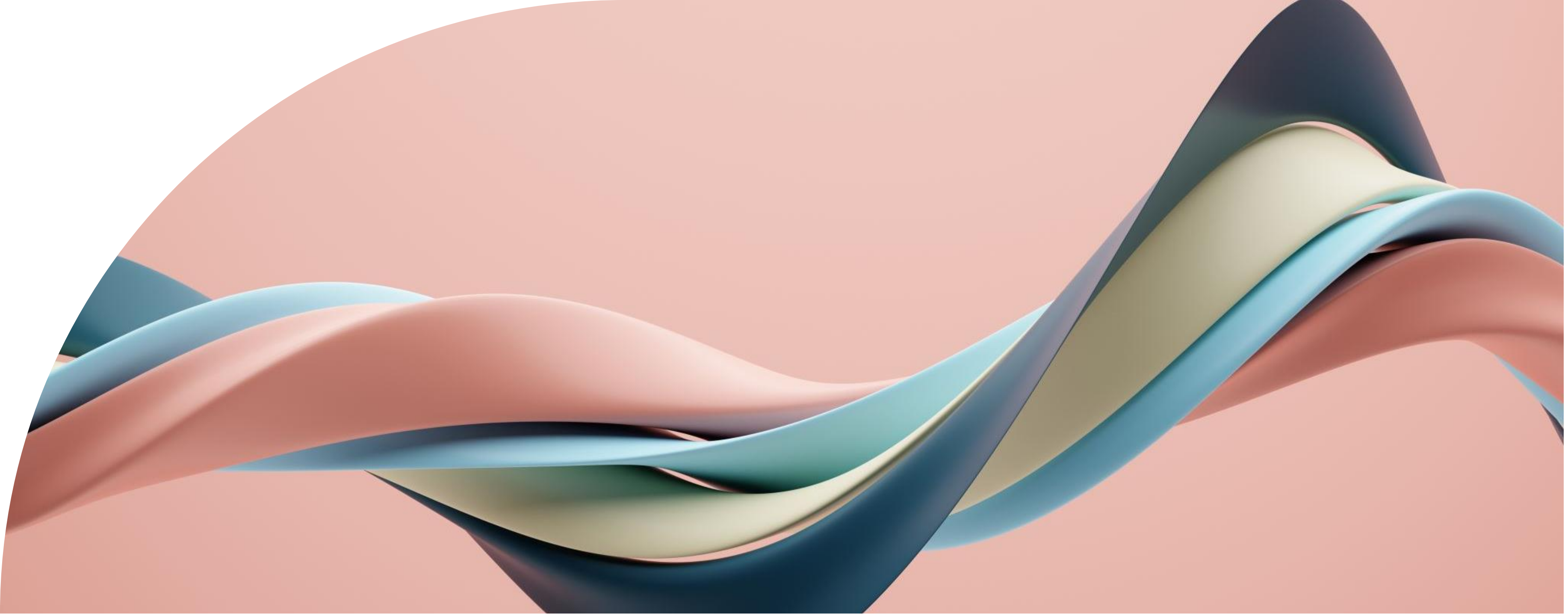

ARCHITECTURE OF SOVEREIGN FINANCING

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1. International Architecture of Sovereign Financing

Photo Credit: Fernando Santander

States, especially developing countries, often cannot mobilise sufficient domestic resources, such as through taxes and returns on investments, to fund governmental activities, economic development projects or deal with natural or man-made disasters. Borrowing from domestic and external sources help states bridge this financing gap.

- The International Law Association (2010) categorised sovereign debt into two types:

- External debt: 'debt expressed in some foreign currency, typical payable abroad, governed by some external law and subject to the jurisdiction of external courts'. Examples include official debt owed to bilateral and multilateral creditors; commercial bank debt; sovereign bonds; trade debt and other liabilities.

