



THE IMPACT OF COVID-19 CRISIS ON EXTERNAL DEBT IN SMALL ISLAND DEVELOPING STATES

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Please cite this paper as Piemonte, C. (2021), *“The Impact of the COVID-19 Crisis on External Debt in Small Island Developing States”*, OECD, Paris.

This document is also available in the OECD document database under the document code DCD (2021)23.

Revised version, August 2021. The previous title was: *External debt in small island developing states (SIDS): One-year into the COVID-19 crisis, where do we stand?*

Abstract

This paper gives an overview of debt in small island developing states (SIDS). It provides an analysis of their liquidity and solvency problems in the aftermath of the COVID-19 crisis, and introduces a quantitative estimation of so-called “off-the-radar” Chinese overseas loans. It finds that debt challenges are not homogeneous across SIDS and that, while exacerbated by the economic consequences of the pandemic, they are deeply rooted, and not a one-off liquidity problem linked to the crisis. Lastly, it reviews measures currently implemented by the Development Assistance Committee (DAC) members and multilateral organisations to help SIDS overcome the looming debt crisis, as well as measures that could contribute to enhance resilience and sustainability of SIDS development financing.

Foreword

Since 2016 the OECD has conducted a number of studies on the responses of the international community to the sustainable development and financing challenges faced by SIDS. After two general reports, *Climate and Disaster Resilience in SIDS* (OECD/The World Bank, 2016^[1]) and *Making Development Co-operation Work for Small Islands Developing States* (OECD, 2018^[2]), two country studies looked at SIDS graduation experiences: an ex-post analysis of Cabo Verde's graduation from the least developing country (LDC) category (Morris, Cattaneo and Poensgen, 2018^[3]), and an ex-ante analysis of the Solomon Islands' graduation from the LDC category (Piemonte and Fabregas, 2020^[4]). Three additional papers explored the consequences of the COVID-19 pandemic: *Mapping the Economic Consequences of COVID-19 in SIDS*, (Piemonte, 2020^[5]), *COVID-19: Understanding Health Risks in SIDS* (Piemonte, 2020^[6]) and *COVID-19 Pandemic: Towards a Blue Recovery in SIDS* (OECD, 2021^[7]).

Those reports provided additional evidence that, while most SIDS are upper-middle income countries they are often among the most vulnerable developing countries due to their small size, remoteness and vulnerability to climate-related impacts.

This paper aims to further contribute to the Development Assistance Committee's reflections on the most appropriate responses to the COVID-19 pandemic. It describes the overall official debt situation in SIDS; incorporates some "off-the-radar"¹ Chinese debt to give a more comprehensive picture of SIDS' debt; and reviews the impact of COVID-19 on debt in SIDS as well as measures that have already been implemented to alleviate the burden, differentiating liquidity from solvency issues.

This paper was written by Cecilia Piemonte and benefited from comments by Olivier Cattaneo, Martin Kessler and Rolf Schwarz (OECD), Sebastian Horn (Kiel Institute) and FCDO Treasury officials.

¹ "Off-the radar" debt refers to liabilities that are outside the standard perimeters of public debt statistics and do not therefore get reported. Data on "off-the radar" debt is not official OECD data and builds on (Horn, Reinhart and Trebesch, 2019^[9]).

Table of contents

Abstract	3
Foreword	4
Abbreviations and acronyms	7
Executive summary	8
1 Pre-COVID-19: State of external debt in small island developing states	10
The state of SIDS' debt in 2019 according to official sources	11
Incorporating "off-the-radar" Chinese debt: how does it change the picture?	12
2 Post-COVID-19: Preliminary assessment of the impact of the crisis on small island development states' external debt	15
Not all SIDS are equal in front of the crisis	16
Some early measures have been put in place in response of the crisis	18
3 What's next? How to prevent a new debt tragedy	21
Annex A. External debt trends over the period 2011-19 in small island developing states for which data on off-the-radar Chinese overseas lending is available (by country)	24
References	27

Tables

Table 2.1. The diversity of debt composition in SIDS	16
Table 2.2. How the Debt Service Suspension Initiative could benefit SIDS	19
Table 2.3. IMF short-term facilities used by SIDS	20

Figures

Figure 1.1. Private creditors hold the bulk of total SIDS' external debt	11
Figure 1.2. Service-based upper-middle income SIDS present higher levels of public and publicly guaranteed debt than other UMIC-service-based developing countries : 64% vis à vis 32%	12
Figure 1.3. When incorporating off-the-radar Chinese debt, SIDS' private guaranteed-like debt increases by almost 50 %	13

Figure 1.4. Off-the-radar Chinese loans could represent up to one-fourth of total external debt in countries like the Maldives, but remain marginal in other SIDS	14
Figure 2.1. Countries with high shares of debt servicing-over-export ratios, especially service-based economies, could face worrying solvency problems	18

Boxes

Box 1.1. Concepts and data concerns	10
Box 2.1. Debt liquidity and debt solvency	15

Abbreviations and acronyms

DAC	Development Assistance Committee
DCD	Development Co-operation Directorate
DSSI	Debt Service Suspension Initiative
GDP	Gross domestic product
GNI	Gross national income
IDA	International development association
IFI	International financing institutions
IMF	International Monetary Fund
LDC	Least developed country
LIC	Low-income country
LMIC	Lower middle-income country
MIC	Middle-income country
ODA	Official development assistance
ODC	Other Developing country
ODF	Official development flow
PNG	Private non-guaranteed debt
PPG	Public and publicly guaranteed
SDG	Sustainable Development Goal
SIDS	Small island developing states
UMIC	Upper middle-income country
WB	World Bank
WBG	World Bank Group

Executive summary

Governments around the world borrowed at historic levels during the COVID-19 crisis in response to the sudden halt of economic activity during lockdowns. Not all countries, however, had equal margins of maneuver, and some countries already on the brink of debt distress could have been pushed into default by declining fiscal resources, as illustrated by the Zambian case.

Small island developing states (SIDS) are among the most vulnerable countries in the world, with small domestic markets and a high dependence on a limited number of exports, such as travel and transport, hence limited fiscal space to respond to external shocks such as the COVID-19 crisis. Debt sustainability is therefore of paramount importance to SIDS' capacity to respond to the crisis and recover.

This paper takes stock of the external debt of SIDS at the eve of the COVID-19 crisis, including “off-the-radar” debt owned by China, and analyses effects of the crisis on debt sustainability. It observes a large heterogeneity of situations across SIDS, in particular with regard dependence vis-à-vis Chinese lenders, and suggests that liquidity problems could turn into solvency problems if no actions were taken.

Service-based and higher income SIDS rely heavily on public and publicly guaranteed lending – official and private. In the service-based upper-middle income SIDS (service-based UMIC-SIDS), mostly tourism-based economies, public and publicly guaranteed debt (official and private) weigh heavily in sovereign balance sheets, representing on average 64% of the total external debt, compared to 32% in other UMIC-service-based developing countries (service-based UMIC-ODCs).

Levels of external debt differ significantly from one small island developing state to another. SIDS' debt-to-GDP ratio ranged from 25% to 96% in 2020², at 48% on average³.

For the eleven SIDS for which data is available in 2019, so-called “off-the-radar” Chinese debt⁴ is estimated to add an extra USD 3.8 billion, on average, or 7% of their total external debt. However, this aggregate picture hides a wide disparity of individual cases. In the Maldives, Dominica and Fiji, off-the-radar Chinese debt reaches 28%, 21% and 20% of total external debt, respectively, while other SIDS like Comoros or Guyana are not concerned.

Prior to the COVID-19 crisis, eleven out of twenty-two SIDS already had solvency problems: they were qualified as high risk or being in debt distress. However, the crisis is generating liquidity impasses that could magnify existing solvency problems or create new ones, despite official alleviating mechanisms such as the Debt Service Suspension Initiative (DSSI).

SIDS' debt problem is more than a temporary liquidity issue linked to the COVID-19 crisis – it is more deeply rooted. The heterogeneity of situations requires tailor-made, case-by-case responses,

² Estimations, including off-the-radar Chinese debt when available.

³ Weighted average.

⁴ Off-the-radar Chinese debt refers to liabilities that are usually outside of the standard perimeters of public debt statistics and do not therefore get reported.

including negotiations and co-ordination with private lenders, DAC members and other official providers of development co-operation.

