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Haiti's recovery should start with cancelling its debt

Rebuilding the Haitian economy will require massive international investment, along with local ownership of the policy and reform agendas to ensure the revival of State capacities. Given the scale of destruction, and Haiti's precarious financial position even before the earthquake, international support for reconstruction must begin with a moratorium on debt servicing, followed quickly by its cancellation, UNCTAD argues in this policy brief. Without such action – and without development assistance in the form of grants, and not loans – a new debt crisis is all but assured.

The massive response of the international community to the earthquake that hit Haiti on 12 January 2010 has understandably been directed towards saving lives and providing immediate relief to the victims. However, even at this stage it is necessary to think about the finances and the reconstruction work required to rebuild the Haitian economy, put its people back to work and provide a more hopeful future.

Given the scale of the damage – social, infrastructural, and economic – recovery in Haiti will take time. The Government must be given the policy space necessary to undertake the reforms and adjustments needed to create a viable economy. It will also need massive investments, which will depend on multilateral funding along the lines of a Marshall Plan, as has been suggested by the IMF's Managing Director, Dominique Strauss-Kahn.

The Marshall Plan is all too readily evoked in the wake of large-scale disasters. But the parallel is particularly apposite for Haiti, given the scale of the devastation, its links to political instability, and the need for a prolonged engagement by the international community with the process of post-disaster reconstruction. Moreover, given that international involvement prior to the disaster had failed to establish a viable development path for one of the world's poorest countries, talk of a Marshall Plan raises the hope that, this time around, there will be a different and more productive approach, by donors and the national authorities. UNCTAD believes this task should begin by immediate and total cancellation of Haiti's existing external debt obligations.

Haiti's vicious debt cycle

Haiti has had a long and difficult history of external indebtedness. Although a significant portion of its debt was acquired under periods of dictatorship, recurrent natural disasters in recent years have compounded the problem.

UNCTAD's study of the impact on debt sustainability of 21 large natural disasters that struck low-income countries between 1980 and 2008 shows that natural disasters add on average 24 percentage points to the debt-to-GDP ratio in the three years that followed the events (see figure).[1] Shocks on such a scale can lead to a vicious cycle of economic distress, more external borrowing, burdensome debt servicing, and insufficient investment to mitigate future shocks. It is worth recalling that George Marshall was concerned with just such a vicious cycle gripping post-war Europe when he was designing his reconstruction measures. In 1947, he recognized that "Europe's requirements for the next three or four years of foreign food and other essential products – principally from America – are so much greater than her present ability to pay that she must have substantial additional help or face economic, social, and political deterioration of a very grave character. The remedy lies in breaking the vicious circle and restoring the confidence of the European people in the economic future of their own countries and of Europe as a whole." The challenge facing Haiti, in light of its existing development deficits, is of a similar order of magnitude to that facing Europe in 1947, and the case Marshall made for international support resonates again in the current Haitian disaster.

Despite having recently benefited from debt relief under the Highly Indebted Poor Country (HIPC) and Multilateral Debt Relief (MDRI) Initiatives, Haiti was already classified as being at high risk of debt distress prior to the earthquake, in large part because of the numerous and successive external shocks that have recently hit the country. Considering the large direct cost of the earthquake (conservative estimates put this at 15% of GDP), in the absence of further international action a new debt crisis is all but assured.

[1] The average increase would be higher (43 percentage points) if natural disasters were not usually followed by rapid increases in foreign aid.

Rebuilding Haiti's economy while avoiding a future debt crisis

The enormity of the rebuilding task in Haiti stems from the fact that it will be difficult to separate relief and recovery from efforts to create institutional and policy frameworks capable of fashioning an inclusive national agenda that is not only broader and longer-term than in the past, but also able to repair trust in public institutions and authority.

A sustainable recovery will also depend on the revival and creation of state capacities to handle public finance, implement an emergency housing programme, create jobs and strengthen public security. The large financing gap means that the involvement of the international community will be essential and unavoidable, but it is imperative that local capacities are also mobilized as quickly as possible and that local ownership of the policy agenda is guaranteed from the outset.