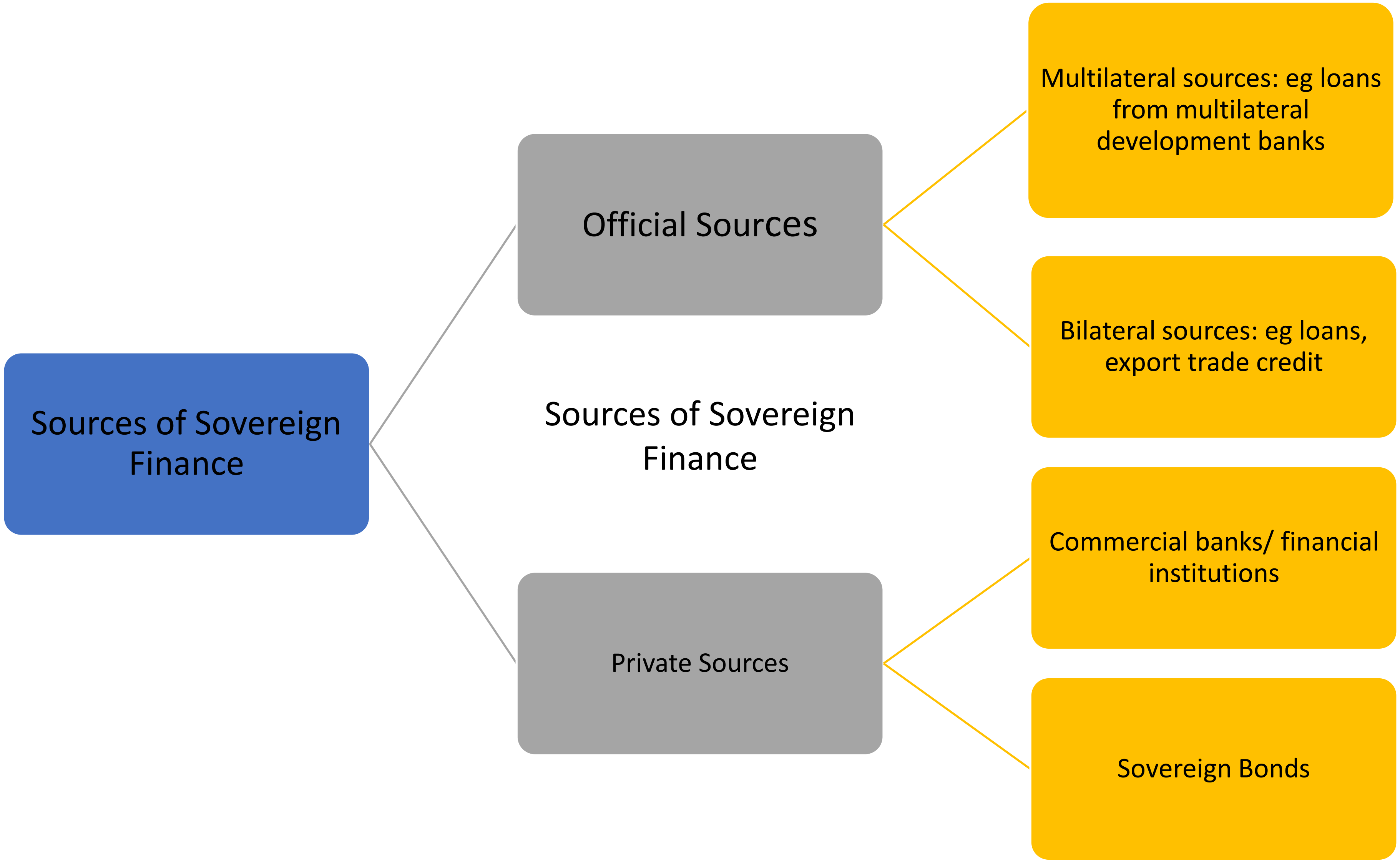
- Domestic debt: 'debt governed by domestic law (usually implied), subject to local exclusive jurisdiction ... denominated in domestic currency and traditionally, though not necessarily, predominantly held by local residents ... Debtor states are able to change domestic debt unilaterally by legislation'. Examples include treasury bills and gilts; administrative liabilities, such as civil service salaries; and local project loans.

