-3.7	-1.6	-3.6	-5.6	49.4	55.4	57.4	59.4	6.0	8.0	10.0	8.0			
Seychelles	5.0	-10.8	1.2	-0.8	-2.8	54.5	62.9	64.9	66.9	8.5	10.5	12.5	10.5			
St Kitts and Nevis	5.0	-8.1	-2.3	-4.3	-6.3	59.5	70.3	72.3	74.3	10.8	12.8	14.8	12.8			
St Lucia	5.0	-8.5	-2.6	-4.6	-6.6	71.6	84.8	86.8	88.8	13.1	15.1	17.1	15.1			
St Vincent and the Grenadines	5.0	-4.5	-1.5	-3.5	-5.5	71.4	80.0	82.0	84.0	8.6	10.6	12.6	10.6			
Trinidad and Tobago	5.0	-4.5	-4.9	-6.9	-8.9	49.8	59.7	61.7	63.7	9.9	11.9	13.9	11.9			
Tuvalu	5.0	-1.0	-4.4	-6.4	-8.4	21.8	27.5	29.5	31.5	5.7	7.7	9.7	7.7			
Vanuatu	5.0	-3.3	-3.8	-5.8	-7.8	52.2	60.4	62.4	64.4	8.2	10.2	12.2	10.2			

On average, debt could be expected to rise from 57.4 per cent across Commonwealth small states to 70.6 per cent, surpassing the IMF's 60 per cent benchmark.

This is not as high as the average debt burden that has been observed in the past decade following the US financial crisis, but could just be the start. However, according to the estimates presented in the IMF's April 2020 World Economic Outlook, the 13.2 per cent increase in debt ratios for small states could be almost double that of all developing countries (7.5 per cent). Beyond the statistics, the more important observation is that the pandemic will in absolute terms represent a reversal in these countries' fiscal performance and heighten their vulnerability to shocks.

Particularly affected will be countries like Barbados and Jamaica, which have made exceptional efforts to return their economies to a sustainable footing but whose economies were still in dire straits before the pandemic, and Maldives, which depends almost solely on tourism and for whom debt is likely to rise as high as 78.8 per cent in the current environment.

Conclusion and recommendations

It is apparent from the assessment in this paper that even with fairly conservative IMF and WTO predictions, the impact of the ongoing pandemic on small states' debt sustainability will be both highly negative and broad based. On average, debt across this set of countries will move from a position of aggregate sustainability to one of high risk of debt instability, and could double the increase in debt ratios across Commonwealth developing countries. It can also be concluded that small states will be ever more

susceptible to additional risks stemming from natural disasters and volatility in commodity markets.

Should the world not actually experience a V-shaped recession, but more of a pronounced, flat-bottomed U-shaped downturn, the debt crises would in all probability be substantially more devastating. This is especially considering the expected hit on tourism which experts suggest could fall by around 60 per cent in 2020. Without some form of debt relief, the fate of the small states rests on a quick and effective vaccine that could help the global tourism industry rebound quickly and arrest their decline in GDP. Without this the current and unavoidable fiscal stimulus being implemented will have one consequence – an increase in debt – which if not matched by rebounding income can only result in debt crises.

Again, it does not require the most astute of economists to arrive at these conclusions.

Small and other vulnerable countries need relief and the G20 must assess how it can extend the relief of debt service initiative.

This can be done through acknowledging the following prerequisites:

- Put aside the historical dispute about the use of GDP per capita and recognise that maintaining the mantra that relief should not be given to middle-income countries could result in debt crises of unwanted proportions
- Recognise that this is not a failure of willingness to pay but of ability to pay brought on by an act of God, and that small states, even with their best efforts, will not be able to ride out this pandemic without jeopardising their fiscal situations

- Construct a special debt relief initiative, contingent on a structural programme led by the IMF, that builds fiscal capacity and prudence in small states, increases their fiscal space and improves their resilience.

Notes

- 1 <https://www.bbc.co.uk/news/business-52236936>.
- 2 [https://g20.org/en/media/Documents/G20_FMCBG_Communicu%C3%A9_EN%20\(2\).pdf](https://g20.org/en/media/Documents/G20_FMCBG_Communicu%C3%A9_EN%20(2).pdf).
- 3 Countries are eligible if their current GNI is not more than double their IMF quota.
- 4 Small states have been given special dispensation so that they have access to IMF debt service relief once their GNI per capita is not more than twice the prevailing World Bank International Development Association (IDA) operational threshold (IMF, 2020a).
- 5 Potential GDP growth losses calculated by subtracting IMF WEO April 2020 projections from IMF WEO projections made at October 2019.
- 6 For example, Guyana's economy is still projected to experience growth of 50 per cent but will lose 30 percentage points in potential GDP. Brunei Darussalam will still grow by 1.3 percentage points but will lose 2.4 percentage points in potential GDP.
- 7 Other major sectors for small states include agriculture, fisheries, oil and gas and mining, which have also been affected.
- 8 See <https://www.forbes.com/sites/daphneewingchow/2020/04/27/the-united-nations-predicts-billions-of-dollars-in-tourism-losses-for-small-island-developing-states/#2a8a8c9d43c4>.
- 9 See <https://www.forbes.com/sites/daphneewingchow/2020/04/27/the-united-nations-predicts-billions-of-dollars-in-tourism-losses-for-small-island-developing-states/#2a8a8c9d43c4>.
- 10 Data was obtained from the EM-DAT disaster database.

- 11 Lesotho, Botswana, Namibia and Trinidad and Tobago.
- 12 <https://www.imf.org/en/Publications/SPROLLS/world-economic-outlook-databases#sort=%40imfdate%20descending>.
- 13 [http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/DOC/WKP\(2017\)5&docLanguage=En](http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DEV/DOC/WKP(2017)5&docLanguage=En).
- 14 <https://www.imf.org/external/pubs/ft/dsa/>.

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- IMF (2020b). IMF World Economic Outlook April 27, 2020: The Great Lockdown

Appendix

- I. Probability of Natural Disaster Impact
Estimated as follows:

$$P_{disasters} = \frac{\sum_t^i disaster\ occurrences}{\sum_t^r disaster\ occurrences}$$

Where:

$P_{disasters}$ is the probability of disasters, calculated as the sum of all natural disasters for country i $\sum_t^i disaster\ occurrences$, divided by the sum of all natural disasters for country i region, represented by r $\sum_t^r disaster\ occurrences$, over the estimation period $t = 1900-2019$.

- II. Projecting Debt Ratios using Debt Dynamics Equation

The debt dynamics equation used in this paper is as follows:

$$D_t = \frac{1+r_t}{1+g_t} D_{t-1} - P_t$$

Where:

D_t is the projected debt level at 2020 and D_{t-1} is the estimated debt level in year 2019 taken from the IMF WEO October 2019 database.

r_t is the interest rate on debt, proxied by the IMF and OECD recommended discount rate for concessional loans.

g_t is the growth rate in GDP which is inputted from the IMF WEO April 27 Report.

P_t is the primary balance, proxied by the fiscal balance due to lack of recent information on the primary balances for

Commonwealth countries. As the primary balance omits interest expense, the fiscal balances would normally be an over-estimate of the primary balance if used to proxy. However, the assumption is that this is an acceptable estimation in light of ongoing fiscal stimulus.



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