WHY PANDEMIC CLAUSES SHOULD BE INCLUDED IN LENDING AGREEMENTS

"…with the power of the pen, we can impose natural disaster and pandemic clauses in our debt. With the power of the pen, we can change the capital that is available to multilateral development banks that will remove the barriers that currently exist for us to fight poverty."

— Prime Minister of Barbados, Mia Mottley, Sept. 22, 2022, New York

In brief: Prime Minister Mia Mottley has publicly championed the importance of pandemics being a part of the multilateral development bank (MDB) reform agenda. However, countries are hesitant about whether pandemics should be at the heart of the Summit for a New Global Financial Pact in Paris in June. This brief makes the case for why pandemic debt suspension clauses — one concrete, targeted and tested solution for pandemic financing — should be prioritized in the MDB reform agenda as well as by bilateral creditors. The recommendations made in this brief could be adapted to work for suspension clauses in response to other external shocks.

Ask: Cost free pandemic suspension clauses of a one-to-two-year period should be included in all new debt contracts by MDBs, bilateral creditors, and private creditors as of now. In case of any debt restructuring, the restructured debt should also include those clauses.

Why should progress on pandemic finance be a key outcome of the Paris Summit? The COVID-19 pandemic triggered the worst global economic downturn since the Great Depression in a matter of months. The acceleration of climate change and rising temperatures makes the incidence of outbreaks and pandemic threats even more likely in the future. Lives and livelihoods depend on leaders taking action now. We call on the parties to the Paris Summit to prioritize pandemic debt suspension clauses and other means to finance pandemic preparedness and response as a key outcome of the Summit. Lack of action in June will perpetuate the cycle of neglect from generations of leaders before.

Mitigating the impact of pandemics and climate change are intrinsically linked: The Bridgetown initiative developed last summer and published on Sept. 23, 2022 includes vital mentions of pandemics, including the mention of pandemic threats as part of step one of the agenda. Pandemics should be considered as the twin threat alongside climate change, and we saw starkly with COVID-19 and other pathogens that epidemics and pandemics threaten progress against poverty. The lack of action on pandemics has undermined trust between low- and middle-income countries (LMICs) and high-income countries (HICs), affecting prospects to reach solidarity-based solutions on a range of international affairs including climate.

Pandemic financing is vital for a wide range of LMICs: The scale and speed of the economic impact of COVID-19 on LMICs was dramatic. The eighth Africa Regional Forum on Sustainable Development noted that “Pandemic driven debt distress dampens fiscal space, consequently weighing down on provision of social services and fueling socio-economic fragilities within and among countries resulting in a vicious cycle going from debt distress to reduced fiscal space ending up in social and political instability and fragility on the continent.” The inequity was worsened by the lack of leverage LMICs had to engage in negotiations to acquire the tools they needed to keep their own citizens safe and protect lives and livelihoods. The impact of pandemics on LMICs is not just a health issue but a systems-wide challenge. Before the next pandemic strikes, it is essential that countries and communities have avenues to quickly access capital when needed for food, shelter, energy, and more to keep communities and whole societies afloat.

How would a pandemic debt suspension clause work? Based on the novel approach taken by Barbados, a pandemic debt suspension clause (DSC) would be activated on demand over a one-to-two-year period when a public health emergency is declared by both the WHO and the Government in question and this is combined with a significant and predefined economic contraction or a notable and predefined surge in government spending as a response to the shock. As highlighted by Avinash Persaud in a recent article, if all developing countries had pandemic clauses in their sovereign debts during the pandemic, it would have released US$1 trillion in liquidity. It is vital that this liquidity is released earlier in the pandemic lifecycle.

What can creditors and borrowers lose? In their design, DSCs are financially neutral, which means they don’t require financial contributions as the country pays back its suspended debt with accrued interests. The debt suspension would apply to principal and interest falling due over a one-to-two-year period after a pandemic hits. The Private Sector Working Group (PSWG) established by the U.K. in 2021 held the view that DSCs are likely not to have a meaningful cost, as they provide space for debtor countries to overcome what would amount to a liquidity shock and prevent repayment default.

Isn’t the international financial community already responding well to pandemic financing? LMICs did not have access to the kind of liquidity needed to be able to prepare their countries at the outset of the

COVID-19 public health emergency, another reason why the immediate relief of a pandemic clause would be helpful. Bilateral lenders have tended to be responsive to pandemic shocks and, early during the COVID-19 pandemic, suspended debt repayments through the debt service suspension initiative (DSSI). That said, several countries decided not to participate in the DSSI either because the benefits did not outweigh the bureaucratic costs of participation or because they were worried about rating downgrades. Including contractual pandemic clauses would significantly alleviate those two concerns while giving predictability for debtor countries. The international financial institutions can provide notable surge financing, but debt suspension clauses can provide additional buffers to mobilize further financing during a pandemic, when most developing economies are unable to mount a countercyclical policy response. Beyond their immediate efficacy, bilateral lenders have a role in demonstrating that debt suspension clauses can be streamlined and systematically included in debt contracts, especially for the private sector and MDBs that have notably not participated in the DSSI, despite being the largest group of lenders.

Resources

Media

- Barbados issues world's first pandemic-protected bond, Sept. 22, 2022
- Barbados Blue Bond to help Caribbean with Liability management, September 2022
- Credit Suisse finances debt conversion for marine conservation in Barbados, September 2022

Reports

- IMF Country Report, Request for an arrangement under the extended fund facility and request for an arrangement under the Resilience and Sustainability Facility. December, 2022
- Breaking the Deadlock on Climate: The Bridgetown Initiative
- Sovereign Debt Evolution: The Natural Disaster Clause, Spring 2021
- Policy Brief: Technologies for Averting, Minimizing and Addressing Loss and Damage in Coastal Zones

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AVAC
Center for Indonesia's Strategic Development Initiatives (CISDI)
Euro-Mediterranean Economists Association (EMEA)
E3G
Friends of the Global Fight Against AIDS, Tuberculosis and Malaria
Global Citizen
Global Public Investment Network (GPIN)
Joep Lange Institute
Korean Advocates for Global Health (KAGH)
Malaria Youth Army Champion/DRC
Oxfam
Pandemic Action Network
Quality Assurance Network Uganda
Results CanadaSpark Street Advisors
Stowarzyszenie Higieny Lecznictwa (SHL)
Teal Climate
The ONE Campaign
Uganda Child and Aid Development Foundation (UGACAD)
Uganda Peace Foundation