- External debt more problematic because of two characteristics:

  (1) Governed by a foreign jurisdiction

  (2) Denominated in an external currency

1. International Architecture of Sovereign Financing



2. Legal Framework for Sovereign Financing & Debt Management

- The law of sovereign financing refers to the law governing the relationship between the debtor sovereign state and its creditors, whether official or private, domestic or external. It deals with, *inter alia*, rules and regulations governing sovereign borrowing and lending and, importantly, the resolution of sovereign debt disputes.

- No overarching body of rules aimed at regulating sovereign borrowing or lending and no single international organisation charged with the oversight of sovereign financing

- *Ex-ante* rules governing sovereign borrowing mainly 'soft law' instruments, eg: Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets 2004 and UNCTAD Principles on Responsible Sovereign Lending and Borrowing, and IMF and World Bank's debt sustainability assessments (DSAs)

- *Ex-post* rules governing sovereign insolvency is fragmented and depends on the governing legal jurisdiction of the debt contract, usually municipal laws

- There is no agreed legal definition of sovereign insolvency but it usually means that states are unable to pay their debts without significant adverse impacts to government functions and public expenditure. There are different thresholds of what is considered unsustainable debt. For example, the IMF and World Bank consider a debt to gross national income (GNI) ratio of between 100 to 200 percent unsustainable.

Debt restructuring can be defined broadly as negotiations to vary the terms of existing debt contracts, notably a modification of payment terms that can include an element of debt relief, such as reduction in debt stock or postponement of debt service, to secure a more sustainable liability profile over time.

Photo Credit: Melinda Gimpel

2. Legal Framework for Sovereign Financing & Sovereign Debt Management

Official Debt

- Paris Club
- Multilateral initiatives, such as the Heavily Indebted Poor Countries Initiative (HIPC), Multilateral Debt Relief Initiative (MDRI), COVID-19 Debt Service Suspension Initiative (DSSI), G20 Common Treatment Framework