To prevent this situation from reoccurring, **DAC members can target their financial and technical support** towards:

- mobilising additional domestic resources;
- building capacity to use innovative solutions, such as access to climate funds or debt swaps;
- improving debt transparency;
- strengthening debt management, i.e. facilitating a systematic adoption of de-risking clauses and mechanisms when negotiating private debt; and
- encouraging the adoption of qualities of investment principles, so as to promote higher quality investment for higher return on loans.

1 Pre-COVID-19: State of external debt in small island developing states

Box 1.1. Concepts and data concerns

Total external debt refers to the sum of the long-term and short-term external debt stocks as defined by the World Bank.

The long-term external debt stocks are the sum of official creditors' public and publicly guaranteed (PPG) debt (from bilateral and multilateral donors), private creditors' PPG debt (creditors are bondholders/private financial institutions), private non-guaranteed debt (or PNG, for which lenders are bondholders/private financial institutions), and the use of International Monetary Fund (IMF) credit.

Short-term external debt has an original maturity of one year or less. Available data do not allow distinction between public, publicly guaranteed, and private nonguaranteed short-term external debt. Total external debt is periodically reported by IMF/WB countries and disseminated by the World Bank (World Bank, 2020^[8])

This paper places a special accent on the public and publicly guaranteed debt (from official as well as – and mainly – private sources in SIDS) because such debt affects the countries' sovereign balance sheet (unlike public non-guaranteed debt).

Although the Development Assistance Committee (DAC) recognises thirty-three countries as SIDS, this note considers only two-thirds of them, due to a lack of debt data. These twenty-two countries are: Belize, Cabo Verde, Comoros, Dominica, Dominican Republic, Fiji, Grenada, Guinea-Bissau, Guyana, Haiti, Jamaica, Maldives, Mauritius, Papua New Guinea, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Sao Tome and Principe, Solomon Islands, Timor-Leste, Tonga, and Vanuatu. The eleven remaining SIDS not included in this analysis are: Antigua and Barbuda, Cuba, Kiribati, Marshall Islands, Micronesia, Montserrat, Nauru, Niue, Palau, Suriname, and Tuvalu.

In recent months, small island developing states (SIDS) have repeatedly called on the international community to increase efforts in support of solving debt problems.⁵ With low economic diversification, constrained fiscal spaces, scarce economic mitigation possibilities, and high dependence on remittances – SIDS will suffer even more significantly than other countries from the COVID-19 crisis. In 2020, they should see a decrease of 7.1% in their total GDP compared to a 4.1% decrease for other developing countries.⁶ Devastating economic effects, adding to the direct stress on the health sector, place SIDS in a very precarious situation.

⁵ SIDS have called the international community for further organisation and engagement (e.g., the Alliance of the Small Island Developing States Call for Action, or Compact, AOSIS, and ECLAC proposal for Caribbean countries); <https://www.cepal.org/en/pressreleases/eclac-presents-five-proposals-increase-fiscal-space-caribbean-countries>); https://www.aosis.org/wp-content/uploads/2020/07/AOSIS-Statement-on-Debt_verJune-29.pdf

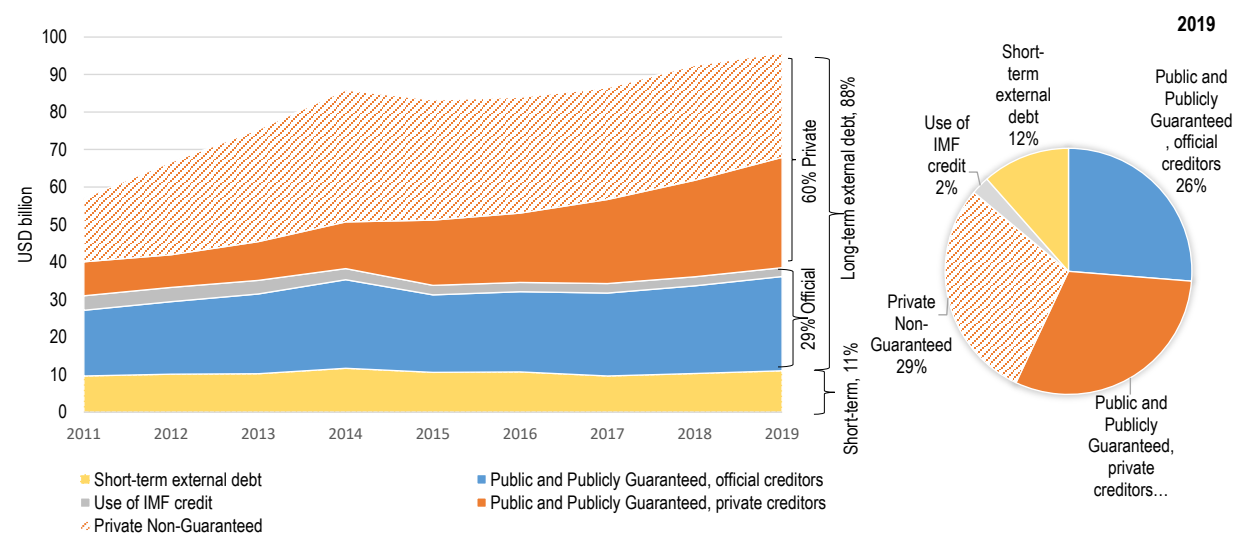
⁶ Arithmetic average, based on IMF forecasts (IMF, 2021^[27])

The state of SIDS' debt in 2019 according to official sources

Over the past decade the overall external debt stocks in SIDS have been on the rise (+7% on average per year over 2011-19, reaching USD 96 billion in 2019). Debt composition has also evolved, becoming more and more privately owned. Over this period the private long-term share of SIDS' total external debt grew by fourteen points, from 46% in 2011 to 60% in 2019 (Figure 1.1).

Figure 1.1. Private creditors hold the bulk of total SIDS' external debt

USD billion, current prices



Note: Based on the 22 SIDS for which data are available.

Source: Author's calculations based on World Bank debt statistics (2020) <https://datatopics.worldbank.org/debt/ids/>

In 2019, SIDS' total long-term external debt stocks reached 45% of their total GDP⁷ – compared to 25% in other developing countries (ODCs).⁸ However, a broad heterogeneity across countries hides critical situations in terms of debt composition --private versus non private, guaranteed or not-- and levels.

In service-based⁹ upper-middle income SIDS (service-based UMIC-SIDS), public and publicly guaranteed debt (PPG debt, official and private) represents 64% of total external debt on average, compared to 32% in other UMIC-service-based developing countries (service-based UMIC-ODCs). This issue mostly concerns tourism-based economies. Moreover, in service-based UMIC SIDS the private share of this public and publicly guaranteed debt (private PPG debt) is higher than in service-based UMIC-

⁷ For 22 out of the 33 SIDS as described in the DAC List of ODA Recipients: <http://www.oecd.org/dac/financing-sustainable-development/development-finance-standards/dac-list.htm>.

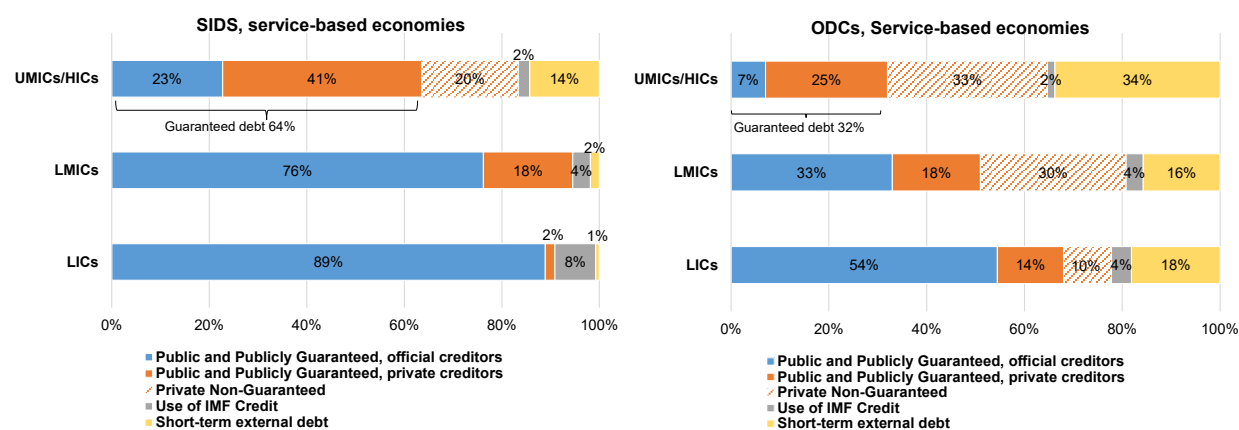
⁸ This represents total figures as a group: (total SIDS' debt) / (sum of SIDS' GDP); and (total ODCs' debt) / (sum of ODCs' GDP).

