

INTERNATIONAL MONETARY FUND

Proposal for a Post-Catastrophe Debt Relief Trust Fund

Prepared by the Strategy, Policy, and Review and the Finance Departments

(In consultation with the Legal Department and other Departments)

Approved by Reza Moghadam and Andrew Tweedie

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ABBREVIATIONS and ACRONYMS

DSA	Debt Sustainability Analysis
ECF	Extended Credit Facility
ENDA	Emergency Assistance for Natural Disasters
ESF	Exogenous Shocks Facility
EPCA	Emergency Post-Conflict Assistance
GRA	General Resources Account
HIPC	Heavily Indebted Poor Country
IA	Investment Account
IDA	International Development Association
LIC	Low-Income Country
MDRI	Multilateral Debt Relief Initiative
PCDR	Post-Catastrophe Debt Relief
PRGT	Poverty Reduction and Growth Trust
RCF	Rapid Credit Facility
SDA	Special Disbursement Account
SCF	Standby Credit Facility
UCT	Upper Credit Tranche

EXECUTIVE SUMMARY

This paper proposes a new trust fund that would enable the IMF to join international debt relief efforts for Haiti and other low-income countries hit by similar catastrophic disasters. Following the devastation caused by the recent earthquake in Haiti, an international consensus emerged that creditors should consider full debt relief to support Haiti's recovery. Haiti's debt to the IMF stands at SDR 178 million.

As Haiti already benefited from Heavily Indebted Poor Country (HIPC) and Multilateral Debt Relief Initiative (MDRI) debt relief in 2009, there are two broad options for providing additional debt relief. A "Haiti-only" solution would be possible, but would have to be financed entirely by bilateral donor contributions and would leave the Fund with limited tools in potential future cases. A more general mechanism would enable members hit by catastrophic disasters to be treated in a uniform manner, permit use of existing Fund resources to finance the debt relief for Haiti, and allow the Fund to respond in a timely and coherent way in potential future cases.

The proposal is to establish a Post-Catastrophe Debt Relief (PCDR) Trust Fund, separate from the Poverty Reduction and Growth Trust (PRGT). The PCDR Trust would allow provision of debt relief in order to free up resources for meeting exceptional balance of payments needs that arise as a result of catastrophic disasters and the subsequent economic recovery efforts, complementing financial assistance by donors and the Fund's liquidity support through the PRGT.

PCDR support would be limited to the poorest and most vulnerable member countries that have suffered a catastrophic disaster. Qualification would be based on a finding by the Executive Board that the disaster's impact is likely to exceed certain thresholds in terms of economic damage and population affected. The thresholds are based on historical evidence that the largest-scale disasters can create substantial and protracted balance of payments needs.

Qualifying countries would automatically receive debt flow relief, and may also be eligible for eventual stock of debt relief. Debt flow relief would be provided through PCDR grants covering all debt service over two years. The Board may also declare the country's qualifying debt eligible for stock relief if it judges that the disaster has created substantial and protracted balance of payments needs and that the resources freed up by debt stock relief would be critical for meeting these needs. Stock of debt relief, which would also cover the immediate post-catastrophe emergency disbursement, would be conditional on concerted debt relief efforts by official creditors as well as a policy track record.

Emergency liquidity support would be provided through the Fund's existing concessional lending windows. This would typically involve the shocks window of the Rapid Credit Facility (RCF). Subsequent financial assistance would typically be at moderate levels, as significant grant-based reconstruction assistance would be expected from donors.

The PCDR Trust could be financed through existing IMF resources and donor contributions, with the Fund as Trustee. The Trust would likely require a minimum of SDR 250–300 million in initial resources, of which SDR 180 million would be needed immediately for the Fund’s debt relief for Haiti. The remaining resources would likely cover debt relief in a potential future catastrophic disaster, after which new fundraising could replenish the trust fund. A possible financing source could be the transfer to the PCDR Trust of the projected surplus in the MDRI-I Trust, complemented as needed by additional financing mobilized from donors.

*This paper discusses a possible approach that would allow the Fund to join international debt relief efforts for Haiti and any possible future such cases.*¹

I. MOTIVATION

1. **The Fund’s concessional facilities can provide effective financial support to low-income countries (LICs) that are hit by natural disasters.** In such disasters, donors play a central role in mobilizing humanitarian relief and highly concessional financing for reconstruction. The Fund can complement these efforts by providing short-term liquidity support to meet urgent balance of payments needs as recovery-related imports spike and export capacity may suffer. The Fund has a long history of meeting liquidity needs caused by natural disasters, mainly through Emergency Natural Disaster Assistance (ENDA) and augmentations of existing arrangements. The Fund’s capacity to provide rapid and flexible support in such cases has been further enhanced by the recent reform of concessional facilities under the Poverty Reduction and Growth Trust (PRGT), including by creating the Rapid Credit Facility (RCF) for responding to urgent balance of payments needs.

2. **After the devastating earthquake in Haiti in early 2010, the international community responded with rapid humanitarian assistance and substantial pledges of aid, while also calling for exceptional additional support through debt relief.** The Fund was the first international financial institution to provide liquidity support, which helped preserve the functioning of the payments system and create room for critical imports right after the disaster.² Donors pledged some US\$9.7 billion in aid at the March 31, 2010 donor conference. Given the massive destruction and humanitarian disaster in an already very poor country, an international consensus emerged that Haiti’s creditors should consider providing exceptional support in the form of debt relief and thereby free up additional resources for the recovery.

3. **This paper discusses how the Fund might be able to join international debt relief efforts for Haiti.** With Haiti having already benefited from comprehensive debt relief under the Heavily Indebted Poor Country (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI) last year, additional debt relief presents institutional and financial challenges for official creditors. The World Bank is expected to provide debt relief by using surplus income from an existing trust fund, while the IADB would use some of the resources provided through a possible capital increase. For the IMF, options are significantly

¹ Prepared by an IMF staff team consisting of C. Mumssen, H. Joly, J. Martijn, B. Mukhopadhyay, P. Jenkins, B. Arnason, C. Geiregat, K. Gerling, and L. Kaltani; R. Powell, P. Njoroge, and R. Price; in collaboration with R. Weeks-Brown, I. Mouysset, and G. Rosenberg.

² The disbursement was made through an augmentation under Haiti’s Extended Credit Facility (ECF) arrangement, equivalent to 80 percent of quota (US\$102 million). As it was the last scheduled disbursement under the three-year arrangement, no additional conditionality was required.

constrained as existing Fund resources cannot be allocated on a country-specific basis, but must be made available on a uniform basis to all members facing a similar situation.³

4. **As the devastation and human suffering caused by Haiti’s earthquake was highly exceptional in its severity, one option would be for the Fund to seek resources for debt relief to Haiti and respond to any potential future such events on a case-by-case basis.** Such debt relief would have to be financed through bilateral donor contributions, given the uniformity of treatment requirements that apply to the use of the Fund’s own resources. In total, SDR 178 (US\$270) million would need to be raised from donors. This case-specific fund raising approach could be replicated in any potential future Haiti-style disasters.