Commercial Bank Debt

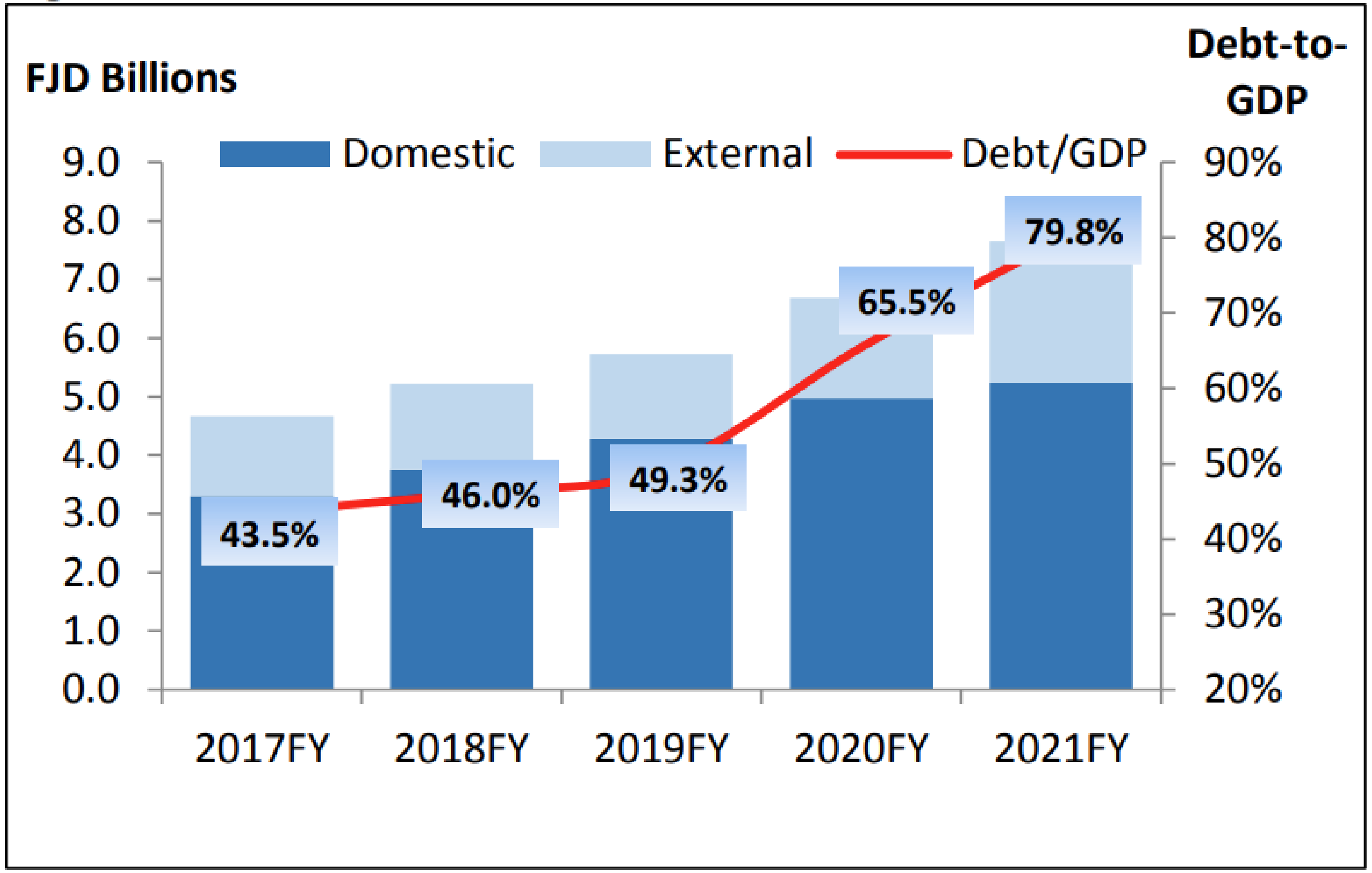
- London Club

Sovereign Bonds

- Exchange offers with bondholders

Contemporary sovereign debt restructuring relies on what Herman et al term the ‘informal imperfect coordination of the debtor and its creditors, usually by the IMF under the guidance of the Group of 7 major industrialized countries’ (Herman et al, 2010a: 4).

Figure 1: Central Government Debt and Debt to GDP ratio



Source: Reserve Bank of Fiji & Ministry of Economy

Current State of Fiji's Public External Debt

CENTRAL GOVERNMENT DEBT STATISTICS (FJ$ Millions)					
PARTICULARS	**Jul-17**	**Jul-18**	**Jul-19**	**Jul-20**	**Jul-21**
EXTERNAL DEBT	**1,370.9**	**1,457.5**	**1,456.8**	**1,709.5**	**2,422.5**
BONDS (Global Bond)	**402.3**	**420.3**	**433**	**424.3**	-
LOANS:	**968.6**	**1,037.20**	**1,023.80**	**1,285.20**	**2,422.5**
ADB	344.3	383.6	389.3	525.4	932.4
AIIB	-	-	-	-	104.2
EXIM China	501.3	489.3	462.0	409.0	444.9
JICA	13.2	11.5	9.7	50.9	290.3
World Bank Group	107.6	150.6	160.3	297.6	650.1
IFAD	2.1	2.2	2.5	2.3	0.7
% of External Debt to Total Debt	**29.3%**	**27.9%**	**25.4%**	**25.6%**	**31.6%**
% External Debt to GDP	**12.8%**	**12.8%**	**12.5%**	**16.7%**	**25.2%**

Table 10: Government External Debt ($M)

