PACIFIC ISLANDS FORUM SECRETARIAT

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FORUM ECONOMIC OFFICIALS MEETING

6-7 July 2021

FORUM ECONOMIC MINISTERS MEETING

13-14 July
Virtual

AGENDA ITEM 3A: REGIONAL INITIATIVES TO SUPPORT ECONOMIC RECOVERY

Purpose

The paper presents initiatives developed by the COVID-19 Economic Recovery Taskforce (CERT) for consideration of Forum Economic Ministers. The initiatives cover a framework for monitoring and evaluating national and regional responses to COVID-19, options to deal with the high debt burden of Forum Island Countries (FICs), and a proposal to assist businesses facing high freight costs in the region.

Mandate

i. The 2020 Forum Economic Ministers Meeting (FEMM) established CERT to support FICs in their COVID-19 economic recovery efforts.

ii. Forum Economic Ministers "***recognised*** *the value of collective action in addressing common challenges and therefore* ***agreed*** *to establish a regional COVID-19 Economic Recovery Taskforce comprising interested Members to lead a coordinated response that addresses COVID-19 regional economic priorities, including health, digital economy and connectivity, food security and agriculture, and building resilient and sustainable economies"*.

iii. Pacific Islands Forum Leaders, as part of their response to the impact of COVID-19, have also made a "*strong, concerted plea for development partners to support FICs, including those classified as high-income countries, by providing debt relief, in line with the April 2020 G20 decision"*.

A. Problem/Opportunity Identification

The COVID-19 pandemic is having a devastating impact on the Pacific region as a result of the economic fall-out from the implementation of containment measures taken by Forum Island Countries (FICs) in response to the pandemic. The closure of borders and restrictions on international travel across the globe has led to a slow-down in FIC economies, as well as the economies of major trading partners, and external markets. The key channels of impact in FICs are through growth, trade, employment, tourism, fisheries, investment, trade and remittances.

2. The UN ESCAP, at the launch of the 2021 Economic and Social Survey of Asia and the Pacific in May 2021, estimated GDP growth in FICs for 2020 at -6.4%, and predicted growth in 2021 at 2.8%. Uncertainties due to the emergence of new variants, coupled with the slow rollout of vaccines continue to weigh heavily on the effort of FIC governments, as they consider the reopening of borders, and the easing of international travel restrictions in order to stimulate much needed economic activity. It will no doubt take a number of years for many FICs to fully recover from the impacts of the pandemic.

3. FICs responded to the pandemic through policy actions at the national level. Donors and development partners also responded quickly and assisted FICs through the provision of needed medical equipment, supplies as well as cash grants and concessional loans. The pandemic presents opportunities for FICs to come up with innovative ideas to address other issues like debt and the sudden increase in freight costs.

Background

4. CERT comprises twelve (12) Members: Australia, Cook Islands, Fiji, French Polynesia, Kiribati, Nauru, New Caledonia, New Zealand, Niue, Samoa, Tuvalu and Vanuatu. It began its work in October 2020, focusing on the following four thematic areas:

- maximising returns from the fisheries sector;
- e-commerce and digital economy;
- sustainable development financing options; and
- pathways towards a tourism bubble.

5. Based on further work by CERT, these issues were narrowed down to short-term deliverables around the first three themes, which better responded to Members immediate priority areas. These included developing a framework to monitor and evaluate national and regional responses to the pandemic, an assessment of the debt burden of FICs, and a proposal to address the increase in freight costs due to COVID-19.

B. Policy Initiatives

6. This section of the paper will discuss the identified short-term deliverables respectively, followed by their specific recommendations for consideration by Members.

Monitoring & Evaluation Framework

7. This section measures Member governments' economic and financial responses to COVID-19 since last year when the pandemic warranted measures to help address the severe downturn in regional economies. The data used in the analysis is drawn from the Asian Development Bank's COVID-19 Policy Database published through its Economic Research and Regional Co-operation

Department (ECRD) [1]. The monitoring and evaluation framework is an important mechanism for tracking regional and national responses implemented by Member countries and is a useful tool to inform decision making.

8. **Box 1** highlights the responses to the COVID-19 pandemic since early 2020.

