

CHAPTER 7

RESPONDING TO THE ECONOMIC AND FINANCIAL CONSEQUENCES OF THE VOLCANIC EMERGENCY

7.1 Introduction

7.1 The economic effects of the volcanic eruption were catastrophic; a 44% decline in GDP by the end of 1997 and estimated losses of up to £1bn. Montserrat has effectively become dependent on British financial assistance. The evaluation has looked at how economic impacts have been addressed: through strategic economic planning; through measures to support and promote the private sector; and through budgetary aid. Financial sector aspects have also been reviewed. Annex 7 provides a fuller account of the economic and financial impacts of the eruption and HMG's response.

7.2 Economic development strategies

7.2 Until mid 1997 HMG activity was essentially focused on funding measures in the north to meet the immediate needs of the remaining population. The GoM was also addressing the emergency and, at the same time, pursuing economic objectives but they were substantially the same objectives as existed prior to the eruption. The crisis events of 25 June 1997, the loss of Plymouth and evacuation of Salem marked a shift in attitudes and priorities: from this point on, both HMG and GoM accepted that the future of the island would be dependent on economic development and social structures in the north. Both recognised that they would have to invest to attract private investment. In September 1997 both sides committed themselves to a Sustainable Development Plan (SDP) to be jointly agreed. The plan would provide a context and structure for the programmes under way in the north and it would identify economic development goals and ensure policy consistency across the sectors. The Plan was finalised in November 1998 to cover the 5-year period 1998 – 2002. By early 1999 GoM had also (in consultation with DFID) formulated the new Country Policy Plan (CPP) covering 1998/99 – 2001/2.

7.3 Had a clear medium term economic strategy existed prior to 1997, HMG aid resources might have been spent more effectively. However, it is doubtful that a coherent strategy could have been formulated until the loss of Plymouth in mid-1997 narrowed development possibilities and a report on the ash, available in January 1998, eased concerns about long term health risks in the north. That said, there were opportunities, even in the first two years of the crisis, to address the potential economic impacts of the eruption, which could have been taken sooner.

7.4 First, the GoM's draft National Physical Development Plan of 1995 did include a strategy to disperse development and economic activity away from Plymouth and the south west of the island, but there were no moves to implement this. Secondly, more could have been done to sustain economic

activity. There were delays in implementing high priority infrastructure projects, which indirectly benefited the private sector, and direct support for the private sector has been slow. There has been a fundamental failure to appraise individual actions or projects in a broader framework, taking into account the aggregate economic effects of individual decisions.

7.5 The size and composition of Montserrat's future population are clearly essential to any planning exercise. Perhaps reflecting the enormous uncertainty about the eruption and its effects, until mid-late 1998 neither HMG nor the GoM had been able to make explicit demographic assumptions. DFID-funded projects also typically omitted explicit population projections. HMG, in conjunction with the GoM, should have made more explicit efforts to forecast future levels of population since mid-late 1998. Such forecasts would help to prioritise activities and make decisions more transparent.

7.3 The private sector

7.6 The Sustainable Development Plan states that 'the redevelopment of Montserrat will not be possible without the involvement of the private sector.' Nevertheless, there is a widespread sense on the island that, to date, very little has in fact been done to support the private sector through the volcanic emergency and that the assistance which has been provided has come too late. This is an assessment with which the evaluation agrees.

7.7 DFID assistance was sought particularly to provide storage and factory space in the north of the island and to secure a small-scale credit scheme. All three types of assistance were fully justified in that they helped overcome some of the principal constraints faced by businesses in re-establishing operations. Funding was increased under the credit schemes, but other assistance was limited in the first three years (see para 7.10). Assistance to the private sector could have been provided much more quickly and if it had it would almost certainly have helped reduce the scale of economic decline. Instead, delays increased the assistance required. For example, because businesses did not have storage or operating space in the north, they lost assets and stock which were left in the exclusion zone. It also meant that numbers of people were facing increased risks when they visited the exclusion zone to get access to those assets.

7.8 That DFID found it so difficult to respond quickly to these requests for assistance is partly a reflection of too narrow a focus and a failure to look at individual decisions in the broader context of an assessment of the medium to long term future of the island.

7.4 Budgetary assistance

7.9 Prior to the eruption Montserrat had a balanced recurrent budget. Because of reduced revenue and increased expenditure the island now receives budgetary aid and as a consequence its finances are now under the supervision and, in effect, control of the Secretary of State for International Development. The

purpose of budgetary aid has been to ensure that the population remaining on the island is provided with a reasonable level of essential services. Largely timely and adequate levels of budgetary assistance have meant the GoM has not had to resort to borrowing or a rundown of reserves. DFID has been flexible in identifying and responding to changes in budgetary assistance requirements.

7.10 The GoM would have favoured tax reductions as a means of encouraging economic recovery. DFID has preferred to maintain revenue income in order to minimise budgetary aid. With the benefit of hindsight a tax incentive strategy review should have been undertaken in 1996, when GoM first proposed fiscal incentives to the private sector. Instead reviews were only undertaken in 1997 and 1998, with few tax concessions before March 1998.