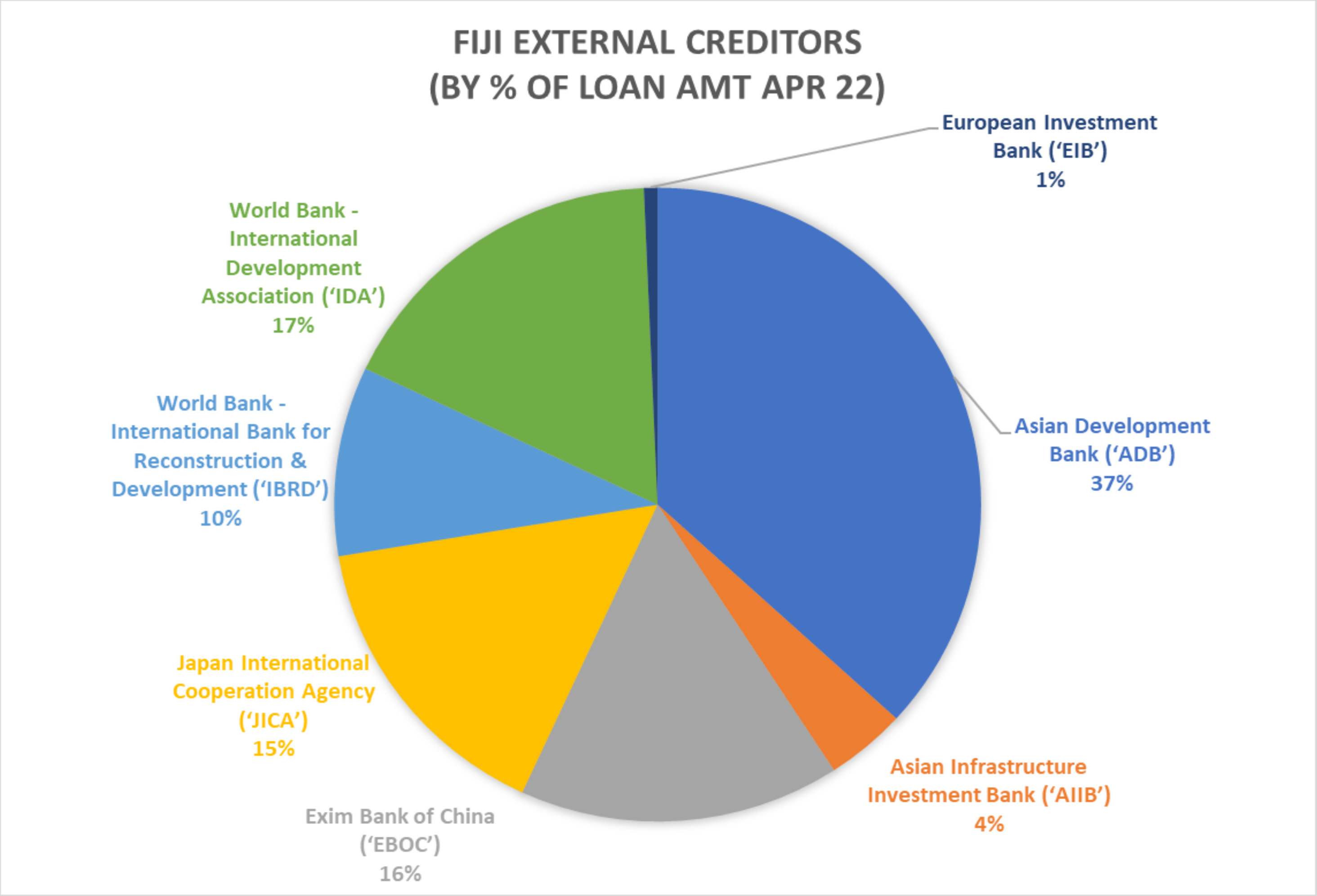
Particulars	**Jul-18**	**Jul-19**	**Jul-20**	**Jul-21**	**Jul-22 (f)**
Loans	1,037.2	1,023.8	1,285.3	2,422.5	3,337.1
Global Bonds	420.3	433.0	424.2	-	-
Total External Debt	**1,457.5**	**1,456.8**	**1,709.5**	**2,422.5**	**3,337.1**
External Debt to GDP (%)	*12.8%*	*12.4%*	*16.0%*	*25.8%*	*32.8%*