9. Assessment of the progress to date on the three areas of work (PHP-C, SEIA and CERT) on COVID-19 responses provides useful information for FEMM consideration. Findings and observations from the assessments will help consolidate and shape a substantive set of policy recommendations for FEMM. These recommendations include:

(i) measures to enhance the delivery and effectiveness of the PHP-C initiative, as the situation transits from containment to vaccination and recovery of Members;

(ii) SEIA Taskforce advice on further work to be done on the ground (in Member countries) to address the social impact of COVID-19 on the vulnerable groups in communities; and

(iii) CERT advice on the progress of national and regional economic COVID-19 responses and options to further accelerate its relevance and impact on Members.

(iv) Consideration for amalgamating other areas of work undertaken by PHP-C and SEIA into an overarching monitoring and evaluation framework to inform future work.

Box 1. Categorisation of Economic Response Measures

The methodology includes a framework of measures in the taxonomy of COVID-19 macroeconomic responses developed by the ECRD, which can be simply laid out as follows:

- **Measures 01–05**: are broadly categorised as **uses of funds**.
  - Measures 01–04 correspond to monetary policy measures implemented through central banks to control the supply of credit and money into the economy by using their macro-prudential powers to regulate the banks and financial institutions.
  - Measure 05 corresponds to fiscal policy where governments influenced demand and targeted specific sectors by allocating and spending money in those areas.
- **Measures (06-08)** are categorised as **sources or funds**
  - Measure 06 relates to domestic public funds sourced or redeployed from within existing budgetary allocations to meet COVID-19 responses
  - Measure 07 pertains to central bank financing of governments through direct lending, reserve drawdowns or through purchase of government securities in the secondary market.
  - Measure 08 relates to international assistance through loans and grants
- **Measure 09** is redundant in this analysis since it corresponds to the **international development assistance a country provides**, which is not relevant to FICs.
- **Measure 10** corresponds to those group measures for which **no breakdown** is provided but relates to deliberate policy responses that could have been funded from sources such as **domestic and international market borrowings, other revenue sources and sovereign reserve drawdowns**.
- **Measures (11 – 12)** corresponds to other economic (11) or non-economic (12) responses that does not fall into any of the categories above.

10. The monitoring and evaluation framework will provide a good basis to assess how national and regional interventions have played out in terms of coverage, overlaps and gaps. This will also include assessments of the effectiveness and success of the stimulus packages introduced by governments in response to the pandemic. It will only lead to better informed policies and strategies to enhance the alignment, focus and outcomes of these response measures moving forward, as Members shift from containment to recovery mode of interventions.

[1] The ADB database source draws from (and makes reference to) other primary sources such as bilateral and multilateral partners and member countries.

Opportunity to address FIC Debts

11. Easing the debt burden of FICs through debt relief arrangements is critical to freeing up funds tied up in debt servicing that could be additional resources for building back better, as they deal with the economic impacts of COVID-19. With many FICs already facing limited fiscal space and in high risk of debt distress, there is an opportunity for innovative ideas to urgently address the debt situation, in the short to medium term, as well as potential solutions that enable long-term improvements in living standards for FICs.

12. Many FICs have increased borrowing to combat the economic and health fall-out of the pandemic, and are experiencing high risk of debt distress, reflected by the high 'debt-to-GDP' levels. According to the World Bank, in 2020, most FICs have been assessed at high risk of debt distress (**Table 1**). The risk of debt distress in FICs is being exacerbated by the region's high vulnerability to disasters and climate change and debt management challenges, inherent in their small size. In the first quarter of 2021, five (5) severe tropical cyclones buffeted the region, causing widespread damage to key economic infrastructure, and significant disruptions to the flow of goods and services and livelihoods of people.

13. FICs urgently need to address their debt profile to reduce their high debt distress levels and restore fiscal space to deal with other pressing national needs such as in health and education services impacted by the COVID-19.

Table 1: Forum Island Countries Public Debt (as % of GDP), plus selected comparable countries

Country	2018	2019	2020 (Est)	2021 (Proj)	2022 (Proj)
Cook Islands	28.8	27.0	19.0	43.0	49.0
Fiji	46.4	48.9	73.6	83.6	78.2
FSM	18.8	17.1	16.0	15.3	12.8
Kiribati	19.4	18.1	17.2	21.3	28.6
Marshall Islands	23.3	23.3	23.8	23.2	23.3
Nauru	74.3	62.0	59.7	36.0	36.0
New Caledonia	n/a	16.0	19.0	n/a	n/a
Palau	43.1	49.3	52.6	44.4	44.4
PNG	36.7	40.0	49.2	49.6	49.7
Samoa	52.8	47.4	49.2	49.6	54.1
Solomon Islands	8.3	8.3	13.9	22.3	26.2
Tonga	45.9	41.3	41.6	43.7	43.2
Tuvalu	17.3	16.3	14.2	11.8	9.8
Vanuatu	48.1	45.3	44.2	48.7.9	50.1
Similar countries:					
Cape Verde	125.6	125.0	139.0	137.6	131.3
Seychelles	59.1	57.7	98.4	110.4	108.5
St Lucia	60.0	61.3	84.4	88.4	87.5