- The advantages of such a case-by-case approach would be that the scope and mechanism of any exceptional support could be tailored to country circumstances and that it would not require ex-ante locking up scarce Fund concessional resources for highly uncertain future events.
- There are, however, two important disadvantages. First, it would leave the Fund with limited tools to respond to similar catastrophic disasters: in particular, while in the case of Haiti no debt service is due for another two years, in future cases it may well be important for the Fund to be able to provide debt flow relief immediately. Second, it is highly uncertain whether the necessary donor contributions can be mobilized, given the very tight budgetary environment for most donors (see Section IV for a discussion of financing issues).

5. **There are important arguments for considering an alternative, more generally applicable, mechanism that could also be used in future cases.** First, a more general approach would facilitate the uniform treatment of disaster stricken members by providing guidance on common principles, triggers, and delivery mechanisms for exceptional support in case of catastrophic disasters. Second, it would allow the Fund to provide immediate debt flow relief in cases of extreme disruption, which would not be possible without a standing pool of resources. Third, a general approach would enable the Fund to signal its readiness to participate in eventual debt stock relief, thus avoiding the uncertainties and time lags that would be inevitable in any *ad hoc* approach. Fourth, a general framework would allow the use of the Fund’s own financial resources as well as of the resources managed by the Fund, and could thereby facilitate the mobilization of resources to address future disasters. In sum,

³ This requirement arises from the principle of uniformity of treatment which applies to all uses of the Fund’s resources under the Articles of Agreement. In contrast, this principle does not apply in circumstances where the Fund, pursuant to Article V, Section 2(b), administers resources provided by others. For a more detailed discussion of uniformity of treatment in connection with LIC debt relief, see *The G-8 Debt Cancellation Proposal and Its Implications for the Fund—Further Considerations* and *The Multilateral Debt Relief Initiative (G-8 Proposal) and Its Implications for the Fund—Further Considerations—Supplemental Information*.

a general approach to providing debt relief in cases of catastrophic disasters would facilitate rapid and effective responses to future large-scale catastrophes, based on a coherent set of rules and policies approved by the Executive Board.

6. **The primary purpose of post-catastrophe debt relief by the Fund would be to free up additional resources for meeting the affected country’s massive and protracted recovery-related balance of payments needs.** The purpose and delivery mechanism of Fund-provided debt relief following Haiti’s and any potential future catastrophic disasters would thus be different from those of the debt relief provided under the HIPC Initiative.⁴ Specifically, the case for full debt stock relief for Haiti is not rooted in a Debt Sustainability Analysis (DSA) and does not target a specific threshold of debt that would be seen as sustainable.⁵ Instead, it is based on the recognition that the disaster not only destroyed a large part of a country’s capital stock and productive capacity, but also created a massive and potentially long-lasting humanitarian disaster and significant economic uncertainty in an already very poor and vulnerable country. In such circumstances, it would be warranted to supplement the provision of new resources by donors with debt relief as a distinctive response to the humanitarian needs and an exceptional additional contribution to the recovery.⁶

7. **The remainder of the paper discusses how a general mechanism could be implemented, based on the establishment of a trust fund to be administered by the Fund pursuant to Article V, Section 2(b), that would provide grant-based debt relief to low-income countries affected by catastrophic disasters.** Section II provides an overview of past catastrophic disasters and their economic consequences. Section III sets out the objectives and proposed modalities of the trust fund in conjunction with a new policy on catastrophic disasters that provides guidance on the use of existing PRGT instruments by members experiencing a catastrophic disaster. The financing framework and governance structure, and the approval requirements for the proposed trust, are discussed in Sections IV and V respectively. The proposed decisions and draft instruments associated with the establishment of the trust would be prepared once the Board has had an opportunity to discuss the proposal and provide guidance to the staff.

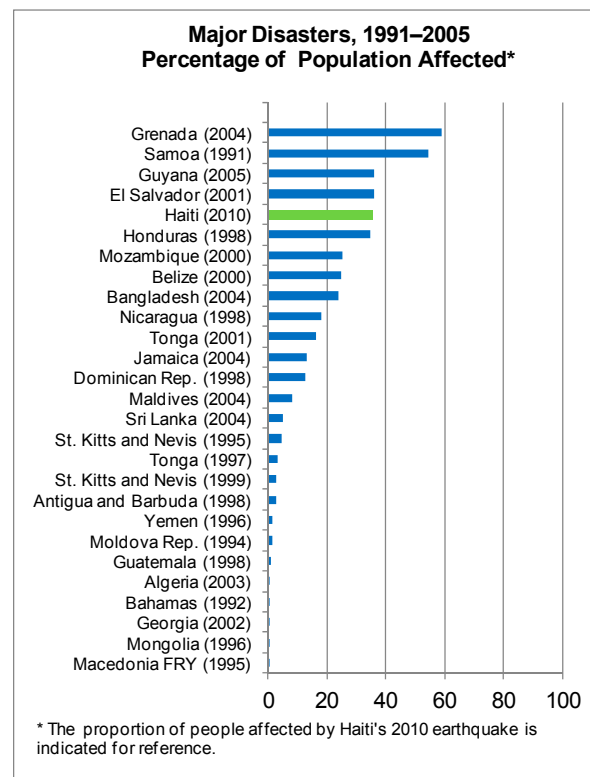
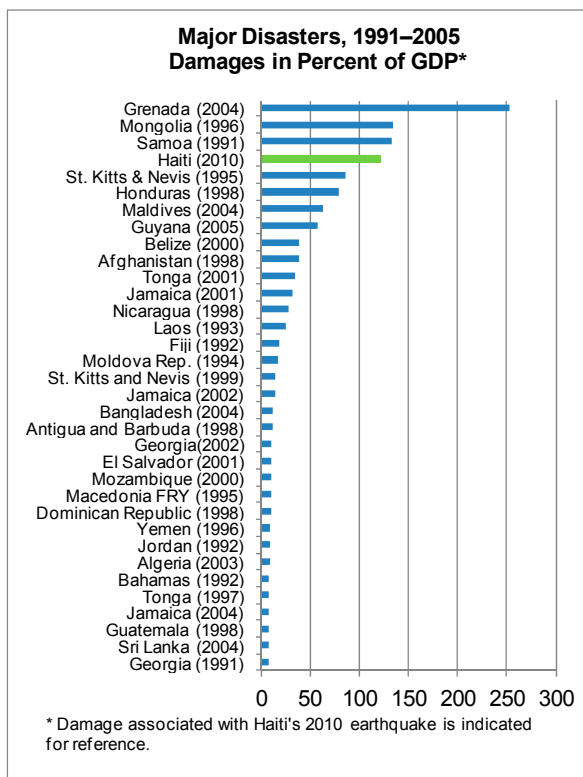
⁴ The proposal is more similar to the MDRI, which provided full debt relief by major multilateral creditors with the aim of freeing up financial resources for meeting the Millennium Development Goals.