(Source: Ministry of Economy)

Source: ECONOMIC AND FISCAL UPDATE SUPPLEMENT TO THE 2022-2023 BUDGET ADDRESS, Ministry of Economy 15 July 2022

- As of 2021, Fiji's external debt took the form of loans, following the government's repurchase of its sovereign bond in 2020 (issued in 2006)
- The biggest creditors are the multilateral development banks (MDBs), followed by China and Japan
- In terms of currency composition, the $USD continues its dominance in the external debt portfolio at 70.4 percent, followed by the Chinese Renminbi at 18.4 percent, and then 11.2 percent in Japanese Yen
- According to Government's Quarterly Debt Bulletin of January 2022, "approximately 52.3 percent of the total external debt portfolio is subject to floating interest rates, while 47.7 percent are under fixed interest rate terms"

Fiji only has official external creditors, as of 2022



Source: Ministry of Economy
Quarterly Debt Bulletin – April 2022. Chart and calculation by author

Recent financing initiatives

Green Bond

- In November 2017, Fiji became the first developing country to issue a ‘green’ sovereign bond
- Green bonds are fixed income, liquid financial instruments that are used to raise funds dedicated to climate-mitigation, adaptation, and other environment-friendly projects
- The Fijian Government announced the bond issuances on 1 November 2017 after receiving keen interest from domestic and international investors (notably, the Green Bond attracted overseas investment for its for its FJD-denominated bond)
- Due to outsized interest, two bonds were issued:
    - Five-year maturity of 4% for FJD 20 million
    - Thirteen-year maturity of 6.3% for FJD 20 million
- The funds were used for investments in crop resilience, flood management and reforestation, projects
- While one series of the green bond matured in November 2022, there is still a 6.3% coupon that needs to be paid the next 7 years to 2030 (for the remaining FJ$60million)

DSSI

- Fiji was one of many countries that participated in the G20's Debt Service Suspension Initiative (DSSI) in response to COVID-19
- The DSSI was launched in April 2020 to help low-income countries manage the economic impacts of the pandemic by suspending debt service payments for a period of time. It was concluded in December 2021
- Fiji's participation in the DSSI was an important step in ensuring the country's economic stability at the time
- By participating in the DSSI, the country was able to free up financial resources that would have otherwise been used to pay debt service, and redirect these resources towards critical social and economic needs [see next slide for details]

Fiji’s participation in the Debt Service Suspension Initiative (DSSI)

					Estimated Deferred Debt Service 2020[6]		Potential DSSI Savings (January - December 2021)[1]	
Country[4]	DSSI Participation?[5]	Risk of external debt distress[2]	Risk of overall debt distress[2]	Latest DSA	% of GDP	In millions of US dollars	% of GDP	In millions of US dollars
Fiji[3]	Yes[5]	...	...		0.2	10.5	0.5	29.6

Source: World Bank

- The two bilateral creditors that were eligible under the DSSI were the Export and Import (‘EXIM’) Bank of China and JICA
- As of April 2021, Fiji’s government had finalised Debt Suspension Agreements with the EXIM Bank of China
- This resulted in the suspension of debt servicing amounting to CNY143.8 million (equivalent to $45.2 million)
- The temporary suspension of these amounts created fiscal space, allowing the Government to channel funds into COVID-19 responses in the form of social, health and economic programs