7.11 Monitoring and report requirements have increased over time to a level which the already overstretched Ministry of Finance in Montserrat has found difficult to cope with, and which is possibly excessive.

7.12 More positively, DFID did recognise the need to stem the out flow of key public sector workers, approving a variety of measures (including pay increases, bonuses and special allowances) in 1997 – though these incentives should perhaps have been offered sooner.

7.5 The financial sector

7.13 The emergency has had serious implications for Montserrat's financial sector. The situation became most acute with the effective withdrawal of insurance cover in August 1997. The availability of new lending to both businesses and households contracted sharply, and the already severe problem of default on private loans was intensified. These developments threatened the viability of the two on-island financial institutions, the Bank of Montserrat (BoM) and the Montserrat Building Society (MBS). HMG has had very little direct involvement in addressing the impact of the crisis on the financial sector, but has been under strong pressure from the International Development Committee (IDC 1997; 1998a – see footnote 1), the GoM and business and civil society institutions on Montserrat to intervene. Annex 7, section 5 provides more detail of the financial sector issues.

7.14 A Soft Mortgage Scheme, aimed at financing housing for those in work, was agreed in principle in September 1997. The principle behind the scheme is clearly appropriate, helping to restore private housing construction, rather than forcing people to rely on the provision of houses built under various forms of external assistance. The fact that the scheme had still to be launched (as of September 1999) reflects poorly on all concerned – HMG institutions, the GoM, the BoM and the Eastern Caribbean Central Bank (ECCB) (see Annex 7, especially Box 7.1).

7.15 DFID's commissioning of a study to address problems related to insurance cover was well motivated, but it was too late. The study has apparently achieved very little while the withdrawal of

insurance cover has had disastrous consequences, precipitating the effective collapse of the MBS and resulting in the temporary halt of the issue of new loans, whether for private housing or business.

7.16 The MBS is an apparently wholly reputable local institution and had failed through no fault of its own. The decision not to provide support reflected the concern to avoid setting a precedent for the UK or OTs and also the view that the needs of the less well-off Montserratians affected by closure would be met from welfare schemes.

7.17 HMG's decisions on GoM mortgages and MBS were based on carefully researched reasoning, which HMG has been careful to explain. However, again the focus has been too narrow; issues were analysed without regard to their aggregate consequences. The consequences have proved disastrous both for individuals and for the wider economy.

7.18 The fact that Montserrat did not have a qualified financial regulator from mid-1998 to March 1999 is also very unsatisfactory.

CHAPTER 8

MANAGING THE EMERGENCY IN MONTSERRAT, BARBADOS AND LONDON

8.1 Introduction

8.1 The complex and changing lines of management and responsibility for Montserrat have been strongly criticised, notably by the International Development Committee, for reducing the effectiveness of HMG's response to the volcanic emergency. These criticisms were acknowledged in HMG's response to the Committee's First Report.⁷ The evaluation has looked at how management arrangements and lines of responsibility have evolved since 1995 – particularly in terms of efficiency and effectiveness. We have also looked at the distribution of responsibilities in London, Barbados and Montserrat. The roles of the principal bodies are summarised in Chapter 3 and Annex 3 provides a full account of the institutional arrangements and changes since 1995.

8.2 HMG's changing management arrangements and the shifting locus of responsibility

8.2 At the time of the emergency, there were 4 key HMG officials involved with Montserrat, all at Grade 5 level: the Governor in Montserrat; the heads respectively of FCO's Dependent Territories Regional Secretariat (DTRS) and ODA's British Development Division in the Caribbean (BDDC) in Barbados; and the head of the Emergency Aid Department (EMAD) in London. They reported to 3 separate Directors in London. In what was an unprecedented emergency involving a rapidly changing and uncertain situation, overall supervision could only be achieved by co-ordination at the highest level.

8.3 EMAD became involved immediately in 1995, and in September 1995 an Emergency Relief Co-ordinator (ERC) was placed on-island reporting to the Head of Unit in London. As the need for budgetary assistance emerged DTRS and BDDC were directly drawn into reviewing requirements and supervising the GoM's public expenditure. In February 1996 DTRS decided to put a First Secretary (Aid) at G7 level on-island in the Governor's office. There followed lengthy discussions about the division of responsibility between this post and the ERC so that the First Secretary was not in place until 5 months later in October. Between January and April 1997, ODA set up an Aid Management Office (AMO) on Montserrat, reporting direct to EMAD in London for emergency spending and also to DTRS. The triangular relationship between Montserrat, Barbados and London had many disadvantages. In particular many activities could be DTRS, BDDC or EMAD-funding responsibilities. But the different funding routes imply different procedures and the involvement of different departments. More positively, DTRS and BDDC had easy access to substantial advisory capacity on development and governance, familiar with the island and the regional context, which was useful throughout the emergency.