⁵ While Haiti was considered to be at a high risk of debt distress, this mainly reflected a very low export base. Incorporating remittances in the DSA would have indicated a more moderate risk. In any case, full cancellation of Haiti’s debt would not be necessary to achieve a moderate or even low risk of debt distress.

⁶ Possible alternative approaches may be less suitable for this purpose. In principle, additional resources could be provided through outright grants, fresh loans, and/or debt service rescheduling rather than through debt relief. However, neither of these options would address existing debt. Moreover, outright grants would be at odds with the Fund’s normal financing role of providing temporary balance of payments support, whereas grants have generally been used to repay the Fund’s own credit as is proposed above. Finally, debt service rescheduling would be operationally complex as discussed in *The Fund’s Facilities and Financing Framework for Low-Income Countries*, paragraph 54.

II. BACKGROUND ON LARGE-SCALE DISASTERS

8. **A review of the experience of countries that have suffered extreme natural disasters illustrates the potential severity of the initial economic and human impact.** Over the 1991-2005 period, 34 member countries experienced natural disasters in which the initial destruction exceeded 7 percent of the previous year's GDP.⁷ Disaster damage in the eight most severe of these disasters (top quartile of the sample) is estimated to have averaged 116 percent of the previous year's GDP.⁸ While it is impossible for data to fully capture the devastating human toll of these most serious catastrophes, in five of these cases a third or more of the population is estimated to have been affected.⁹ By comparison, approximately a third of Haiti's population is estimated to have been affected by the recent earthquake, while damage is evaluated at 121 percent of GDP.



⁷ Data presented in this section are primarily derived from the OFDA/CRED International Disaster Database of Université Catholique de Louvain (<http://www.emdat.be>), the U.N. International Strategy for Disaster Reduction (<http://www.unisdr.org>), the IMF's World Economic Outlook database, and staff calculations.

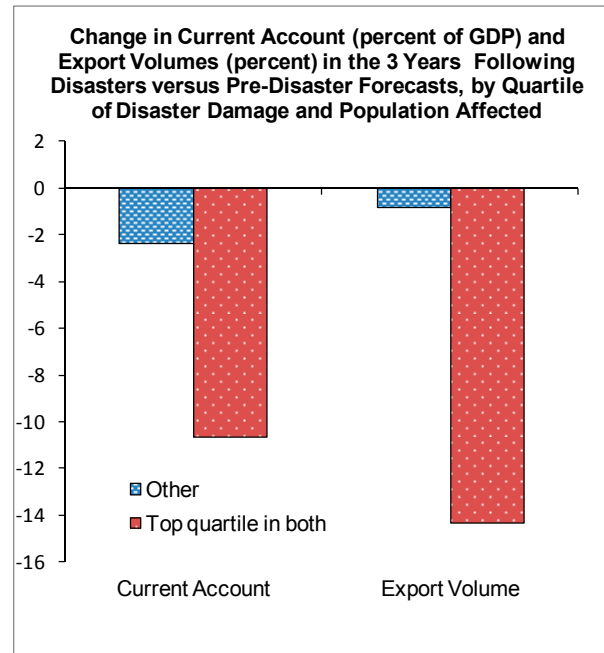
⁸ This calculation excludes Tajikistan's 1992 flood owing to questions over the reliability of the data.

⁹ Among the 10 countries experiencing the most severe disasters over the 1991-2005 period, measured by the proportion of people affected, the average percentage of the population affected was also approximately one-third. The number affected includes people requiring immediate assistance during a period of emergency; it can also include displaced or evacuated people.

9. **The incidence of disasters with large-scale economic and humanitarian implications is concentrated in LICs.** Poor countries are more vulnerable to the initial destruction from a disaster, owing to a more fragile infrastructure. In addition, the economic and humanitarian toll of severe shocks in LICs is aggravated and prolonged by thinner resource cushions (e.g., lower personal savings, fiscal revenues, international reserves) and less well-developed public and private institutions that are needed for the recovery effort.

10. **While most disasters have only transitory economic effects, the most catastrophic disasters have significant adverse effects on economic performance over the medium term, and can contribute to substantial balance of payments needs.** The impact of disasters on broad measures of economic activity, such as GDP, is difficult to assess, owing to the sharp rise in construction spending and external assistance often witnessed in the reconstruction phase following a disaster. A useful proxy for economic disruption is the impact on the volume of exports, which tends to decline significantly in the most severe disasters—evidence of a sharp disruption in productive capacity. As this is often accompanied by a spike in reconstruction-related imports, the result is frequently a marked deterioration in the external current account balance.

11. **The most severe disasters have a disproportionately adverse impact.** A comparison of actual export volumes of countries having experienced major natural disasters over the 1991-2005 period with pre-disaster World Economic Outlook projections indicates that countries whose initial damage placed them in the top quartile exported on average 9 percent less than forecast over the three years following the disaster. By contrast, there was hardly any lasting export effect in the other countries affected by natural disasters. A similar pattern can be observed for the impact of disasters on the current account balance.¹⁰ On average, countries having experienced disasters placing them in the top quartile by initial damage experienced a current



Sources: EM-DAT: The OFDA/CRED International Disaster Database of Université Catholique de Louvain (<http://www.emdat.be>); United Nations (UNISDR); IMF

¹⁰ The sample of countries used for calculation of changes in current account balances differs somewhat from that used for changes in export volumes, owing to differences in the availability of data. The average level of damage in the top quartile of the country sample used for calculating the export impact was 109 percent of GDP, whereas the average damage in the top quartile of the sample used for calculating the current account impact was 88 percent of GDP.

account deterioration of nearly 11 percent of GDP in the three years following the event, compared with pre-disaster forecasts. For other countries, the effect was minor, as in the case of exports.

12. **Economic dislocations tend to be higher when a large share of the population is affected by the disaster.** While the initial damage estimate can be a useful proxy for the destruction of the physical capital stock, it does not take account of the diversion of the labor force from productive activity in the tradable sector. While data limitations prevent a fuller analysis, there is some evidence that current account performance is weaker in disaster-affected countries where a relatively high share of the population is affected.¹¹ As a result, there is a large and sustained adverse balance of payments impact when both economic damage and share of the population affected are in the top quartile, while the impact is negligible on average for other cases (see Figure).