⁹ The literature has consistently clustered SIDS within two economic groupings: commodity-exporters and service-based economies – the latter grouping mainly dependent on tourism and financial services. The author carried out this analysis within those two economic groupings (and income categories) but does not show results on export-economies as there are too few SIDS in this grouping to allow useful comparisons across income categories and with other developing countries.

ODCs: it represents 41% of their total external debt compared to 25% for service-based UMIC-ODCs - while the non-private or official PPG debt represents respectively 23% and 7% of their total external debt. This latter phenomenon is principally due to the small island IDA exception¹⁰ (Figure 1.2).

Figure 1.2. Service-based upper-middle income SIDS present higher levels of public and publicly guaranteed debt than other UMIC-service-based developing countries : 64% vis à vis 32%

2019 data



Note: Based on 22 SIDS for which data are available. Under the LIC service-based category figures Haiti; under the LMIC service-based grouping Cabo Verde, Comoros, Sao Tomé and Príncipe, and Vanuatu; under the UMIC/HIC: Belize, Dominica, Dominican Republic, Fiji, Grenada, Jamaica, Maldives, Mauritius, Samoa, St. Lucia, St. Vincent and the Grenadines, and Tonga.

Source: Author's calculations based on World Bank debt statistics (2020) <https://datatopics.worldbank.org/debt/ids/>

Service-based UMIC-SIDS are those in the most pressing debt emergency situations (eight out of eleven UMIC-SIDS are in high risk or in debt distress, as defined by the IMF). In this sense, the question arises if the significant presence of official lenders could act as a cushion or guarantee in face of extreme situations (default risk) and thereby incentivise a 'more than optimal' injection of private financing, at least vis à vis ODCs. In the extreme case of default or near-default, the official lending portion can be much easily negotiated than the rest of the debt (e.g., through the Paris Club), increasing the probability of private lenders continuing to be serviced.

In order to have a more complete picture of external debt in SIDS, the following section introduces the concept of so-called 'off-the-radar' debt, when data is available.

Incorporating "off-the-radar" Chinese debt: how does it change the picture?

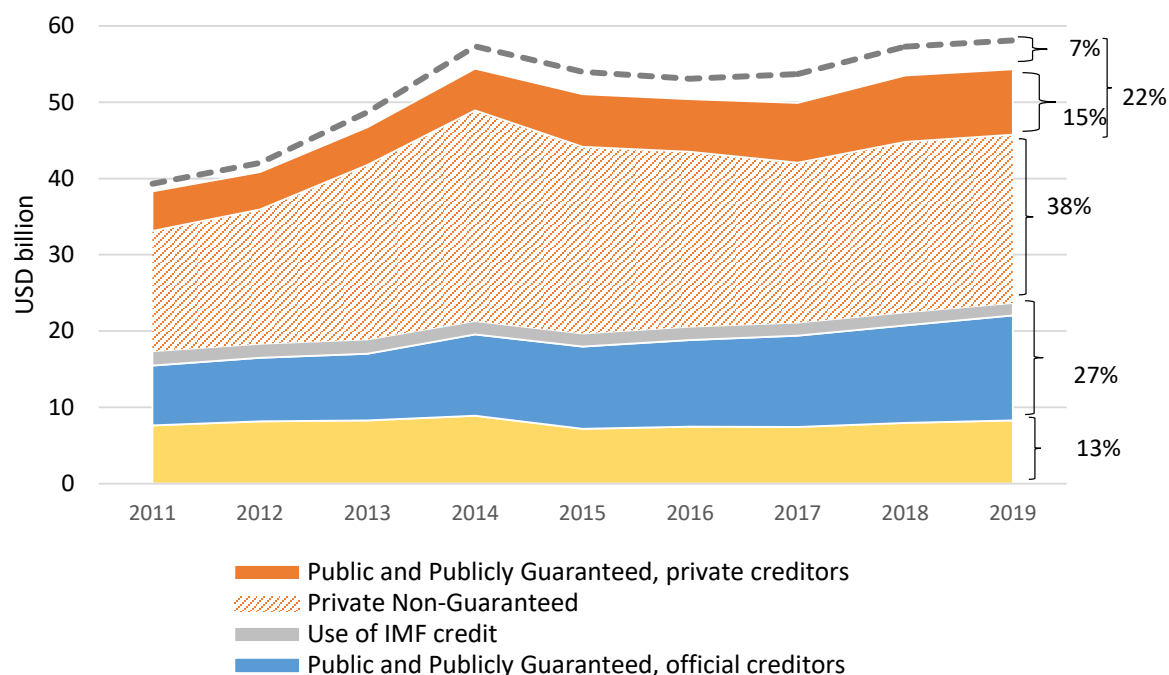
Not all foreign debt is reported to the IMF, and a share of it remains 'off-the-radar'. As defined in Box 1.1, long-term external debt stocks are periodically reported by IMF/WB countries. While People's Republic of China (hereafter 'China') reports on debt stocks and flows, some of its debt might only be partially reflected in official IMF/WB data. In "*China's overseas lending*", Sebastian Horn et al. explain this is because Chinese official creditors often lend to state-owned enterprises or special-purpose vehicles and their liabilities are usually outside of the standard perimeters of public debt statistics and do not therefore get reported (Horn, Reinhart and Trebesch, 2019^[9]). However, these transactions still represent an

¹⁰ This facilitates SIDS' access to concessional financing even after having surpassed the IDA's graduation operational cut-off (World Bank, 2019^[37])

obligation from the debtor country to an official Chinese entity. See also “How China Lends” (Parks et al., 2020_[10])

Figure 1.3. When incorporating off-the-radar Chinese debt, SIDS’ private guaranteed-like debt increases by almost 50 %

USD billion, current prices



Note: The eleven SIDS considered in this figure are Cabo Verde, Comoros, Dominica, Fiji, Guyana, Jamaica, Maldives, Mauritius, Papua New Guinea, Samoa, and Vanuatu. “Off-the-radar” Chinese debt compiled by (Horn, Reinhart and Trebesch, 2019_[9]) are built under the model of the Creditor Reporting System (CRS) database, and completely comparable with them.

Source: Author’s calculations based on IMF and Horn data World Bank Debt Statistics 2020, (World Bank, 2020_[8]) and (Horn, Reinhart and Trebesch, 2019_[9]) data. Horn data are based in turn on AidData’s Chinese Official Finance database (Dreher et al., 2017_[11]), which encompasses more than 1 200 loans and 2 300 grants to 140 recipient countries during 2000-2014 (it is based on hundreds of primary sources such as creditor and debtor annual reports, embassy press releases, news sources, debtor aid management systems and the academic literature to identify Chinese foreign loans and grants to 140 recipient countries between 2000 and 2014). Transactions only enter the final dataset after an extensive data triangulation. Horn complements and crosschecks it with a rich source of various region- and sector-specific databases that have good coverage for subsets of China’s foreign lending.

For the eleven SIDS for which data are available¹¹ in 2019, off-the-radar Chinese debt is estimated to add an extra USD 3.8 billion, on average, or 7% of their total external debt. This would raise their total external debt to USD 58.1 billion in 2019, or USD 54.3 billion excluding such hidden debt (Figure 1.3). These eleven SIDS would then show a long-term external debt-to-GDP ratio of 64% (compared to 60% excluding this off-the-radar debt), and even more challenging, their private guaranteed-like debt could increase by almost 50%, reaching 22% of their total external debt (from 15%).