Source: IMF World Economic Outlook, April 2021 and data from national authorities

14. Debt servicing costs of FICs have also increased because of higher debt levels and borrowing from commercial sources as well as increased borrowing supported by explicit or implicit guarantees leading to some notable increase in 'interest to revenue' ratios. Coupled with a squeeze in domestic

revenue generation, as well as limited room for consolidation of public expenditure, an increase in debt servicing would exert huge pressure on government finances, including budget deficits which would further exacerbate sovereign debt challenges of FICs.

15. Several options for debt relief are available to FICs. Some of these options are presented in **Table 2** below. Given the current global economic downturn due to COVID-19, the uncertainties of the financing landscape and subdued appetite for debt forgiveness, the realistic debt relief options for FICs would be debt restructuring, including the debt service suspension initiative, IMF debt facilities and debt swaps.

Table 2: Debt Relief Options available to FICs

Type of debt relief	Advantages	Disadvantages	Further Comments
Debt Service Suspension Initiative (DSSI). The DSSI rolled out by G20 in April 2020 and supported by the World Bank and IMF offers temporary suspension of debt repayments to help developing countries cope with the economic fallout of the COVID-19 pandemic.	The DSSI is available to 73 of the world's poorest countries. 43 countries have signed up for DSSI deferring over $5 billion of their debt repayment obligations.	The DSSI however, does not forgive debt; it simply delays debt service payments with a one-year grace period and repayment period of five years. High income FICs are not eligible for the scheme.	10 FICs are eligible for the DSSI and 4 have signed up to be part of the scheme. The potential savings for eligible FICs is US$424.7 million, of which, 83% is by PNG.
IMF Debt Relief Assistance: The IMF provides debt relief to its members to ease debt repayments. IMF's debt assistance comes under the Catastrophe Containment & Relief Trust Fund (CCTRF), Rapid Credit Facility (RCF) and Rapid Financing Instrument (RFI).	The CCRTF provides upfront grant financing. The RCF provides rapid access and concessional financing (zero interest, 5.5 years grace period and 10 years maturity)	Access to RCF depends on member's quota holdings.	Four FICs have benefited from the RCF/RFI facilities receiving US$424.08 million, of which, PNG received 86%.
Debt Swaps: A debt swap is when debt is exchanged for another asset. The debt is paid in another form or to another creditor that has taken over the debt. The most common debt swaps are: 'debt for debt' (DDS), 'debt for equity'(DES) and 'debt for nature' swaps (DNS). 'Debt for climate' swaps (DCS) is an emerging option.	Debt swaps have been around since the 1980s and have been used for solving debt servicing problems of developing countries.	The use of 'debt swaps' have been limited in the Pacific. Debt-for-equity swaps (and similarly debt-for-resources swaps) in particular, have proved controversial when used elsewhere. Debt swaps may not be an immediate solution to FIC recovery efforts.	

Type of debt relief	Advantages	Disadvantages	Further Comments
Debt-for-Resilience-Swap (DRS): This is a form of 'debt for climate swap', where creditors and debtors agree on debt relief in exchange for investment in resilience building. (**Figure 3 in Annex 2**). FICs could contribute a portion of their revenue annually into the Pacific Resilience Facility (PRF) and those payments could be treated as debt swaps against debt repayments to bilateral or multilateral creditors.	The proposal addresses the region's debt problems and resilience building against climate change and disasters. As the PRF already exist, it could be the Special Purpose Vehicle (SPV) through which such a debt swap can be implemented.	Further groundwork is required to assess the practicalities of the proposal. A lot of effort is required to implement this type of swap and may take time to realise the benefits of this option.	The negotiations could take place during the regional conference between FICs and all their Creditors.

Source: World Bank, IMF, Economic Social Commission for Asia Pacific and Economic Commission for Latin America and Caribbean

16. **Regional Debt Conference (RDC) for FICs and their Creditors:** To provide a platform to discuss options for debt relief, FICs as a group of borrowers could come together to negotiate debt relief options with their lenders/creditors. Negotiating as a group has advantages than bilateral negotiations. The RDC could be convened in late 2021 or early 2022 and modelled on the Honiara Club Agreement in Solomon Islands (**Annex 3**).