13. **The findings of recent econometric studies support the view that the most severe natural disasters can have significant negative effects over the medium term.** Typical of these results is Raddatz (2007 and 2009), Noy (2009), and Hochrainer (2009).¹² Two findings in the literature are particularly noteworthy. First, Loayza et al. (2009) note that while small disasters may, on average, have a positive impact (as a result of the reconstruction stimulus), large disasters always have severe negative consequences for the economy in their immediate aftermath.¹³ Second, Noy finds that developing countries and smaller economies face much larger output declines following a disaster of similar relative magnitude than developed countries or bigger economies.

14. **Taken together, the empirical evidence suggests that disasters have sustained adverse economic consequences in cases where: (i) the level of per capita income is low, (ii) the initial damage is exceptionally high, and (iii) a very large proportion of the population is affected.** While the damage estimate is the most direct indicator of the economic impact of a shock, the severity of the humanitarian and economic impact and the speed of the recovery also depend crucially on the share of the population affected and the initial incidence of poverty. These considerations suggest that exceptional support, including from the Fund, may be important in the most catastrophic of disasters.

¹¹ For the top quartile of the sample, the population affected averaged 36 percent and the current account deteriorated by 6 percent of GDP over the three post-disaster years, compared with pre-disaster forecasts.

¹² Hochrainer, S. (2009): "Assessing the Macroeconomic Impacts of Natural Disasters—Are there Any?" World Bank Policy Research Working Paper 4968; Noy, I. (2009): "The Macroeconomic Consequences of Disasters," *Journal of Development Economics*, vol. 88, pp. 221-231.

Raddatz C. (2007): "Are External Shocks Responsible for the Instability of Output in Low-Income Countries?" *Journal of Development Economics*, vol. 84, pp. 155-187, Raddatz (2009): "The Wrath of God: Macroeconomic Costs of Natural Disasters," Manuscript.

¹³ Loayza, N., E. Olaberria, J. Rigolini and L. Christiansen (2009): "Natural Disasters and Growth-Going Beyond the Averages," World Bank Policy Research Working Paper 4980.

III. PROPOSAL FOR A POST-CATASTROPHE DEBT RELIEF TRUST FUND

A. Objectives

15. **The proposal is to create a PCDR Trust—separate from the PRGT—that could provide debt relief to Haiti and other eligible LICs hit by catastrophic disasters.** In severe disasters, donors play a critical role in providing highly concessional assistance and the Fund can use its PRGT instruments, notably the RCF, to provide rapid liquidity support. In the very rare cases of truly catastrophic disasters, the proposed PCDR Trust would allow the Fund to supplement its support with debt service relief, and, if appropriate, by joining international efforts to provide relief on the stock of debt.

16. **The purpose of the proposed PCDR Trust is to help meet exceptional balance of payments needs of the poorest and most vulnerable low-income countries that arise as a result of catastrophic disasters and the subsequent economic recovery efforts.** This exceptional assistance would be in the form of PCDR grants that would deliver debt service relief and could also potentially provide full elimination of the eligible debt stock, which would include all pre-existing PRGT and GRA credit as well as any immediate emergency disbursement following the disaster. Debt relief would create financial space to meet the country's massive recovery-related balance of payments needs by reducing its debt burden, which can be appropriate in light of both the heightened vulnerability and humanitarian considerations after catastrophic disasters. Accordingly, the purpose of PCDR debt relief is not to attain a particular benchmark for debt sustainability, but rather to complement concessional lending under the PRGT, as well as broader donor assistance, with exceptional balance of payments support in the form of debt relief in order to free up additional resources for the economic recovery. Thus, it would allow the Fund to join international efforts to provide exceptional assistance including by alleviating the country's debt burden.

17. **Typically, decisions on emergency PRGT financing and PCDR-financed debt service relief would be made shortly after the catastrophic event.** The decision to make the country's existing debt to the Fund (including any immediate post-catastrophe emergency disbursement under the PRGT) eligible for possible future stock relief would typically be made at a later date, depending on the severity of the disaster and on the availability of resources in the PCDR Trust at the time the decision is to be taken. In any case, the debt stock relief would only be disbursed once a comprehensive agreement has been reached among a critical mass of external creditors and subject to certain policy standards, as discussed below.

18. **The proposed approach aims to balance several important goals.** First, it preserves the Fund's unique financial role in LICs, including the ability to provide rapid liquidity support, and the integrity of the PRGT facilities architecture, avoiding any overlaps

that would result from creating new (e.g., more concessional) liquidity support instruments.¹⁴ Second, it allows immediate debt service relief in the recovery following the catastrophic disaster. Third, it gives the Fund the ability to give an early signal that it could join international efforts to support the recovery and provide debt stock relief.

B. PCDR-Financed Debt Relief

19. **The poorest and most vulnerable member countries could qualify for PCDR support in the event of a catastrophic disaster.** To help preserve scarce PCDR resources and target support at those countries that are most in need after such a disaster, eligibility would be limited to PRGT-eligible countries with annual per capita income below the prevailing operational International Development Association (IDA) cut-off (currently US\$1,135), or below twice the cut-off for those PRGT-eligible countries meeting the definition of a “small country” under the PRGT eligibility criteria (i.e., with a population below 1 million). The higher income cut-off for small countries is consistent with the existing special treatment of such countries for PRGT eligibility purposes.¹⁵ It also takes into account the additional vulnerabilities of small countries to catastrophic disasters.¹⁶

20. **Alternatives that would expand eligibility to higher income countries could be very costly and would be less targeted.** As discussed in Section II, the adverse impact of catastrophic disasters is particularly severe in the poorest countries, given weak initial conditions and greater underlying vulnerabilities. In addition, as IMF credit to higher income program countries tends to be relatively high, expanding eligibility would substantially raise the cost of debt relief.¹⁷ The proposal therefore limits eligibility to countries with initial conditions that are not significantly stronger than Haiti’s.*

21. **A potentially eligible country would qualify for PCDR assistance when the Board makes a finding that the country is experiencing an exceptional balance of**

¹⁴ As discussed in *The Fund’s Facilities and Financing Framework for Low-Income Countries*, Section III, Fund financing is aimed at providing temporary balance of payments support to smooth adjustment toward a sustainable macroeconomic position, whereas aid by donors typically provides a more permanent resource transfer.

¹⁵ See *Eligibility to use the Fund’s Facilities for Concessional Financing*, Box 2.

¹⁶ Specifically, in very small countries, a single disaster is more likely to wipe out a significant part of the country’s administrative capacity, specialized skills, and a large share of its infrastructure. Also, there are less likely to be resources or systems in other parts of the country (not affected by the disaster) that could provide backup support and a basis for timely reconstruction. In addition, the fixed costs associated with reestablishing administrative capacity and rebuilding vital infrastructure will weigh far more heavily on the smallest countries (given their far smaller absolute GDP at the same level of per capita income).