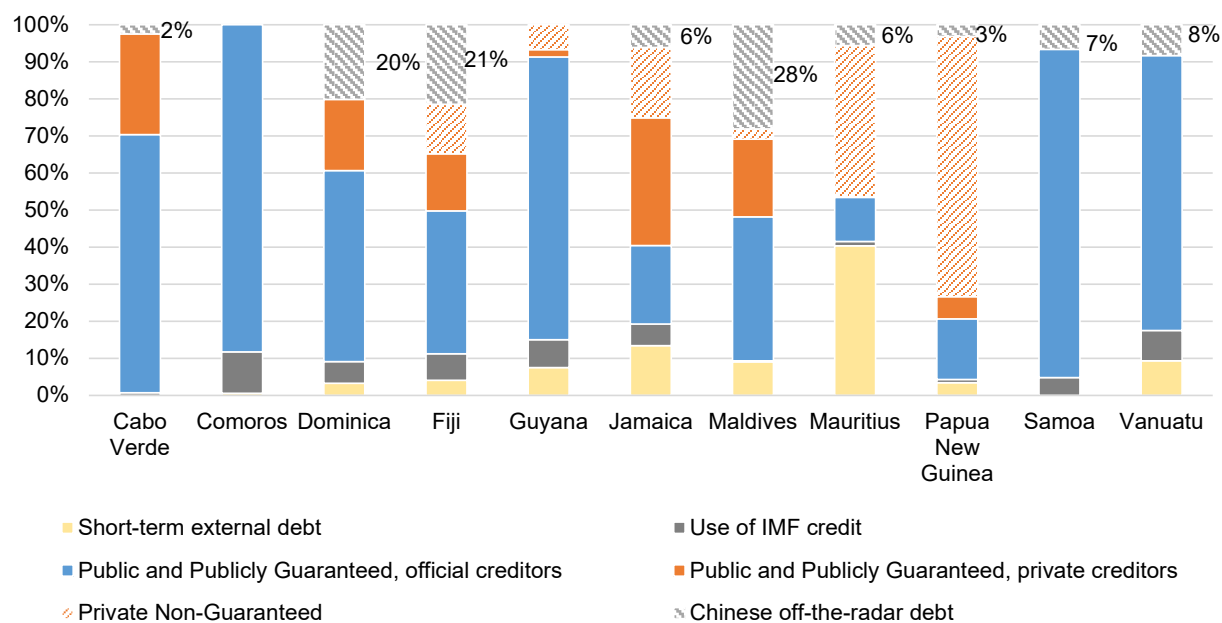
However, this aggregate picture hides a wide disparity of individual cases. For example, for countries such as the Maldives, Dominica and Fiji, off-the-radar Chinese debt could reach 28%, 21% and 20% of

¹¹ Coverage of data: (Horn, Reinhart and Trebesch, 2019_[9]) included in their database all recipient countries with significant amounts of Chinese lending. If a country was not included, it is because they were not able to identify Chinese lending transactions.

their total external debt, respectively, while other SIDS such as Comoros or Guyana seem unaffected. (Figure 1.4 and country-by-country trends in Annex).

Figure 1.4. Off-the-radar Chinese loans could represent up to one-fourth of total external debt in countries like the Maldives, but remain marginal in other SIDS

USD billion, current prices, 2019



Note: 2017 hidden Chinese debt levels are estimated to equal those of 2019.

Source: Author's calculations based on World Bank Debt Statistics 2020, (World Bank, 2020^[8]) and (Horn, Reinhart and Trebesch, 2019^[9]) data.

2 Post-COVID-19: Preliminary assessment of the impact of the crisis on small island development states' external debt

With low economic diversification, constrained fiscal spaces, scarce economic mitigation capacities, and high dependence on remittances, SIDS are projected to suffer even more significantly than other countries from the economic effects of the COVID-19 crisis: in 2020, their total GDP should drop by 7.1%, compared to a decrease of 4.1% in ODCs.¹² SIDS with higher GNI per capita levels are not necessarily more resilient to the economic consequences of the crisis (Piemonte, 2020^[5]). These devastating economic effects, adding to the direct stress on the health sector, place SIDS in a very precarious situation.^{13 14}

Box 2.1. Debt liquidity and debt solvency

Can a country pay its debts today? The answer to this simple question could summarise what liquidity means. For sovereign, external debt, liquidity is currently evaluated through some simple and practical tools, like the short-term external debt-to-reserves ratio, plus some stress testing.¹⁵

In the case of solvency, the answer to the question “*is a country able to pay its debt at all stages in the future?*” would be the most suitable to judge the capacity of a country to respond to long-term obligations – that is, track its solvency. In such a case, indicators like the long-term debt-to-GDP ratio and the importance of the debt service as a share of exports are the most recognised and utilised to reflect capacity of future payments.

However, some liquidity crises can turn into solvency problems. The next section attempts, including the off-the-radar Chinese debt when available, to distinguish countries most likely to confront liquidity problems (and for which debt restructuring facilities could be a plausible solution) from those with structural debt problems.

Source: Author based on (IMF, 2013^[12])

¹² Arithmetic average, based on IMF forecasts (IMF, 2021^[27])

¹³ Even if the international community has rapidly reacted by providing new resources (USD 4.2 billion were committed to SIDS in 2020) to help SIDS overcome the direct effects of the crisis. (OECD, 2021^[7])

¹⁴ See also “COVID-19: Understanding Health Risks in Small Island Developing States (SIDS)” (Piemonte, 2020^[6])

¹⁵ “An appropriate level of reserves is defined as one which provides a high probability (e.g., 95 %) that external liquidity will be sufficient to (say) avoid new borrowing for one year” (IMF, 2000^[28])

Depending on how long the COVID-19 crisis will last, the international community may see a number of SIDS face debt liquidity and sometimes even solvency problems. Difficulties associated with the production and delivery of vaccines, as well as the mutation of the virus, may further delay a return to 'normality'.

With time, some SIDS that had been so far spared from debt issues could start facing liquidity problems, and potentially, others already in such situation prior to the crisis could start facing critical solvency problems. Solutions will thus need to evolve as the crisis unfolds, and be tailored to specific country debt characteristics and needs, from debt service suspension to debt relief. There will not be a one-size-fits-all solution to SIDS debt problems, and case-by-case negotiations will be required.

Not all SIDS are equal in front of the crisis

Following the most recently available IMF debt classifications, eleven SIDS currently present solvency problems: two SIDS are in debt distress (one LMIC and one UMIC) and nine at high risk (one LIC and eight UMICs). Another eleven SIDS are at low or moderate risk or enjoy a sustainable debt outlook (six UMICs, four LMICs and one LIC). (column h, Table 2.1).

SIDS that could experience significant liquidity problems include Belize, Cabo Verde, Dominica, Jamaica and the Maldives (column b/d and e, Table 2.1). Liquidity problems – or difficulties to service debt obligations in the short-term, which are highly likely to occur under the current crisis – may be exacerbated for countries with high shares of their guaranteed debt in private hands, e.g. those showing high shares of private PPG¹⁶, like the five countries listed above.

Table 2.1. The diversity of debt composition in SIDS

	Long-term debt-to-GDP ratio, official reporting, %		Long-term debt-to-GDP ratio including China's off-the-radar debt stocks, %		Long-term debt-to-GDP ratio, estimate*, %	Short-term external debt over reserves, %	Current IMF classification of the external debt risk	Income category in 2020 (World Bank)
	2019 (a)	Of which private PPG debt (b)	2019 (c)	Of which private PPG-like debt (d)	2020e (e)	2019 (f)	2020 (g)	(h)
SIDS indebted to China for which figures exist - from less to more indebted								
Fiji	17	21	22	38	27	5	sustainable	UMIC
Comoros	23	0	23	0	24	1	moderate	LMIC
Guyana	35	2	35	2	27	21	moderate	UMIC
Maldives	41	33	59	54	62	44	high	UMIC
Vanuatu	41	0	45	9	48	8	moderate	LMIC
Mauritius	45	0	50	10	57	71	sustainable	UMIC
Dominica	46	25	58	41	63	7	high	UMIC
Samoa	48	0	51	7	54	0	high	UMIC
Papua New Guinea	72	6	75	9	77	28	high	LMIC
Jamaica	83	43	89	47	96	62	sustainable	UMIC
Cabo Verde	92	28	94	30	96	0	high	LMIC
SIDS without ties to China (People's Republic of) for which official debt figures are available								

¹⁶ And at the same time high levels of debt-to-GDP (expected in 2020). This was not assimilated to solvency problems as GDP should recover rapidly after the crisis.