What debt initiatives Fiji could consider - Part 1

Blue Bonds

- Sovereign blue bonds are a type of financial instrument designed to raise funds for ocean conservation
- Proceeds are typically used to fund projects such as expanding marine protected areas, sustainable fisheries, and the reduction of marine pollution. Their impact on ocean conservation is still being studied
- The concept of sovereign blue bonds was introduced by the World Bank in 2018, and since then several countries have issued such bonds. Most recently:
  - **Belize**: in 2021, the Nature Conservancy (TNC)[1] announced a US$364 million deal with the Government of Belize to reduce its debt burden by $180 million for marine conservation
  - **Barbados**: in 2022, Barbados completed a $150 million debt conversion with the TNC that is expected to free $50 million to support the expansion of marine protected in the next 15 years

Common Framework

- The G20's Common Framework for Debt Treatments was an agreement launched in November 2020 to provide a coordinated approach to debt relief for low-income countries affected by COVID-19
- It was intended to complement the G20’s Debt Service Suspension Initiative (DSSI), launched in April 2020
- Under the framework, eligible countries may apply for relief on a case-by-case basis, taking into account their debt sustainability, financing needs, and other relevant factors.Crucially, the common framework attempts to coordinating sovereign debt relief among all of its members and request the same restructuring terms from private lenders
- So far, only four countries (all in Sub Saharan Africa) have enlisted to the initiative. None have yet completed their debt negotiations
- Fiji is not currently eligible for Common Framework treatment. However, eligibility is subject to ongoing review and could change in the future

[1] *See following slide*

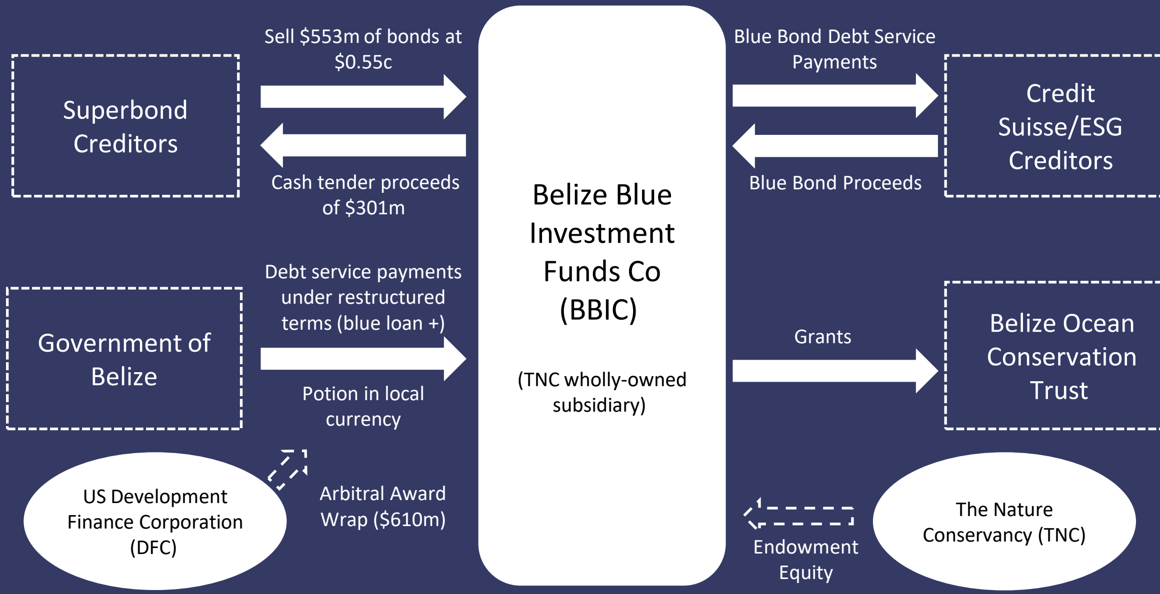
What debt initiatives Fiji could consider - Part 2