¹⁷ For example, for PRGT-eligible countries that have per capita income above the IDA operational threshold and do not meet the small country definition, average access to Fund financing in recent programs amounted to 307 percent of quota (and SDR 325 million). By contrast, for the countries that could be covered by the PCDR, average access to Fund financing in recent programs was 84 percent of quota (and SDR 106 million).

* [Supplement 1](#) provides a further discussion of the income criteria.

payments need arising from an exogenous catastrophic disaster.¹⁸ The assessment will be guided by predefined principles and criteria. Specifically, a country would qualify for PCDR support if the Board determines, based on available information, that a catastrophic disaster has likely (i) directly affected more than a third of the population,¹⁹ and (ii) destroyed more than a quarter of the country's productive capacity, as estimated by early indications such as destroyed structures and impact on key economic sectors and public institutions, or caused damage deemed to exceed 100 percent of GDP. Based on these definitions, PCDR support is in effect limited to catastrophic disasters that are truly exceptional events, and would not be expected to occur more than once or perhaps twice every decade.²⁰

22. The proposed qualification criteria balance the need to (i) limit PCDR qualification to the most catastrophic of disasters, (ii) establish transparent thresholds, and (iii) allow timely decisions in the face of high uncertainty and limited reliable data. Early estimates of the physical damage and share of population affected are typically available soon after the disaster. The criteria are chosen such that only the most catastrophic of disasters would qualify for PCDR support, as Section II has shown that only such disasters tend to create substantial protracted balance of payments needs.²¹ The data needed for this assessment will typically be preliminary, and the decision on PCDR support will ultimately require a judgmental assessment by the Executive Board, based on all available information soon after the disaster.²²

23. For countries that have been determined to meet the above qualification criteria, the PCDR Fund will automatically provide grants to cover all debt service payable on qualifying credit outstanding for a period of two years, conditional upon the availability of Trust resources. Qualifying credit would comprise both existing PRGT and GRA credit, including any immediate emergency disbursement after the catastrophe. The Executive Board decision on qualification for PCDR support is expected to be adopted in the immediate aftermath of the catastrophe, upon which the PCDR Fund would provide grants that pay all debt service (interest and principal) on qualifying outstanding credit, including interest on

¹⁸ Qualifying exogenous catastrophic disasters are exceptionally destructive natural disasters, which could include earthquakes, floods, droughts, hurricanes, tsunamis, and other disasters.

¹⁹ This includes people killed, injured, and/or displaced. In exceptional cases, a somewhat lower share may satisfy the criterion depending on the severity of the impact on the population.

²⁰ This narrow definition is consistent with the Fund's ability to provide effective temporary balance of payments support in most natural disaster circumstances based on its existing toolkit.

²¹ These thresholds are broadly consistent with the empirical evidence presented in Section II above, which suggests that the top quartile of the most severe disasters (with average damage of about 100 percent of GDP, and 36 percent of the population affected), created disproportionately large balance of payments needs.

²² Alternative criteria would be less useful for this purpose. Purely parametric approaches on the size of the disaster (e.g., earthquake scale or Hurricane strength) would not be reliable indicators of the actual level of destruction. Direct economic indicators (e.g., exports, current account) would not be available for a long time.

any credit disbursed after the catastrophic disaster, falling due to the Fund over the two-year period immediately following the catastrophic disaster.

24. **In addition, the IMF’s Executive Board may decide to declare the country’s entire existing qualifying debt (as defined above) eligible for possible future stock relief as part of a concerted international debt relief effort.** Eligibility for stock of debt relief can be established by the Executive Board at any point within a two-year period after the disaster.* The stock relief would include any liquidity support provided in the immediate aftermath of the catastrophe. In addition to the findings required for PCDR support specified in paragraph 21, eligibility for debt stock relief would require a finding by the Board that (i) the catastrophe has created or exacerbated substantial and protracted balance of payments needs arising from the economic recovery efforts that would be expected to persist beyond the flow relief period and (ii) the resources that would be freed up by debt stock relief would be critical for meeting these needs.²³ ** These findings, which may be based on preliminary estimates and any other relevant information, would be made on the basis of assessments of relevant factors such as: (i) the catastrophe’s long-term impact on physical infrastructure, human capital, and institutional capacity, based on up-to-date damage estimates by relevant agencies; (ii) prospects for GDP, exports, and revenues; and (iii) the country’s debt vulnerabilities as measured by an updated debt sustainability analysis.²⁴

25. **The stock relief would be in the form of PCDR grants to pay down the stock of qualifying debt outstanding, which includes any emergency credit disbursed immediately following the disaster.** Disbursements qualifying for stock of debt relief would include all disbursements that were made as an emergency response to the disaster, normally within four months of the disaster,²⁵ but exclude any subsequent support for the recovery phase.²⁶ Actual delivery of the stock relief could occur at any point while qualifying debt remains outstanding, once the requirements described below have been met.

- The decision by the Executive Board on delivery of stock relief would be conditional on a concerted effort by the international community to provide debt relief, evidenced by the participation of official creditors accounting for at least 80 percent of total

*[Supplement 1](#) amends this proposal: “A minimum post-catastrophe ‘cooling-off’ period of six months would normally apply before the Fund may take a decision on a member’s qualification for stock of debt relief ...”

²³ The finding of criticality would be based on the expected magnitude and duration of the balance of payments needs and availability of alternative sources of financing, as well as the size and time profile of resources freed up by stock relief. Once the criteria for debt stock relief are met, such relief would apply to the entire stock of eligible debt.

**[Supplement 1](#) clarifies and amplifies the link between updated debt sustainability assessments and the “criticality” test for stock of debt relief from the PCDR Trust.

²⁴ A low level of debt or low risk of debt distress would suggest that the resources freed up by debt stock relief are relatively minor and are, therefore, unlikely to be critical for meeting recovery-related balance of payments needs. In any case, a country with such debt levels or risks that meets the PCDR qualification requirements referred to in paragraph 19 would qualify for debt flow relief.

²⁵ In this context, the disaster is considered to have occurred at the time when the impact of the shock met the qualification criteria presented above.