	Long-term debt-to-GDP ratio, official reporting, %		Long-term debt-to-GDP ratio including China's off-the-radar debt stocks, %		Long-term debt-to-GDP ratio, estimate*, %	Short-term external debt over reserves, %	Current IMF classification of the external debt risk	Income category in 2020 (World Bank)
Haiti	26	2			27	0	high	LIC
St. Lucia	27	48			31	29	sustainable	UMIC
St. Vincent and the Grenadines	43	2			44	0	high	UMIC
Belize	73	40			85	2	high	UMIC
SIDS with official data reported but no information on off-the-radar Chinese debt, if any								
Timor-Leste	12	0			13	0	low	LMIC
Solomon Islands	22	0			23	6	moderate	LMIC
Dominican Republic	38	63			40	28	sustainable	UMIC
Tonga	41	0			44	0	high	UMIC
Guinea-Bissau	43	22			44	0	moderate	LIC
Grenada	44	19			49	6	in distress	UMIC
Sao Tome and Principe	57	0			61	16	in distress	LMIC
Weighted average	45	..			48	..		

Note: * Including off-the-radar Chinese debt if available. Column (f) shows liquidity; solvency indicators are shown in columns (a), (c) and (e). Column (h) includes the IMF classification of the external debt risk. In red: long-term debt-to-GDP ratio¹⁷ over the 60% IMF target¹⁸ -- level assimilated to solvency problems.

Source: Author's calculations based on World Bank Debt Statistics (2020) <https://datatopics.worldbank.org/debt/sids/> and Horn data (2020) (Horn, Reinhart and Trebesch, 2019^[9]) data. Column (g) of the table: based on World Bank data (2020) <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative> and IMF country reports for Belize, (IMF, 2019^[13]); St. Lucia, (IMF, May 2020^[14]); Jamaica, (IMF, May 2020^[15]); Samoa, (IMF, April 2020^[16]); Dominican Republic, (IMF, May 2020^[17]); Mauritius, (IMF, 2019^[18]) and Timor-Leste, (IMF, 2019^[19]). Column (h) of the table WDI, World Bank (2020), <https://data.worldbank.org/indicator/NY.GNP.PCAP.CD>.

Special attention should be given to countries such as Jamaica, Mauritius and Papua New Guinea, with the highest debt servicing-over-export ratios in the recent past.¹⁹ This ratio may worsen because of the crisis. Indeed, countries with high shares of debt servicing-over-export ratios, especially service-based economies²⁰, could be more inclined to run into liquidity difficulties (Figure 2.1).

¹⁷ If debt remains at 2019 levels, and taking into consideration the most recent IMF forecasts for countries' growth.

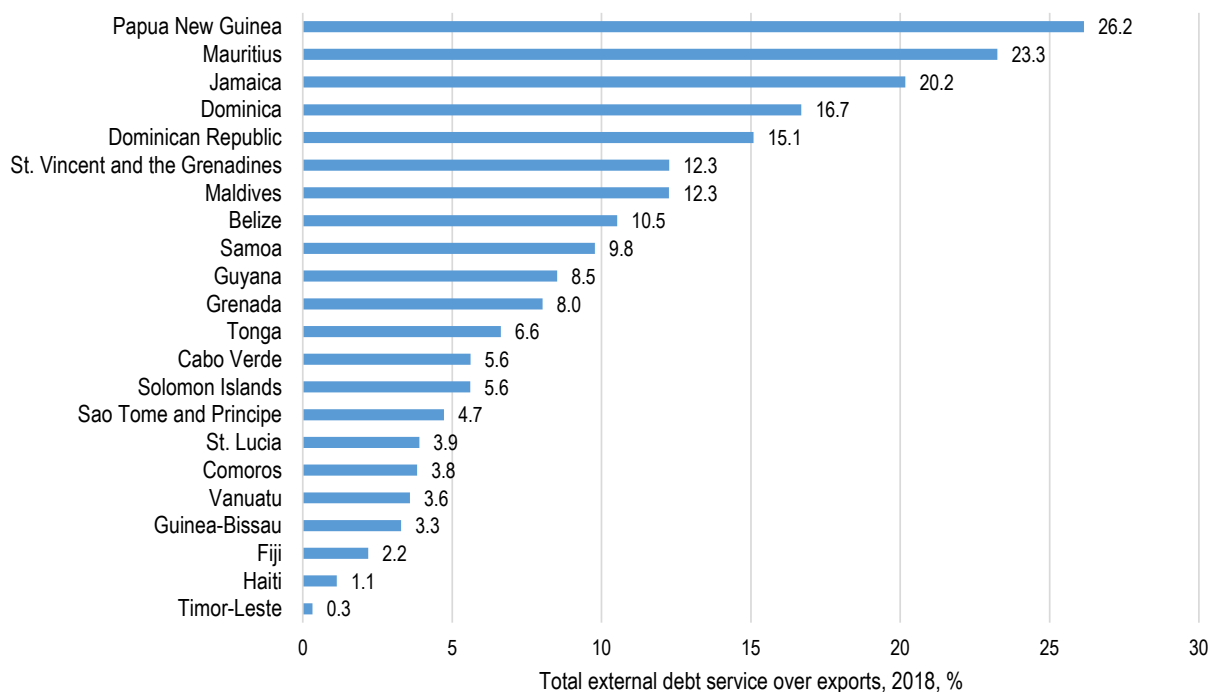
¹⁸ "A debt-to-GDP ratio of 60% is quite often noted as a prudential limit for developed countries. This suggests that crossing this limit will threaten fiscal sustainability." <https://voxeu.org/debates/commentaries/there-optimal-debt-gdp-ratio>

¹⁹ Other indicators and stress tests should be run in order to assess the debt situation comprehensively in the different SIDS. This note does not address the full scope of the problem but tackles the major debt issues SIDS themselves have identified in different fora (e.g., the September 2020 Contact Group of Development Ministers discussion on SIDS).

²⁰ Papua New Guinea is an export-based economy.

Figure 2.1. Countries with high shares of debt servicing-over-export ratios, especially service-based economies, could face worrying solvency problems

Total debt service (% of exports of goods, services and primary income), 2018 data



Note: Papua New Guinea, Guyana, Solomon Islands, Guinea-Bissau, and Timor-Leste are export-based economies.

Source: Author's representation based on World Bank data (2020), <https://data.worldbank.org/indicator/DT.TDS.DECT.EX.ZS>

Overall, external debt greatly differs from one SIDS to another, with debt-to-GDP ratios ranging from 25% to 96% in 2020²¹, and a 48% average, as well as different debt composition (private versus official). Table 2.1 summarises this diversity. Even if some common measures could be proposed for some SIDS, case by case, tailored-made solutions will be necessary for most of them. For example, a Paris Club debt relief intervention could have very concrete, measurable, and bounded consequences in Samoa, Tonga and Sao Tomé and Príncipe; however, private lenders are almost absent in Paris Club talks, so no “one size fits all” response would work in the case of SIDS.

Some early measures have been put in place in response of the crisis

Recognising developing countries' new liquidity problems, the international community has quickly reacted. The World Bank and the IMF, supported by the G20 and the Paris Club, launched in April 2020 a debt service alleviation mechanism targeting the poorest countries: the “Debt Service Suspension Initiative” or DSSI.²² Past debt crises have proven that rescheduling arrangements are feasible – at the least – to buy time, and that “creditors have always found ways of spinning out their repayments in preference to writing them off”. (Bouchet, Clark and Gros Lambert, 2003_[20]). Already eleven

²¹ Estimations, including off-the-radar Chinese debt when available.

²² The G20-Paris Club Communiqué.

[https://g20.org/en/media/Documents/G20_FMDBG_Communique%C3%A9_EN%20\(2\).pdf](https://g20.org/en/media/Documents/G20_FMDBG_Communique%C3%A9_EN%20(2).pdf).