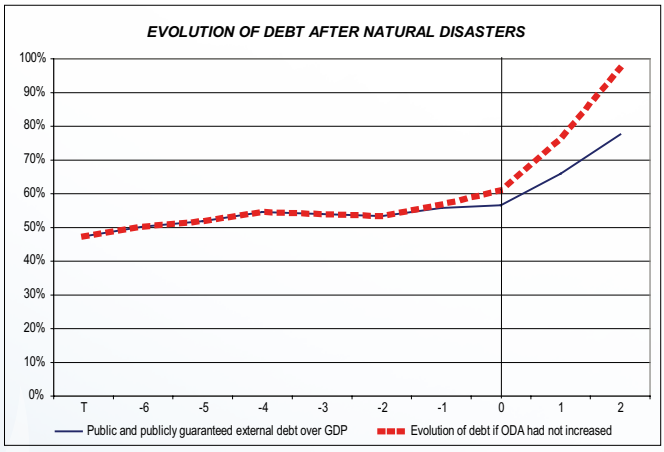
The way to proceed is to declare an immediate moratorium on debt servicing, followed by its cancellation as quickly as possible. Several countries that were hit by the tsunami of December 2004 benefited from a debt moratorium on bilateral Paris Club loans. After the January earthquake, several of Haiti's bilateral creditors announced a similar initiative. Unfortunately, however, the bulk of the country's outstanding $1 billion debt is owed to multilateral creditors (principally the Inter-American Development Bank). Although it would help if the Paris Club creditors still in the process of finalizing their HIPC debt relief agreement expedited this process, cancellation of Haiti's remaining multilateral debt would be the most useful action the international community could take at a time when the Haitian economy has collapsed and debt service capacity is non-existent.

To the extent that Haiti's multilateral creditors do not have the resources or mandate to fully and unilaterally cancel the country's debt obligations, creditor countries will need to provide the political and financial support to ensure a rapid exit path. Just as importantly, any future build-up of new debt as the recovery proceeds would be dangerous. It is therefore critical that as emergency assistance winds down, development assistance from multilateral institutions and other sources takes the form of grants and not loans.

Wider lessons

The challenge facing Haiti underscores the need for a serious rethink of the mechanisms for handling the economic consequences of natural disasters. Currently, there is no multilateral mechanism to provide debt relief aimed at reducing the debt burden of disaster-stricken countries. Initiatives aimed at responding to unsustainable debt situations arising from natural disasters have relied on a patchwork of ad hoc measures at the international and national levels. This approach tends to be inefficient, and sometimes inequitable. A more integrated approach to disaster management could be build around the following:

- A global disaster fund along the lines set out in 2006 by the then-UK Chancellor, Gordon Brown. Any such multilateral mechanism must be well funded to provide sufficient and predictable financing and should not involve heavy policy conditionalities of the kind often attached to multilateral lending programmes.
- An automatic mechanism for extending a moratorium on debt servicing should be considered for countries hit by natural disasters. A meeting of all creditors should be coordinated to carry out the process in a single operation, rather than through bilateral agreements with all Paris Club and non-Paris Club creditors. This would help ease the unavoidable constraints on government revenue following a disaster and enable the Government to safeguard social spending – for example, on education, health, and water and sanitation. Moreover, it would neutralize the political considerations that arise in the process of disbursing funds, reduce the time lags entailed in obtaining funds, and eliminate the negative signals that acceptance of ad hoc offers could send to markets.
- Built-in insurance clauses for debt contracts that kick in automatically for countries hit by massive external shocks. Incorporating natural disaster insurance into loan agreements extended by multilateral financial institutions would be a form of risk-sharing in keeping with the cooperative nature of those bodies, and would also fast-track the approval processes, leading to a prompt response to disasters. Such a mechanism would also reduce debt distress for countries whose debt is mainly multilateral.



Source: UNCTAD.

The solid line of the graph plots the actual evolution of the external public debt-to-GDP ratio in the aftermath of 21 large natural disasters in low-income countries between 1980 and 2008. The dotted line shows the predicted evolution of that ratio in the absence of the increase of aid inflows that usually follows large natural disasters. In the context of this analysis, a large natural disaster is defined as one with a direct cost equal to at least 5% of the country's GDP. Since some countries are hit by multiple natural disasters and it is difficult to assess the impact of two natural disasters affecting the same country within a short period of time, only natural disasters that occur at least 12 years apart are included here.

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