²⁶ In the case of Haiti, the PCDR would cover any pre-existing debt and the disbursement made in February 2010, while it would not cover any potential subsequent disbursements.

sovereign external debt outstanding to official creditors at the time of the catastrophe.²⁷

- Consistent with the approach under other trusts like the PRGT and PRGT-HIPC Trusts, the Board decision would in all cases be conditional upon the availability of resources in the PCDR Trust.²⁸
- Unlike debt relief under the HIPC Initiative and the MDRI, PCDR-financed debt relief in catastrophe cases would not be conditional on satisfactory implementation of a Poverty Reduction Strategy, or on having in place a Fund-supported program, such as an arrangement under the PRGT.
- PCDR-financed debt stock relief would, however, require a finding at the time of delivery of stock relief that the country's recent and current policies do not undermine macroeconomic stability, and that the member is cooperating with Fund staff in designing its macroeconomic policies. Specifically, there should be assurances that (i) the member will cooperate with the Fund in an effort to find, where appropriate, solutions for its balance of payments problems, and (ii) inappropriate measures or policies will not compound the member's balance of payments difficulties.²⁹ The relief will also require a track record of adequate macroeconomic policy implementation covering about six months prior to the decision to disburse debt stock relief.³⁰

C. Using the PRGT Following a Catastrophic Disaster

26. **The Fund has a unique and important role in addressing urgent financing needs in the wake of a catastrophic disaster, while supporting macroeconomic stability and institution building.** The Fund can provide quick liquidity support at a time when financing of critical imports and budgetary spending could be severely constrained by the twin collapses of productive capacity and of the financial infrastructure. The financing instruments under the PRGT allow for the provision of both emergency liquidity support in the immediate wake of a catastrophe, as well as for subsequent assistance in the recovery and reconstruction phase. In addition, the Fund can also provide critical technical assistance to help re-build capacity in core macroeconomic areas.

²⁷ These provisions are intended to support the catalytic effect of IMF debt stock relief; they would also help to prevent free riding.

²⁸ In the absence of adequate resources, the Executive Board would decide on the appropriate distribution of the available amount among qualifying countries.

²⁹ This corresponds to the policy standard for support under the RCF, and a letter of intent outlining the member's policy plans would serve to provide the necessary assurances to the Executive Board.

³⁰ This would be the same type of policy standard that would allow repeated disbursements under the RCF in the absence of repeated exogenous shocks. The track record objectives would take into account the likely very difficult economic circumstances.

27. **An emergency disbursement would typically be made under the shocks window of the RCF, which does not require an upper credit tranche (UCT) quality standard.**

The initial emergency disbursement could be provided under the shocks window.

Alternatively, this initial disbursement could be made through an augmentation of an existing arrangement under the ECF or Standby Credit Facility (SCF). In practice, financial assistance under an SCF or ECF arrangement would be appropriate only in rare cases, as it would likely be difficult for a member to formulate and implement a UCT-quality program in the immediate aftermath of the catastrophe.³¹ Hence, it may in some cases be appropriate to cancel any existing UCT arrangement, including in the GRA, and rely on the RCF instead. In any case, the use of any PRGT instrument would be subject to existing policy standards.

28. **Subsequent (post-emergency) Fund financial support could be provided under the PRGT.** The ECF would usually be the most appropriate facility for providing support in the recovery phase, given the likely protracted nature of the country's balance of payments problem in the years following a catastrophic disaster. However, it may take some time to formulate and (re)gain capacity to implement an appropriate medium-term economic program, especially given initial capacity constraints, in which case the RCF may serve as a bridge (subject to applicable conditions on repeated use).³²

29. **Access would be determined on a case-by-case basis applying established criteria, and would thus likely be moderate.** In line with access policies under the RCF, the initial emergency disbursement would typically not exceed 50 percent of quota, and may be lower in cases where other donors provide rapid support on more concessional terms. In the subsequent recovery phase, PRGT access under any facility would likely be moderate or low (often below the applicable norms), consistent with the expectation that highly concessional donor resources for longer-term reconstruction and development would cover most of the country's balance of payments needs, and that country capacity (and hence the strength of the program) is likely to be constrained.*

D. Other Policy Considerations

30. **A safeguards assessment is not required for the use of PCDR grants, but existing safeguards requirements would remain in effect for post-emergency disbursements under the RCF or other PRGT facility.** In the case of the RCF, these require the authorities to commit to a safeguards assessment, provide staff with access to the central bank's most

³¹ The case of Haiti was exceptional as the augmentation coincided with the final ECF review; i.e., a forward-looking economic program was not part of the review.

³² In line with existing policy, a new SCF arrangement could be requested only if a sustainable macroeconomic position is expected to be restored within two years and in any event not later than three years, which is unlikely to be the case in the wake of a catastrophic disaster. Furthermore, countries whose income exceeds the IDA operational cutoff would not be subject to the presumption of blending as income may not be a reliable indicator of poverty following a catastrophic disaster and risks of debt distress may well move to high level.

*[Supplement 1](#) provides further details on access to PRGT financing.

recently completed external audit reports, and authorize its external auditors to hold discussions with Fund staff.

31. Pre-completion point HIPCs would be eligible for support from the PCDR.

Should a pre-completion point HIPC suffer a catastrophic event, it would be eligible for emergency liquidity support under the PRGT and debt service and stock-of-debt relief from the PCDR Trust based on the same considerations as would apply to other PRGT-eligible countries. As HIPCs, by definition, have extraordinary financing needs owing to high debt burdens, there would be a strong presumption of a prompt international effort to provide comprehensive and deep debt relief in the event of a catastrophe. In such an eventuality, PCDR relief could be provided before any debt relief under the HIPC Initiative, or the MDRI. Should the needed international consensus on the early provision of debt stock relief not emerge, the affected country could still benefit from full debt service from the PCDR Fund and eventual relief under the HIPC Initiative and MDRI.

IV. FINANCING CONSIDERATIONS AND RESOURCE AVAILABILITY

A. Resource Needs

32. Given the unpredictable nature of catastrophic disasters, cost projections are subject to significant uncertainties, which could argue for setting aside substantial resources. Costs would depend on the frequency of catastrophic disasters in the eligible countries, the amount of Fund credit that is initially outstanding to qualifying countries, and the scope of the financial support to be provided. As discussed in Section II, catastrophic disasters have hit eligible countries on average only one or two times per decade. The level of a country's qualifying credit when a decision is made to provide PCDR support would affect the cost of debt service in the immediate period and that of the subsequent stock debt relief if this was granted. Nevertheless, it is clear that a larger fund would provide greater assurance that the PCDR Trust could provide support in more cases. Moreover, given the uniformity of treatment requirements applicable to use of the Fund's resources as summarized above, a Trust financed by Fund resources would need to contain sufficient aggregate financing to support an assessment that it can credibly provide financing beyond one already identified potential recipient.

33. However, there are important alternative uses for scarce grant resources. Tying up substantial funds in a rarely used Trust may be an inefficient use of scarce concessional resources, possibly reducing the Fund's ability to finance other initiatives for LICs over the medium term. To balance the security and scarcity considerations, one approach would be to establish an initial funding base that could cover Haiti and at least one other typical catastrophic disaster, and then committing to fundraising efforts to replenish the Trust as needed.