SIDS participate in this initiative²³ with a potential saving of USD 438.8 million, out of 22 eligible SIDS²⁴ ²⁵ that could benefit from total potential savings of USD 553.2 million (Table 2.2).

Table 2.2. How the Debt Service Suspension Initiative could benefit SIDS

Estimations as of 21 January 2021

	Potential DSSI saving (as a % of 2019 GDP)	Potential DSSI saving (USD million)
Cabo Verde	0.9	18.0
Comoros	0.2	2.3
Dominica	0.7	4.3
Fiji	0.2	13.4
Grenada	0.7	8.0
Guinea-Bissau	0.1	2.1
Guyana	0.3	16.9
Haiti	0.9	76.2
Kiribati
Maldives	0.9	50.7
Marshall Islands
Micronesia
Papua New Guinea	1.3	326.9
Samoa	1.1	9.5
Sao Tomé and Príncipe	0.4	1.7
Solomon Islands	0.1	1.5
St. Lucia	0.2	5.2
St. Vincent and the Grenadines	0.5	4.1
Timor-Leste	0.0	0.0
Tonga	1.2	6.3
Tuvalu
Vanuatu	0.7	6.1

²³ The initiative was initially approved until December 2020 but then extended until June 2021 (United Nations, 2020^[29]). More recently (formalised the 7 April 2021 in the G20 Finance Ministers and Central Bank Governors meeting), the G20 has negotiated and agreed to a final extension through end-December 2021. It allows eligible countries to freeze, between May 2020 and June 2021 the PPG-related debt service. Moreover, because the standstill is offered on a net-present value-neutral basis (meaning that creditors will be fully repaid), multilateral creditors should be able to consider participating without significantly impacting their ratings, with support from their shareholders. Also, over the coming months, a wider package of support for low income countries coming through the international financing institutions (IFIs) will help alleviate further the pressure.

²⁴ <https://in.reuters.com/article/us-imf-worldbank-emerging-debtrelief-fac/factbox-how-the-g20s-debt-service-suspension-initiative-works-idUSKBN27021>

²⁵ However, “among the 30 countries that did not join the DSSI as of 18 September 2020, 23 countries have firmly indicated that they are not interested in the initiative. Around half of the countries not interested in participating in DSSI have very low debt service to official bilateral creditors during the suspension period. Three of these countries have initiated direct dialogue with selected bilateral creditors on debt treatments outside of the DSSI process. Ten countries have expressed concerns about the potential implications from participating in the DSSI for planned non-concessional borrowing, about cross-default clauses in their other borrowing, or possible indirect impacts on their sovereign credit ratings and access to international markets. A few countries decided not to participate since they did not wish to request IMF financing”. (IMF-WBG, 2020^[30]) and (IMF-WBG, 2021^[31])

Note: In bold SIDS that participate in the DSSI.

Source: World Bank-IMF data (2020) <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>

Additionally, the IMF has facilitated some rapid financing mechanisms to help developing countries facing liquidity problems. As of December 2020, fifteen SIDS had benefitted from such mechanisms (the Rapid Credit Facility, the Rapid Financing Instrument, the Catastrophe Containment and Relief Trust, and through augmentation of the Extended Credit Facility) for a total of USD 1.9 billion (Table 2.3). However, because of the diverse origin of the debt, these initiatives seem not to be enough for many SIDS. Indeed, those with the highest debt burden remain outside the scope of this G20 debt process.

Table 2.3. IMF short-term facilities used by SIDS

As of December 2020

USD million	Rapid Credit Facility (RCF)	Rapid Financing Instrument (RFI)	Augmentation of Extended Credit Facility (ECF)	Catastrophe Containment and Relief Trust (CCRT) ²⁶	Total
Cabo Verde	32				32
Comoros	4.05	8.08		2.47	14.6
Dominica	14				14
Dominican Republic		650			650
Grenada	22.4				22.4
Guinea-Bissau			3.4		3.4
Haiti	111.6		11.22		122.82
Jamaica		520			520
Maldives	28.9				28.9
Papua New Guinea	363.6				363.6
Samoa	22.03				22.03
Sao Tomé and Príncipe	12.29		2.08	0.39	14.76
Solomon Islands	9.5	19		0.18	28.68
St. Lucia	29.2				29.2
St. Vincent and the Grenadines	16				16
Total	665.57	1197.08	16.7	3.04	1882.39

Source: Author's design based on IMF statistics (2020) <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker>

²⁶ The [Catastrophe Containment and Relief Trust \(CCRT\)](#) allows the IMF to provide debt service relief to the poorest and most vulnerable countries hit by catastrophic natural disasters or public health disasters.

3 What's next? How to prevent a new debt tragedy

What kind of measures could help SIDS better prepare to avoid the debt tragedy from repeating, and build back better? Some potential measures are proposed as follows, but their application intensity and breadth will depend on each SIDS' particular situation.

Providing appropriate technical support to facilitate SIDS' access to climate funds would be key. SIDS face high risks of natural disasters, frequently enduring extreme weather events²⁷ that make them turn towards creditors with whom they engage in new debt for reconstruction.²⁸ Some studies have shown that the debt-to-GDP ratio grows faster, by almost 5 percentage points the year a storm strikes in SIDS, with a cumulative debt increase of 5 % of GDP a few years later (Acevedo, 2014^[21]). And even if vertical funds and emergency facilities do exist, SIDS' capacity constraints prevent them from accessing them easily. (OECD, 2018^[2]) DAC members could help alleviate heavy processes, and, in this sense, prevent SIDS from contracting new debt after weather emergencies.

This technical support could also be usefully deployed to help SIDS better negotiate new debt, or reschedule/renege existing debt. DAC members could help by providing technical assistance and building capacity and pooling global advisory services through a mechanism similar to the tax inspectors without borders (TIWB) initiative²⁹. This support could for example help SIDS governments set up and negotiate with private lenders more secure lending contracts³⁰ and develop new de-risking³¹ financial instruments especially for SIDS (e.g., risk guarantees, options, catastrophe bonds³², and

²⁷ This is mainly the case for Caribbean SIDS. As expressed by the IMF "Structural fiscal problems have resulted in a sizable accumulation of debt in many countries [...] driven mainly by deteriorating primary balances. While, part of the build-up can be traced to the cost of natural disasters, successive years of fiscal deficit, public enterprise borrowing and off-balance-sheet spending, including for financial sector bailouts, all contributed to high debt". (IMF, 2013^[32])

²⁸ Debt many times negotiated at sub-optimal conditions (mismanagement of debt because of skills deficiency).

²⁹ Tax Inspectors Without Borders. See <http://www.tiwb.org/>

³⁰ For example, as suggested by the IMF-WBG, "looking further ahead, a contingency clause in bonds and loans to promote participation by the private sector in temporary debt service suspension could be considered, including for potential inclusion in restructured debt". (IMF-WBG, 2020^[30])

³¹ De-risking instruments help investors reduce or manage investment risks, typically in exchange for a fee, and thus, improve the perceived risk-reward profile of an investment.

³² A catastrophe bond (CAT bond) involves the participation of insurance and reinsurance companies. See (Wharton University Lab Notes, 2020^[36])

hurricane clauses, this latter securing temporary debt service suspension, even on private debt, in case of a specific climate contingency).^{33 34}

For those SIDS presenting major solvency problems, and in order to promote a just and sustainable recovery, debt swaps with social and environmental goals (e.g. so-called green or blue debt swaps) could offer SIDS with debt relief in exchange for a specific commitment to sustainability goals.

Such a solution could support investment in green/blue activities, tackling both the debt and climate crisis. A well-known example is the Seychelles debt-for-nature swap carried out in 2018 with the Global Environment Facility (GEF) and UNDP for USD 27 million of official debt, committed to set up protected marine parks for climate resilience, fishery management, biodiversity conservation and ecotourism. (World Economic Forum, 2020^[22]). However, this deal was process-heavy and took years to materialise. Technical support to help develop regional training centres could facilitate fast track/effective negotiations. Also, some criticism do exists concerning those initiatives, and their volume and precise objective should be carefully analysed before any new initiative emerges.³⁵

More transparency is needed in order to adequately capture the full scope of debt in SIDS. A better understanding of the real dimension of the so-called off-the-radar Chinese would be very useful. This could facilitate diagnostics and the development of adequate solutions. This could also help identify when China's inclusion (CDB, i.e. regarding their off-the-radar debt³⁶) in debt negotiations is key in order to consider plausible and realistic debt stress exit alternatives. While this would not be simple to put in place³⁷, it is in the best interest of bilateral and multilateral donors to keep pushing to make it happen.

