COVID-19
WHY THE G20 SHOULD PROVIDE A MULTILATERAL DEBT STANDSTILL FOR THE POOREST COUNTRIES

African countries urgently need a massive injection of resources to respond to the COVID-19 pandemic and the resulting economic fallout. The World Bank estimates that Sub-Saharan Africa will enter its first recession in 25 years, costing $79 billion in lost output, and pushing an additional 26-39 million people into extreme poverty. UNECA estimates the emergency health response to COVID-19 will cost African countries $11 billion. Overall, the IMF and World Bank estimate that African countries will need $114 billion in 2020 alone.

What we are seeing is a liquidity crisis caused by a global pandemic. A comprehensive plan is immediately needed so that African governments have the cash to respond to the pandemic and stabilise their economies. A new allocation of special drawing rights (SDR) - alongside a mechanism for richer countries to transfer their SDR to poorer countries - and a debt standstill with the full participation of bilateral, multilateral and private creditors have to be at the heart of this blueprint. Beyond this, new tools are needed to enable countries to continue to access financial markets at low cost.

While all of these components are essential to help the continent weather the storm, this paper focuses on a proposal for multilateral debt service suspension. The G20 responded quickly with bilateral debt suspension for the poorest countries through the Debt Service Suspension Initiative (DSSI). But multilaterals and private creditors are yet to follow suit. Our analysis shows that as of mid-July 2020, the World Bank had received $1.7bn in debt repayments from DSSI countries, but committed only $1.9 billion in new funding for the response. Of this only $250 million was disbursed by the end of May (the most recent available data).

Countries should not be forced to choose between meeting debt payments or responding to COVID’s health and economic emergencies.

G20 Finance Ministers should:

1. Extend the bilateral debt standstill until the end of 2021 to give greater security and ability to plan for use of the funds. This would free up $22 billion for fighting the crisis and supporting recovery in 2021
2. Task the IFIs to respond within 30 days on how they could support a comparable multilateral debt standstill
3. Task the International Monetary Fund to report within 30 days on steps that could be taken to support a debt standstill for private creditors
4. Task the World Bank to respond within 30 days on how it intends to backfill IDA and other accounts for future development spending
Implementing a multilateral debt standstill

Multilaterals such as the World Bank have been reluctant to participate in a debt standstill due to concerns about their cashflow and credit ratings. The World Bank is concerned that without money coming in from debt repayments, it would be unable to frontload new loans and grants. It is also concerned about how a suspension might affect its credit rating, and thus its ability to raise new funds at preferential rates. The World Bank argues that the liquidity crisis in developing countries is best solved through new financing (a combination of loans and grants) and has committed to disbursing $50 billion in International Development Association financing over the next 15 months.

While additional resources are welcome, and this may be the easiest solution for multilaterals, it is less effective for countries as suspending debt payments, and has significant drawbacks.

On the one hand, designing, approving, and disbursing new grants and loans takes time. The World Bank has sent strong signals about mobilising its resources to help countries. Yet speed is crucial when responding to a crisis. As of mid-July 2020, nearly six months into the pandemic, the World Bank had only committed $1.9 billion in new funding for the response in DSSI countries, of which it had disbursed only $250 million by the end of May. The new commitments are equivalent to less than 15% of what DSSI countries owe in debt service to multilateral creditors in 2020 alone. So far this year countries have paid on average $290m a month in debt service to the Bank. In future this will increase to $300m without immediate action.

On the other hand, while new loans might provide needed resources in key areas at low interest rates, they eventually have to be paid back. Currently about three-quarters of new IDA financing is in the form of loans. Total multilateral debt stocks in IDA-only countries stand at $127 billion in 2018. If the World Bank were able to frontload $50 billion, primarily in new loans, over the next 15 months, debt stocks could jump by 30% in IDA countries. These levels of debt might prove unsustainable in the medium-to-long term: 19 African countries are at high risk of, or already in, debt distress. What’s more, as much as 37% of government spending in Angola, 26% in Ethiopia, and 20% in South Africa is spent on debt service – more than any other kind of expenditure.

A second major hurdle to multilateral debt suspension is its potential negative effects on credit ratings. Lower ratings could hurt the Bank’s ability to raise money from markets at the lowest rates, which would then affect its ability to lend money to developing countries. There are two main ways in which suspension could, in theory, affect ratings: It could weaken MDBs financial positions by affecting their cash flow, and it could affect their Preferred Creditor Status (PCS), especially if other creditors (e.g. commercial banks and bond holders) are still being paid.

However, most MDBs enjoy a strong financial position, backed by their wealthy shareholders. This is especially true of the World Bank. Moody’s, a rating agency, has indicated that a time-limited, negotiated standstill would not have an impact on MDBs Preferred Creditor Status. Unfortunately other ratings agencies, like Fitch, have indicated that debt suspension would affect the World Bank’s ratings. There are three main agencies that would need to agree to
leave ratings untouched, and historically they have not.xvi In order to reassure rating agencies and ensure a healthy cash flow for the World Bank and other multilaterals, shareholders could backfill payments to MDBs to compensate for the suspension of debt payments, as World Bank President David Malpass has also confirmed.xvii For this, the World Bank could create a fund, similar to the IMF’s Catastrophe Containment and Relief Trust (CCRT), which is capitalised by aid from donor countries to cover debt repayments due in 2020 and 2021.xviii Full compensation for the debt service due by all DSSI countries might not actually be required in order to reassure agencies. However, estimating the real amount would require assessing the risk profiles of every country that requests relief. At most, given that a significant number of repayments have already been made in 2020, creating a fund for debt service owed to the World Bank would cost $6.5 billion for 2020-2021 (assuming full compensation is needed for debt service from all countries eligible for DSSI). The actual cost is likely to be much lower for donors – and it will definitely be orders of magnitude smaller than the cost of widespread defaults. World Bank shareholders could contribute to this fund in proportion to their ownership of IDA and the International Bank for Reconstruction and Development (IBRD) and the debt service payments owed to each.

**What G20 Finance Ministers should do next**

The world is looking for bold leadership to overcome the greatest global crisis in more than a generation. The G20 should urgently back a comprehensive package comprising a full debt service suspension, a new SDR allocation of $500bn and a mechanism to ease the liquidity crunch confronting African countries. It should make headway by first reaching consensus on multilateral debt service suspension.

G20 governments have rightly stepped forward with trillions in economic stimulus packages for their own countries, but the majority of low-income countries do not have the money to cover the costs. A comprehensive debt moratorium would give countries the budget support they need to avoid a health or economic catastrophe.

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For Sub-Saharan Africa, Coronavirus Crisis Calls for Policies for Greater Resilience


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Assuming that about three-quarters of new COVID-19 IDA funding is in the form of loans, in line with historical numbers.

When dealing with many creditors, having PCS means that repayment is almost guaranteed. This is because the money owed to creditors with PCS must be paid back before paying others.

Lower-rated MDBs (like the Africa Finance Corporation) could nonetheless be affected. Additional shareholder support for such cases should be considered.


Suspension of Debt Payments to MDBs a Risk to Ratings [online] Available at: https://www.fitchratings.com/research/sovereigns/suspension-of-debt-payments-to-mdbs-risk-to-ratings-22-04-2020


For the remainder of 2020, some $5 billion would be needed to cover a multilateral debt suspension for G20 DSSI countries.