34. **An analysis of past and possible future catastrophic disasters indicates that debt relief in potential future cases would typically be less costly than in Haiti.** About SDR 180 million (about US\$0.3 billion) would be needed immediately for the Fund's share of debt relief for Haiti. To assess possible future demand for PCDR resources, several methodologies can be considered (Table 1):

- One way of illustrating potential cost of PCDR debt relief is to calculate the hypothetical costs that would have been incurred for those countries that experienced catastrophes in the past and would have likely met the qualification criteria.³³ Based on this methodology, the cost of flow relief would have been negligible, while stock relief was significant only for Haiti.
- Looking ahead, the typical (median) cost of flow relief for a PCDR-eligible country (based on projected debt service over two-year periods and interest on an assumed additional disbursement of 50 percent of quota) would be less than SDR 7 million (line 2 of Table 1). At the 75th percentile, the cost of flow relief would still be less than SDR 15 million. The immediate provision of flow relief could thus be secured with a relatively small endowment in the PCDR Trust, allowing time to supplement the PCDR resources for potential future stock relief.
- The potential cost of stock relief in a typical case (median cost of relief on all outstanding debt and an assumed additional emergency disbursement of 50 percent of quota) would be SDR 117 million (line 2 of Table 1). At the 75th percentile, the typical cost of stock relief would be SDR 177 million (Haiti is thus just within the top quartile of this sample).

Table 1. Hypothetical and Potential Cost of PCDR Support
(In millions of SDR)

	Flow			Stock		
	Average	Median	75th percentile country	Average	Median	75th percentile country
Past cases						
1. Previous catastrophic disasters (3 countries) ¹						
1.a. Including Haiti	2.1	0.9	...	61.0	8.8	...
1.b. Excluding Haiti	0.6	0.6	...	6.2	6.2	...
Potential cases						
2. Countries eligible for potential PCDR support (48 countries) ²	17.0	6.7	14.3	169.7	116.7	177.1

¹ Disasters that would have likely been assessed as catastrophic disasters, based on the criteria in paragraph 21.

² Countries with per capita income below the IDA operational cut-off plus "small countries" with per capita income up to 200 percent of the IDA operational cut-off (based on latest available data).

³³ These costs are calculated for each country as the amount of outstanding debt immediately following the disaster, which would then be subject to debt relief under the proposal.

35. **The PCDR Trust would require at a minimum about SDR 250–300 million in initial resources to provide adequate assurances that resources are available for potential future cases.** This would allow the Fund to join in the international debt relief effort for Haiti, with about SDR 70–120 million remaining for additional cases. These remaining resources could be broadly sufficient to allow early commitment by the Fund to full stock relief in a typical future catastrophic disaster, even before any additional fundraising. Alternatively, they could cover debt flow relief in virtually all potential future cases, even in countries with large debt service due to the PRGT. The availability of adequate flow relief would ensure that there is time for any fund-raising that may be needed for possible future stock relief.

36. **In view of the unpredictability of catastrophic disasters, it is important that an effective mechanism for replenishing PCDR Trust resources also be established.** Consistent with the standard approach that has been used after the establishment of other new financing vehicles, it is proposed, as discussed below, that the Board would keep the financing of the PCDR Trust under regular review. Moreover, once a portion of the initial resources have been committed by the PCDR Trust in the wake of a catastrophic disaster, a mobilization round should be initiated to top up the PCDR Trust to at least the initial level. Maintaining a reasonable level of resources in the Trust would ensure that the PCDR Trust would be able to disburse as quickly as necessary and so limit the risk of donors being asked to contribute resources to the PCDR at very short notice to meet the financing needs of a specific catastrophic disaster.

B. Financing Options

37. **This section explores the possible sources of the initial financing of the PCDR Trust: new bilateral contributions; use of a part of the balance in the MDRI-I Trust; and use of part of any windfall profits from the ongoing gold sales.** As noted earlier, given uniformity of treatment requirements applicable to a scheme involving use of the Fund's resources, the initial funding would need to cover not only the Fund's share of debt relief for Haiti, but also contain sufficient resources to be a credible source of financing to other members beyond Haiti, based on reasonable assumptions. Once an initial adequate amount is secured, it would be expected that the PCDR Trust would in the future be replenished with donor contributions as necessary.

New bilateral contributions

38. **One financing option is new bilateral contributions for the PCDR Trust.** This would be consistent with the traditional role played by donors in providing the necessary financing for the Fund's concessional financing and debt relief for LICs. Donors have in the past contributed generously for the subsidization of emergency assistance to LICs under

ENDA/Emergency Post-Conflict Assistance (EPCA), the fund-raising for the Exogenous Shocks Facility (ESF), and in the context of the ongoing fund-raising for PRGT financing.³⁴

39. **However, in the present circumstances, it may be unrealistic to seek the full amount of the initial funding from bilateral contributions.** Many of the traditional donors continue to face very tight budgetary constraints in the wake of the global crisis and have had to cut back on the delivery of their overall commitments in support of LICs. In addition, it is imperative that the ongoing fund-raising for the PRGT be completed successfully before launching another fund-raising effort for the PCDR Trust. Depending on Directors' views on the appropriate initial funding level of the PCDR Trust beyond the minimum amounts discussed above, as well as on other financing considerations, an initial funding target from donors could be proposed that would supplement use of the surplus balance in the MDRI-I Trust discussed below. In any case, it is proposed that the Board summing up related to the establishment of the new Trust would indicate an expectation that members would contribute additional resources as may be needed to ensure adequate financing of the PCDR Trust beyond financing for Haiti.

MDRI-I Trust balances

40. **A second option could involve using a portion of the balance in the MDRI-I Trust.**³⁵ The MDRI-I Trust currently has a balance of SDR 293 million. A surplus of about SDR 291 million is currently projected at the end of MDRI operations, although this estimate is sensitive to the assumed timing of the completion point of the remaining four eligible countries (see [Update on the Financing of the Fund's Concessional Assistance and Debt Relief for Low-Income Countries](#)). It is already clear, however, that the minimum level of the surplus in the MDRI-I Trust will be SDR 260 million. The MDRI-I Trust was financed by transfers of SDR 1.5 billion from the Special Disbursement Account (SDA), and it finances MDRI debt relief to qualifying countries with annual per capita income in 2004 at or below \$380. The projected surplus has arisen mainly due to delays in reaching the HIPC completion point by some eligible members, and to the fact that the amount of MDRI-eligible debt has been declining steadily over time, due to the end-2004 cutoff date for eligibility.³⁶ The MDRI-I Trust Instrument envisages that any surpluses when the MDRI-I Trust is liquidated would be transferred back to the SDA.

41. **The Board could consider a transfer to the PCDR Trust of the SDR 260-290 million that it is estimated represents the surplus balance in the MDRI-I Trust.** It is

³⁴ See [Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries](#).

³⁵ All other existing internal resources of the Fund are needed for specific purposes. This includes the resources in the PRGT Reserve Account, the PRGT subsidy resources, and the SCA-1 Account.