DAC members could also help SIDS ensure the debt they will contract in the future will be used in high return/quality and resilient investment. Debt is not bad per se. However, it must ensure social profitability (e.g. investment that promotes gender equality, quality of jobs, climate and green sustainability).³⁸ Much more progress can be made in this sense: the OECD's current cross-directorate work to develop guidelines and international standards to ensure qualities of foreign direct investment (FDIs) is a good first step (OECD, 2019^[23]). Donors should also continue to push blended finance mechanisms to leverage sustainable investment (OECD, 2020^[24]). Impact standards can also guide social and environmental investment, aligned with SDG objectives. (OECD, 2020^[25])

Also, the international community should engage more closely with non-Paris Club private debt owners. Especially in UMIC-SIDS with a high level of guaranteed official debt as a share of the total

³³ See "Introducing hurricane clauses: Lessons from Grenada's recent experience" (The Commonwealth, 2016^[35]): [Hurricane clauses in Grenada] ... "enabled the deferral of principal and interest debt service payments, or the possibility of fast-tracking debt restructuring operations, in the event of a hurricane (or other insured natural disaster)."

³⁴ See also (Mallucci, 2020^[34]). This paper analyses the impact of disaster clauses and extreme weather events on a government's borrowing.

³⁵ A recent WB initiative is currently under study, however some questions remain: Is it fair to ask developing countries 'finance' global public goods when what they really need is finance their own sustainable development and invest in poverty reduction, social services, etc.?.

³⁶ China signed the G20 initiative, but it only counts its official lending. The off-the-radar lending is not covered.

³⁷ Previous crisis experiences, e.g. Mexico 1982, have shown that London Club banks are motivated to participate in debt negotiations as a defensive strategy when highly exposed to a country's risk default: they have to protect their own assets. Today, however, most banks have consolidated their balance sheets by increasing equity and provisions while reducing their country risk exposure. The incentives for SIDS' debt holding banks to negotiate is then lower.

³⁸ For example, evidence has shown that between 2008 and 2015 in countries as Mauritius and Dominican Republic, private indebtedness (non-financial corporate debt, mostly related to private non-guaranteed debt, or PNG debt) has yielded in low social results. (UNCTAD, 2019^[33])

external debt vis à vis their developing country peers (23% versus 7%, respectively), some private lenders might benefit from free-rider practices³⁹ when a country is in debt stress.⁴⁰

Last but not least, domestic resource mobilisation and appropriate tax policy remain a must for SIDS. More efforts can be undertaken to optimise taxation structures and collection mechanisms. Indeed, evidence shows that the share of tax revenues in the external financing mix for those SIDS presenting a GNI per capita over USD 3 800 is on average lower than for other developing countries at similar level of development. (Piemonte and Fabregas, 2020^[41])

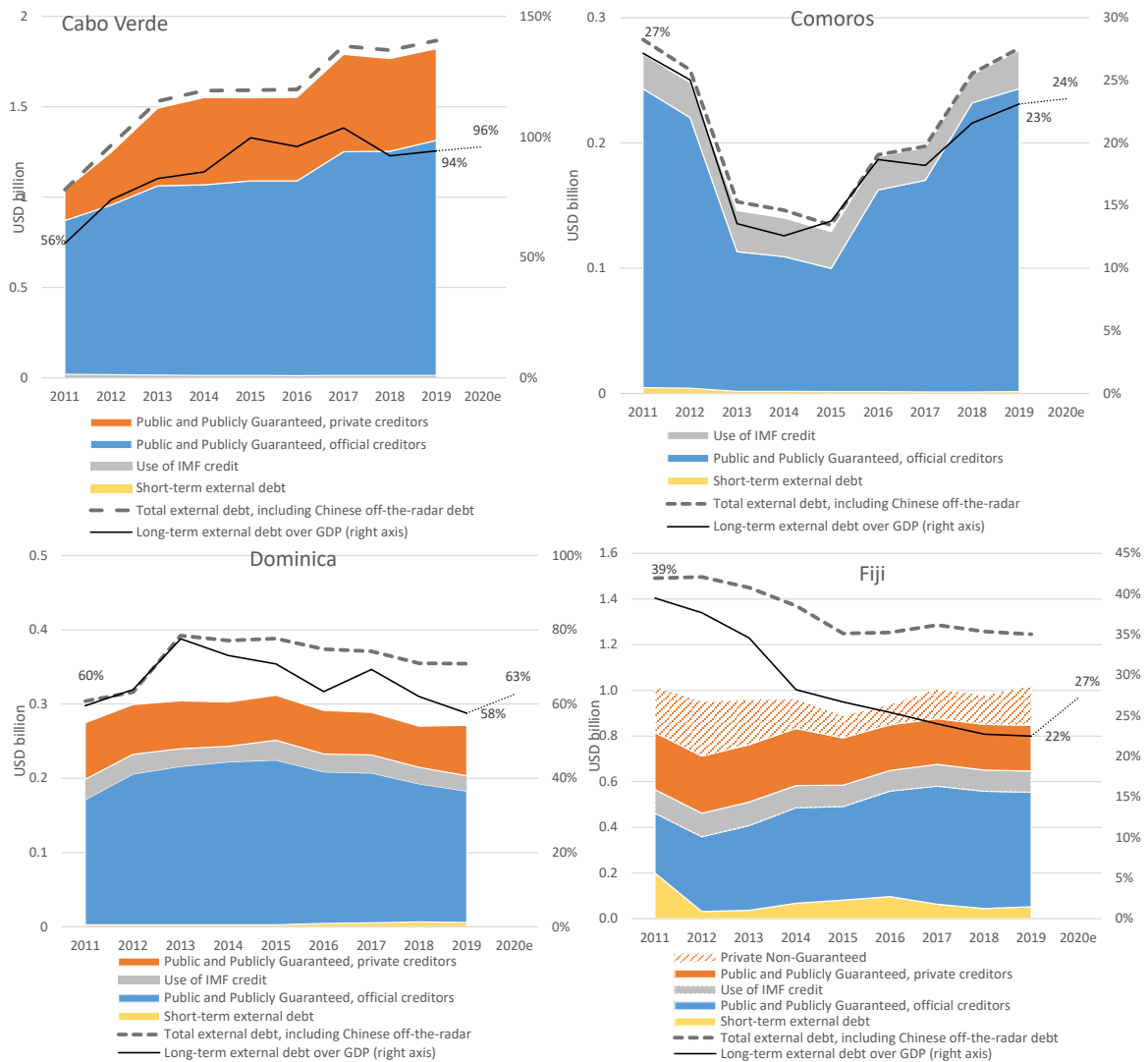
³⁹ See Chapter 5. (Piemonte et al., 2019^[26])