⁷ IDC. 1998b. *The Government's Response to the International Development Committee's First Report of 1997-98: Montserrat*. Memorandum from HMG. Appendix to the First Special Report. London; Stationery Office, 3 February

8.4 As the situation on Montserrat became more complex and critical, its profile within FCO and ODA/DFID grew. The FCO-led Interdepartmental Committee was broadened to include wider representation, including other Government Departments and scientists. The Voluntary Relocation Scheme of April 1996 required interdepartmental Ministerial approval. The responsible FCO Minister visited Montserrat in June 1996 and the £25m programme was announced in August. In December 1996 a higher level inter-departmental official committee was established. Following the election in May 1997, DFID was established with consequent changes in the regional secretariat. Baroness Symons, the responsible Government Minister visited Montserrat in June 1997. Following the fatal events of 25 June, there was a more proactive determination to co-ordinate activity and to achieve results. A special FCO/DFID Task Force under DFID chairmanship was formed. In August 1997 the interdepartmental Montserrat Action Group was set up, chaired by FCO, from November 1997 at Ministerial level. In September 1997, DFID announced the Crisis Investment Programme as part of a new coherent response to all aspects of the emergency. Authority became more concentrated in London. In November 1997 the Montserrat Unit was established and the separate responsibility of EMAD was finished. Delegated authority was largely withdrawn from the AMO. DTRS was wound up in September 1998. Most spending decisions after November 1997 were taken at Ministerial level.

8.3 The Government of Montserrat's role

8.5 An assessment of the performance and effectiveness of the GoM is outside the Terms of Reference of this evaluation. However, in dealing with public action the distinction between GoM responsibilities and those of HMG is often more formal than real, and so aspects of GoM performance need to be taken into account. The important role and achievements of the ED have already been noted. The superhuman efforts of many officials and public employees on-island, including the Police and Montserrat Defence Force (MDF), in warning people directly, organising evacuations and putting themselves at risk, is not just part of the normal course of duty. Teachers and nurses worked in extraordinarily difficult circumstances to maintain services.

8.6 As the emergency continued there was a shift of responsibility and authority from the elected Government to HMG. The Governor's increased role in emergency management planning, formalised in the establishment of the separate Emergency Department responsible to the Governor, was a change in the balance of responsibilities. The return to budgetary aid represented a major shift in authority from GoM to HMG. The growing role of DFID advisers and the direct involvement of the AMO in the work of many government departments also reinforced the fact that, although constitutionally nothing had changed, in fact the shift was enormous.

8.7 An underlying management problem was the lack of experience and expertise available to the GoM in dealing with the crisis. The public sector was much reduced by the migration of key personnel but had to deal with problems on a scale it had not previously encountered. For example, there was no extensive experience of preparing and contracting major projects or of the constraints implied by cost-

effectiveness. Nor was there the capacity within the Land Development Authority to develop a housing and land zoning policy to push forward land issues which were not resolved between GoM and HMG.

8.8 GoM did not have experience in dealing with large complex bureaucratic structures, and their legal and regulatory basis. Nor did it have the capacity to undertake the work on project appraisal sought by HMG officials, advisers and contractors. The evaluation was frequently told that Montserrat was a special case and that HMG ought to make exceptions regarding financial regulations, procedures for development aid and approval of activities.

8.4 Emergency or development aid?

8.9 These management issues are most clearly exposed in the shift from emergency to development aid. Emergency aid projects were dealt with quickly on the basis of little documentation. The procedures for development projects are much more rigorous. There is no fast track approach in the sense that aspects of DFID's normal procedures can be set aside for particular projects. The procedures themselves contributed to many delays in the processing of proposals into projects.

8.5 Assessment of management performance

8.10 A consequence of the concern to work within normal arrangements for Dependent Territories was that key officials in London and in Montserrat, and contracted managers worked under exceptional pressures. Most met this challenge efficiently and with commitment. In particular the two Governors took on very demanding and pressured roles with only very limited additional support.

8.11 There were good reasons for the FCO's desire to avoid unnecessary changes in relations with the Government of a self-governing territory. Nevertheless this resulted in ad hoc arrangements and constant adjustment and catching up as the situation evolved. For example, although scientific monitoring and risk assessment were crucially important, scientific funding was until 1997 on a short-term budgetary basis, making it difficult for scientists to play their part. As it became clear that responsibilities had to be changed, there was indecision and uncertainty in taking matters forward, with the changing lines of responsibility for the AMO the most serious case. Since September 1997 funding approvals have all been made in London and this is seen by many as a cause of delay.

8.12 GoM's responsibility and authority have been much reduced. Until May 1998, GoM had no clear overall budget within which to plan. It has had to argue case by case on e.g. housing specification – and has not felt properly consulted. The different priorities of HMG and GoM have led to problems. For example, GoM was not fully involved in the early contingency planning for off-island evacuation, and formal demographic and social situation assessments that could have helped to shape the social aspects of the response were delayed.

8.13 It was very difficult in the circumstances of Montserrat to balance immediate and longer-term objectives. HMG was slower than GoM to want to address longer-term economic prospects for the island. The crisis programme and the bringing together of responsibilities within the DFID Montserrat Unit was a major step towards connecting emergency actions and planning for reconstruction. It also resulted in the Sustainable Development Plan. The setting of a 3-year financial provision of £75m in June 1998 and the CPP process have taken the process further.