³⁶ See [Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries](#).

expected that the specific amount of this surplus will be known with more certainty by the time the actual transfer decision is presented for consideration by the Board, since the surplus will be affected by the precise timing of the forthcoming completion point for the Democratic Republic of Congo, and the associated provision of MDRI assistance. A transfer in this range would be broadly consistent within the minimum amounts estimated to be needed as discussed in paragraph 34 above, and would cover the immediate need of SDR 180 million for the Fund to join in the international debt relief effort for Haiti. It would also leave resources of between SDR 80–112 million in the PCDR Trust.

Windfall profits from ongoing gold sales

42. **It may be possible in the future to consider options for facilitating donors’ contributions to the PCDR Trust through the use of part of any windfall profits from the ongoing gold sales, over and above what is already anticipated for the new income model and PRGT financing.** So far the Fund has sold about half of the agreed 403 tons of gold. The price attained has exceeded the price needed to deliver on the new income model and generate the agreed subsidies for PRGT financing. If the Board agreed to use a part of any extra windfall profits to facilitate contributions to the PCDR Trust, an arrangement similar to what is envisaged for PRGT LIC financing would need to be put in place for the transfer of these resources. They would thus need to be transferred from the Investment Account (IA) to the GRA, from the GRA to members as dividends, and then from members back to the Fund—likely subject to some leakage—as their contributions to the PCDR Trust.

43. **However, the possible use of resources linked to the gold sales proceeds cannot be assumed in the near term.** The size of any additional windfall profits remains uncertain and will only be known once gold sales are concluded. Indeed, if gold prices were to fall sharply, it is still possible that the sales may not generate sufficient proceeds to enable their use to facilitate financing to meet existing concessional financing needs. Even after the gold sales are completed and adequate profits realized, the possible use of these profits to fund the PCDR would have to be considered along with the other alternative uses including, *inter alia*, retention in the IA/GRA or use to facilitate further contributions for LIC financing.

C. Financing Framework

44. **In order to provide debt service and debt stock relief as foreseen under the policy on catastrophic disasters, the establishment of a separately funded PCDR Trust**

is proposed. While new financing for balance of payments support can be provided through the PRGT facilities, amending the PRGT to provide the proposed grants for debt relief is not consistent with the underlying principles and basic design of the PRGT. A separately funded and managed PCDR Trust, with the Fund as the Trustee, could facilitate these operations and avoid a blurring of the distinction with lending operations. It would also ensure that the resources for the Fund's other concessional operations—under the PRGT and debt relief under the HIPC and MDRI Initiatives—would be preserved.

45. **Operationally, the PCDR Trust would be authorized to provide grants for debt and debt service relief.** The Articles (in addition to precluding the provision of grants from the GRA) also preclude the GRA from having financial responsibility for the operation of administered accounts such as the proposed Trust, and it is not proposed that any other trusts or accounts administered by the Fund would be financially linked to the new Trust. As such, the PCDR Trust would need to hold sufficient funds at the time a commitment is made, and any disbursements would be subject to the availability of resources in the Trust (as is the case for all other concessional financing trusts). The PCDR Trust could have a general account for resources that would benefit all eligible countries. In addition, to facilitate fund-raising, it would be possible for donors to make ear-marked contributions to benefit a specific member in the wake of a qualifying disaster.

46. **A mechanism similar to the delivery of IMF's HIPC debt relief could be considered for use in providing PCDR support.** Once PCDR support has been committed, the IMF would disburse irrevocably all the PCDR assistance from the Trust to the member's individual Umbrella sub-account, which is established on its behalf and administered by the IMF. The Trustee would be authorized to use the resources in the member's Umbrella account to cover the debt service obligations falling due. Any resources in the sub-account from earlier disbursements or investment earnings, and deemed to be in excess of the projected needs, may be transferred back to the Trust. Additional resources could also be committed and disbursed if these are needed to fully cover the stipulated debt service. Ear-marked contributions by donors could be accepted in a member's Umbrella sub-account, which could create potential excess amounts that would reflow to the general account in the Trust. Nevertheless, once the PCDR Trust operations with that country are concluded, any residual resources would be retransferred to the PCDR Trust for untied use for any qualifying member.

47. **In light of the financing uncertainties, a comprehensive review of the PCDR Trust could be proposed after a reasonable period of time has elapsed.** The developments in the operations of the PCDR would be reviewed in the regular semi-annual update of concessional financing, but a more detailed review of the experience could be conducted after a period of, say, five years. This review would include an assessment of the adequacy of the resources of the PCDR Trust. The terms of the Trust could include a presumption that, if the PCDR Trust is liquidated, any excess funds in the Trust would be transferred to the General Subsidy Account of the PRGT.

V. GOVERNANCE STRUCTURE AND APPROVAL REQUIREMENTS

48. Upon request, the Fund could establish the PCDR Trust with assets to be administered by the Fund under Article V, Section 2(b). The Fund could also transfer its own SDA-derived resources from the MDRI-I Trust to the PCDR Trust, to be managed and administered alongside donor resources in the PCDR Trust. The use of SDA resources in the PCDR Trust would be pursuant to the second sentence of Article V, Section 12(f)(ii), which authorizes the use of SDA resources to provide balance of payments assistance on special terms to LICs, a concept that includes providing grants for balance of payments support. The PRGT, PRGT-HIPC, and MDRI-I Trusts are examples of other trusts that were established to facilitate donor contributions pursuant to Article V, Section 2(b), while also leveraging SDA resources within the same Trust pursuant to Article V, Section 12(f)(ii).

49. The Board decision transferring SDA resources from the MDRI-I Trust to the PCDR Trust would require an 85 percent majority of the total voting power, as this would represent a new use under Article V, Section 12(f)(ii) of the SDA resources in the MDRI-I Trust.³⁷ The qualification for and terms of PCDR relief would be set forth in the PCDR Trust Instrument adopted by the Board. Future operational decisions under the PCDR Trust Instrument would be taken by the Executive Board for the Fund as Trustee of the PCDR Trust.

VI. ISSUES FOR DISCUSSION

- What are Directors' views on the proposed PCDR Trust Fund, which would enable the Fund to join international debt relief efforts for Haiti and other low-income countries hit by similar catastrophic disasters?
- Among other design questions, do the proposed eligibility criteria (per capita income thresholds, criteria for qualifying disasters, and eligibility for stock relief) strike an appropriate balance between uniformity of treatment and targeting support at the most vulnerable cases?
- If Directors support the creation of the PCDR Trust Fund, what are their views on the initial size and sources of financing of this Trust?

³⁷ As the MDRI-I Trust currently contains only SDA resources, there are no third party contributors whose consent would be needed for the proposed transfer of resources from that Trust to the PCDR Trust.