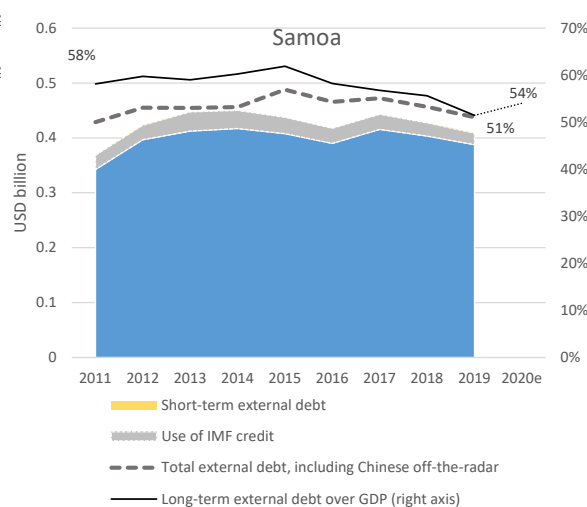
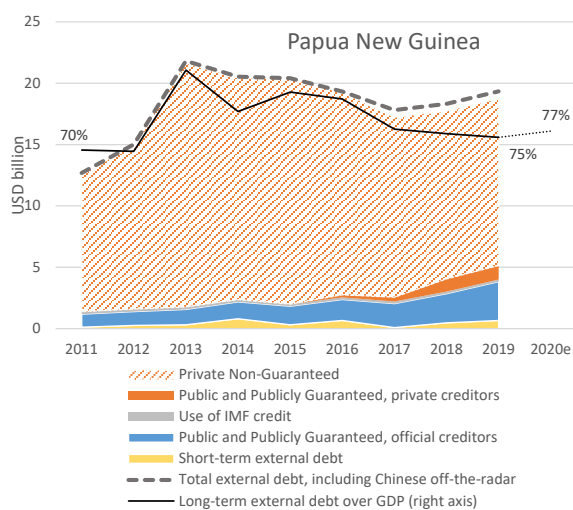
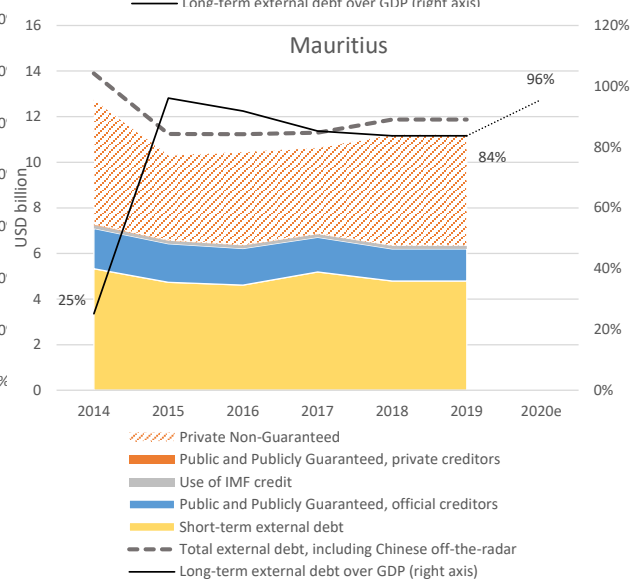
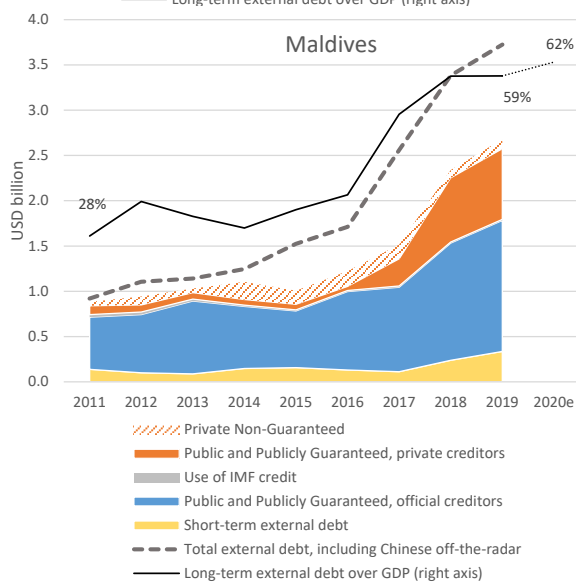
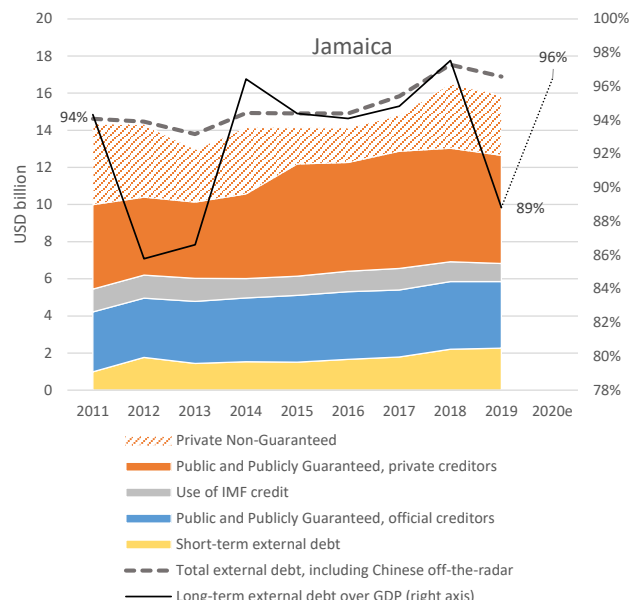
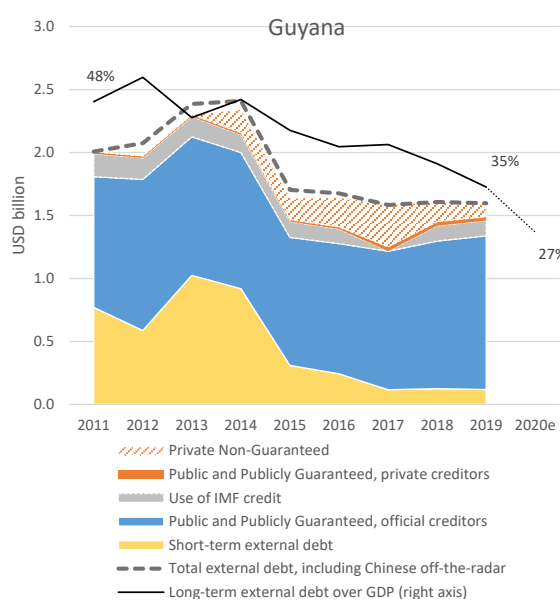
⁴⁰ Indeed, in a debt crisis, a common solution is to ask those who can easily co-ordinate, mainly the Paris Club and official lenders, for debt relief or debt-alleviating interventions. Those exercises rarely engage private creditors. In the case of the current COVID-19 crisis, even if the G20/Paris Club DSSI initiative has made efforts to align private creditors with the DSSI principles (e.g., Saudi Arabia's G20 Statement, https://www.banque-france.fr/sites/default/files/media/2020/11/18/extraordinary_g20_fmcbg_statement_november_13_vf.pdf, and the Institute of International Finance terms of reference release for private participation in DSSI on a voluntary basis, <https://www.iif.com/Press/View/ID/3918/IIF-Releases-New-Framework-to-Facilitate-Voluntary-Private-Sector-Involvement-in-the-G20Paris-Club-Debt-Service-Suspension-Initiative>) at the publication of this note no private lender has made any concrete steps in this direction.

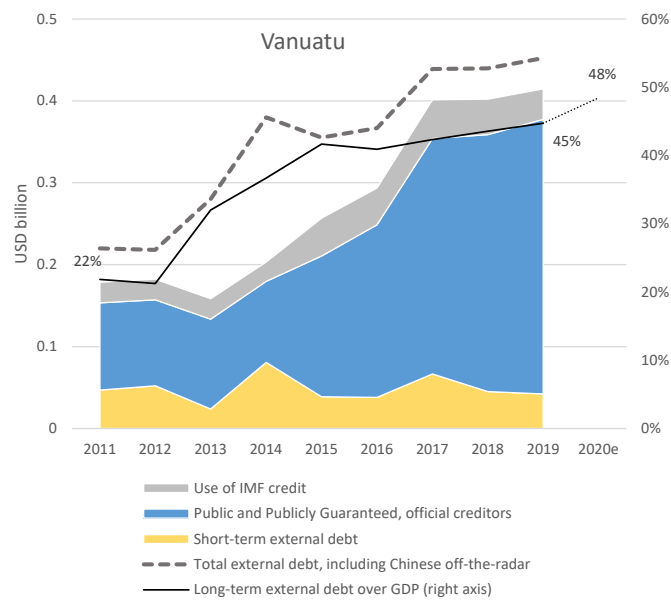
Annex A. External debt trends over the period 2011-19 in small island developing states for which data on off-the-radar Chinese overseas lending is available (by country)

Figure A. Country-by-country trends over the period 2011-19 in SIDS for which data on hidden Chinese overseas lending are available

USD billion, current prices







Note: 2017 off-the-radar Chinese debt levels are estimated to equal those of 2019

Source: Author's calculations based on World Bank Debt Statistics (2020), (World Bank, 2020^[8]) and (Horn, Reinhart and Trebesch, 2019^[9]) data.

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