17. The RDC would be an ideal opportunity to discuss beneficial outcomes for both creditors and debtors. Possible areas for discussion could include:

i. From the Debtors perspective, the RDC would be an opportunity to explore debt relief options, including debt restructuring and debt swaps.

ii. From the Creditors perspective, the RDC could discuss policy and other options for FICs to undertake to create confidence and assurance for creditors. This could include:

- enhancing debt transparency, especially in the production, standardization and publication of up-to-date debt information and also transparency in debt servicing arrangements post debt relief agreements;

- PFM reform actions to improve robustness of government financial management from budget policy settings, to execution and accounting and reporting. These will help achieve the three principal objectives of: (i) fiscal discipline; (ii) allocative and technical efficiencies; and (iii) accountability and transparency;

- strengthen debt management capacity of borrowers to prudentially manage their debts;

- improve debt analysis and debt sustainability assessments; and
- an opportunity for creditor’s to present reforms and other innovative approaches being undertaken to support effective debt management and to review borrower’s debt policies, especially their appetite for taking on new debt.

Regional Freight Assistance Plan

18. The freight costs for moving goods from producers in FICs to their closest markets have tripled because of the disruptions to the supply chain and travel restrictions. This was confirmed by a recent business survey conducted by the Pacific Trade Invest (PTI) network.

19. The closing of borders, increased quarantine requirements, travel restrictions and limited international flights, have all severely disrupted the tourism industry, shipping, fisheries and port services and those industries that rely heavily on maritime and air transport freight for the movement of goods from producers to the world market.

20. As part of its work, CERT considered a proposal to investigate necessary support to the fishing industry have access to finance and identify short-term financial interventions to support the longline industry. One short-term intervention to support the longline industry is through the utilization of the Pacific Humanitarian Pathway on COVID-19 (PHP-C). Although the focus was initially on fisheries products noting their high value and their perishable nature, it was realized that other high value non-fisheries goods can also utilize the same opportunity depending on the priorities of Members.

21. Repatriation flights under PHP-C focus predominantly on the movement of people and essential supplies. There is, however, an opportunity to consider the movement of goods at a subsidized rate compared to the high airfreight rate offered under commercial cargo

22. The proposed airfreight assistance through the PHP-C mechanism complements the existing Government support programs and provides a platform that supports economic recovery and growth. Most governments in the FICs have provided some form of stimulus packages to support businesses and the production of goods and services domestically. Some of these include support to small to medium enterprises (SMEs), debt repayment concessions, direct primary production support, wage bill support, including domestic freight support programs.

23. The freight assistance program will also complement the existing freight assistance programs implemented by the PTI network, particularly PTI Australia. The PTI Australia facility has provided grants to small and medium enterprises meet their freight costs into the Australian market. The Australian Government has provided funding for freight assistance administered and implemented by PTI Australia.

C. Next Steps

24. Based on the Forum Economic Ministers decision on key issues and recommendations in this paper, the Forum Secretariat will work with relevant stakeholders, including CROP agencies, and

development partners to implement the 2021 FEMM decisions as outlined in the 2021 FEMM Action Plan, as appropriate.

D. Regional Governance Implications

25. The 2021 FEMM Action Plan would outline any regional governance arrangements to support the Pacific Islands countries to respond to COVID-19, including responsibilities of relevant development partners and CROP agencies, as well as appropriate regional fora and meetings, such as Forum Economic Ministers Meeting, Forum Fisheries Ministers Meeting, Education and Health Ministers Meetings.