- The concept of debt-for-climate swaps (DFCS) was **first introduced in 1984** by Thomas Lovejoy, vice president of the World Wildlife Fund
- DFCS **allow countries to restructure their debt at lower interest rates and/or longer maturities,** with the difference in proceeds being allocated to conservation projects
- In a commercial DFCS, for instance, a third-party organization (typically an NGO) purchases sovereign debt in commercial markets at a discounted price on behalf of a targeted government
- In exchange, the **debtor country commits to invest the full-face value of its debt repayments into conservation projects**
- Since their inception, DFCS have been applied in over **30 countries**
- From 1987 to 2015, the **total value of debt restructured under DFCS agreements was $2.6 billion,** resulting in about US$1.2 billion of savings for environmental projects
- DFCS are still a niche business, principally due to their high transaction costs and relative novelty
- Target countries for DFCS should have **limited fiscal space**, **large nature financing gaps**, and, ideally, be **undergoing a sovereign debt restructuring**

Belize included a 'blue bond' as part of its 2021 sovereign debt restructuring

- In 2021, Belize signed a **debt-for-climate swap with The Nature Conservancy** (TNC). A TNC subsidiary lent funds to Belize to buy back a $553 million 'superbond' – the government's entire stock of external commercial debt, equivalent to 30% of GDP – at a discounted price of 55 cents per dollar
- The new debt instrument was partially guaranteed by the U.S. International Development Finance Corporation (DFC)
- Savings were channeled into a $23.4m endowment fund for marine conservation projects
- **Potomac Group** advised The Nature Conservancy throughout these negotiations

Indicative Structure of Belize's DFCS



Belize’s Blue Debt-for-Nature Swap

- **Situation Overview**
  - Facing a severe balance of payments crisis, exacerbated by the pandemic, Belize was seeking to restructure its only sovereign Eurobond, known as the ‘Superbond’. Belize was able to secure the consent of a supermajority of its bondholders for the repurchase of this debt In exchange, Belize agreed to substantial marine conservation commitments.
  - This transaction is particularly noteworthy, not only because of the size of the transaction relative to the economy, but also because it constitutes the first time a DFN swap has featured as a core element of a broader debt restructuring.
- **Use-of-Proceeds**
  - USD 533 million to fund the buyback of the outstanding balance of the Superbond at 55 cents on the dollar.
  - USD 24 million marine conservation trust for protecting Belize’s coral reef
  - Policy Commitment: Biodiversity Protection Zones increased from 15.9% to 30% by 2026
  - Various milestones over time for marine protection, transparency, enforcement framework
- **Credit Enhancement**
  - Political risk insurance from DFC (USD 610 million), intended to cover principal and interest
- **Supporting Stakeholders**
  - Credit Suisse
  - US International Development Finance Corporation (DFC)
  - The Nature Conservancy, advised by Potomac Group

USD 364,000,000 Blue Bond

The Nature Conservancy

DFC U.S. International Development Finance Corporation

What debt initiatives Fiji could consider - Part 3

- The government of Barbados, led by Mia Mottley, is championing a new initiative to transform how lending is made to developing nations, particularly for those facing climate crises
- Named the **Bridgetown Initiative**, after the island's capital city, the project is being compared to the Marshall Plan of 1948, when the United States provided more than $13 billion of foreign aid to help Western Europe recover after World War II.
- The Bridgetown Initiative is a proposal to reform development finance, particularly with regards to how rich countries help poor countries cope with and adapt to climate change
- The **first** aim is to stop developing countries spiralling into a debt crisis – by suspending interest payments – in the wake of natural disasters like floods, droughts and storms
- **Second**, Barbados has asked multilateral development banks to lend an additional U$1 trillion to developing countries for climate change resilience over the next decade
- The **third** step is to set up a new mechanism – with private-sector backing, in the order of tens of billions of dollars a year – to fund climate mitigation and reconstruction after a climate disaster
- In June, Paris (France) will host the Summit for a new global financial pact, whose stated goal is to build a new climate finance contract between the countries of the North and the South