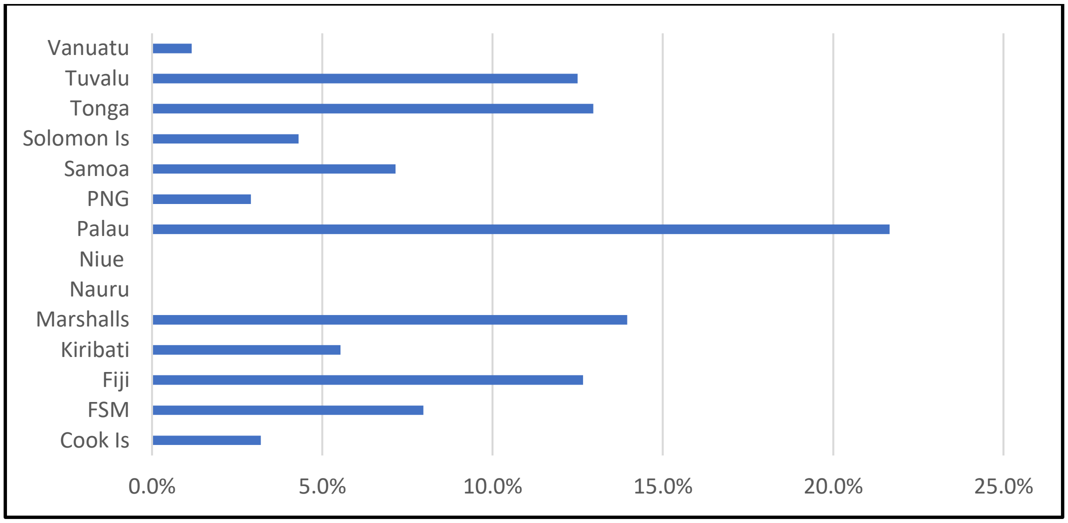
E. International Advocacy and Engagement Implications

26. The Secretariat would advocate for and engage with relevant international and regional stakeholders on appropriate FEMM decisions on the issues covered by this paper, or other associated 2021 FEMM papers to support FICs' economic recovery from the COVID-19 pandemic as well as address their underlying economic challenges.

Pacific Islands Forum Secretariat
21 June 2021

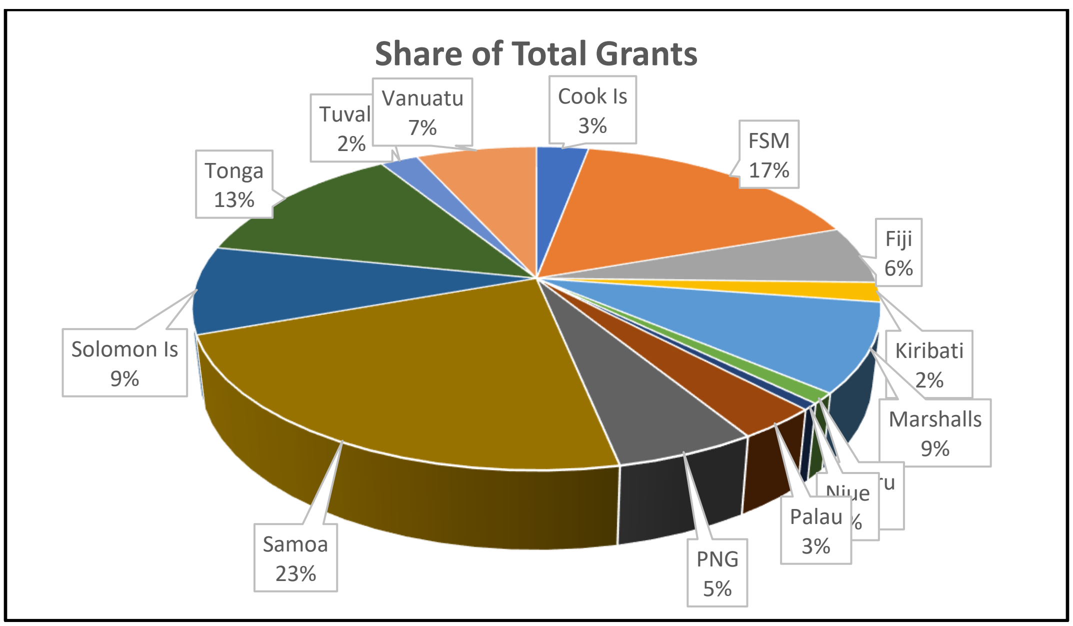
Annex 1

Figure 1: Loans contracted by FICs as a response to COVID-19 (in % of GDP)



Source: CERT Monitoring & Evaluation Framework

Figure 2: Grants received by FICs as a response to COVID-19

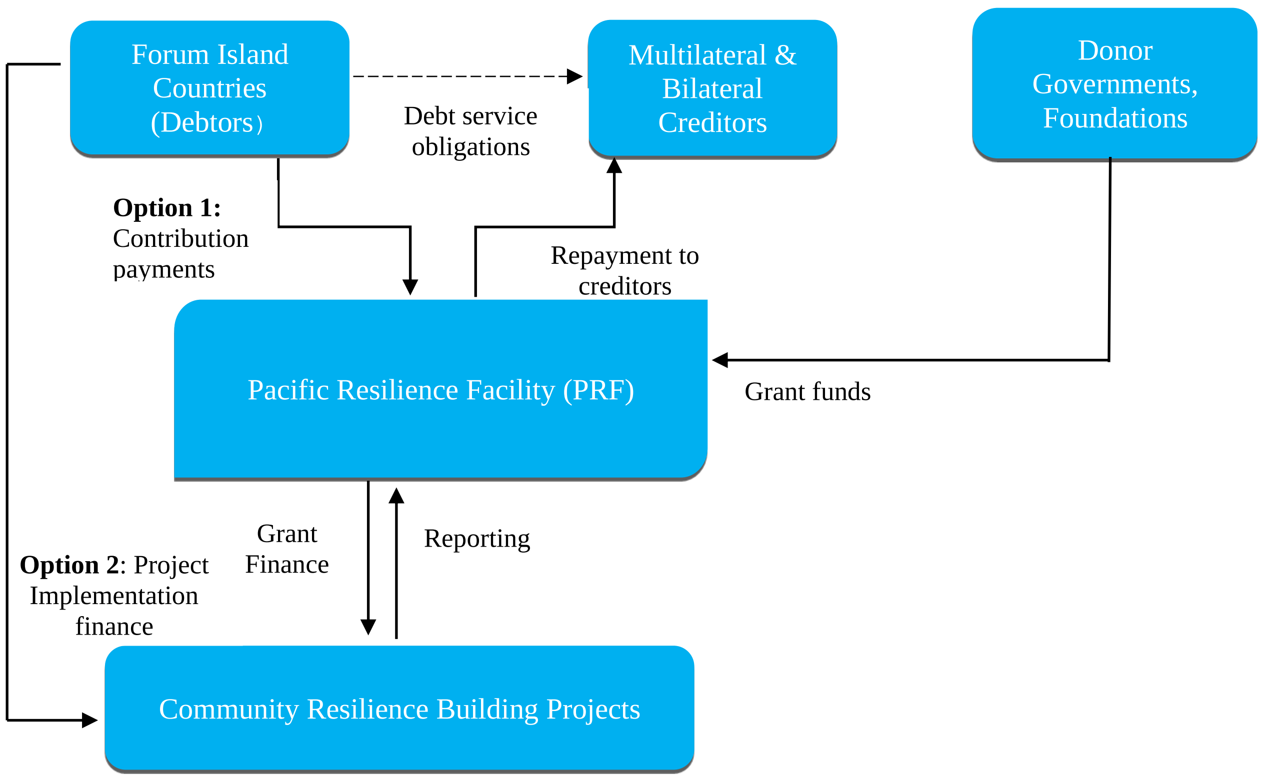


Source: CERT Monitoring & Evaluation Framework

Annex 2

The Flowchart below presents the possible interactions among the various stakeholders involved in a 'debt for resilience' swap. A creditor agrees to treat a debtor's contribution to the PRF in exchange for the debtor's commitments to spend the newly available funds on approved resilience building projects.

Figure 3. Flowchart for Debt for Resilience Swap



Annex 3

The Honiara Club Agreement

1. In the aftermath of the ethnic conflict from 1998 to 2003, the Solomon Islands Government faced with a debt profile of 60% of GDP, signed the Honiara Club Agreement (HCA) with four of its major creditors (Australia, the European Commission, the European Investment Bank, and the International Fund for Agricultural Development). The HCA provided for substantial debt forgiveness and restructuring while committing the Government to no new borrowing until debt sustainability had been restored.

2. The New Zealand Government was engaged as the intermediator between the Solomon Islands Government and its Creditors. The Agreement enabled the Government to improve its debt position from a peak 62% of GDP in 2004 to 18% in 2011.

3 Under the Agreement, the Government allocated 15% of total revenues for debt servicing through a Debt Service Fund set up at the Central Bank, with the stated goal of reducing the external debt-to-GDP ratio to 30%, the Government's "green light" for resumption of new borrowing. Over the years, the ratio of revenue allocated for debt servicing was reduced to 10% and is currently at 5%. As a result of the agreement, funds for debt servicing are available when debts are due. Debt servicing now make up a smaller proportion of the total budget than in the past.

4. The Agreement was reviewed in 2012 enabling changes to the framework, especially the introduction of a new Debt Management Strategy, under which, a Debt Management Advisory Committee (DMAC) was established to advise the government on all matters related to debt.

5. Solomon Islands is classified as subject to 'moderate risk' of debt distress according to a recent debt sustainability assessment by the IMF.