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Lend or suspend?

Maximising the impact of multilateral bank financing in the Covid-19 crisis

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Key messages

- The world's most vulnerable countries urgently need counter-cyclical financial assistance to mitigate lasting socioeconomic damage from the Covid-19 crisis, but the international community's response has been insufficient.
- Multilateral development banks (MDBs) should not join the G20's Debt Service Suspension Initiative (DSSI), as it would reduce their capacity to help fund the recovery in return for a relatively small, temporary benefit.
- The crisis support proposed by MDBs for lower-income countries is a good first step but falls well short of needs. MDB concessional resources should be supplemented with donor resources and a temporary increase in non-concessional lending funded by bond issues.
- Debt sustainability of several lower-income countries was already deteriorating before the crisis and is now worsening. Despite complications occasioned by an increasingly complex creditor landscape, some type of debt relief/restructuring initiative that goes beyond a temporary standstill will be needed in the coming years.

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Acronyms

ADB	Asian Development Bank
ADF	African Development Fund
AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
CEDB	Council of Europe Development Bank
DSA	Debt Sustainability Analysis
DSSI	Debt Service Suspension Initiative
EBRD	European Bank for Reconstruction & Development
EIB	European Investment Bank
GDP	gross domestic product
HIPC	heavily indebted poor country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IIF	Institute for International Finance
IMF	International Monetary Fund
IsDB	Islamic Development Bank
LIC	low-income country
MDB	multilateral development bank
MDRI	Multilateral Debt Relief Initiative
NDB	New Development Bank
NPV	net present value
PCT	preferred creditor treatment
S&P	Standard and Poor's
SOE	state-owned enterprise
UNCTAD	United Nations Conference on Trade and Development

1 Introduction

The Covid-19 pandemic has triggered a collapse in global economic activity that will have lasting economic and social impacts across the world (World Bank, 2020a). Recent World Bank estimates suggest that there could be more than 100 million additional people earning less than $1.90 per day as a result of the crisis. For governments around the globe, there is a pressing need to provide liquidity to face the medical emergency and also to offset the immediate macroeconomic impacts. By injecting resources now, governments can reduce the disruption caused to individuals, firms and the structure of a country's economy. This can be a far less costly and more effective strategy for helping a country pull itself out of the crisis, rather than attempting to repair the damage later (IMF, 2020).

Since March 2020, advanced economies have enacted a series of direct fiscal response packages to counteract the impacts of the crisis equivalent to 9% of GDP for the US and 13% of GDP in the case of Germany (Anderson et al., 2020).[1] For the world's 76 lowest-income countries,[2] that would be equivalent to $200–$290 billion, based on 2018 GDP data. However, governments in lower-income countries have been constrained in mounting responses of a comparable scale because of relatively lower tax revenues, more limited opportunities for domestic borrowing and (in many cases) a lack of access to international capital markets.

The international community does not appear on track to assembling a financial package even close to the scale needed to help close this gap. The International Monetary Fund (IMF) was designed to provide short-term liquidity in the face of crises. Although the IMF has talked up its overall lending capacity ($1 trillion), its actual lending to lower-income countries has been constrained by fixing lending limits according to countries' 'quotas'.[3] Over half of the IMF's overall financing support has gone to just three countries deemed to have 'strong fundamentals' (Chile, Colombia and Peru). Shareholders have not yet permitted creative measures to expand its capacity.[4] Donor countries are coping with their own economic shocks and fiscal restrictions, meaning there have been limited additional bilateral aid commitments. Many eyes have turned to the multilateral development banks (MDBs), even though they are intended to fund longer-term development projects, not short-term liquidity. However, their financial model for supporting lower-income countries

1 These estimates only include direct fiscal injections, and do not include guarantees, deferred payments, tax incentives and many other crisis measures equivalent to a much higher share of GDP – another 35% in the case of Germany (Anderson et al., 2020).

2 The 76 countries currently eligible for concessional financing from the World Bank's International Development Association. GDP data from World Development Indicators.

3 Overall, the IMF is currently making about $250 billion, a quarter of its $1 trillion lending capacity, available to member countries (IMF, 2020a). In response to members' large and urgent Covid-19-related financing needs, access limits under certain windows of its lending facilities have been temporarily increased such as the exogenous shock window of the Rapid Credit Facility.

4 Most notably, a widely supported proposal to expand the IMF's Special Drawing Rights (SDRs) was vetoed by the US in April 2020 (see Ocampo et al., 2020 and Plant, 2020).

depends in large measure on donor support, which limits their capacity to respond at a scale commensurate to the crisis.

One high-profile initiative to help the world's poorest countries was launched by the G20 in April 2020, providing temporary relief on debt repayments. G20 economies have offered to suspend debt repayment of 77 lower-income countries to all official bilateral creditors for 2020 through the Debt Service Suspension Initiative (DSSI). With full participation, a debt standstill would bring roughly $11.5 billion in emergency liquidity support for eligible countries in 2020, equivalent to about 40% of total projected public external debt service (World Bank, 2020b). These measures could free up public resources to contain and mitigate the pandemic, rather than being used for debt service. Unlike the Heavily Indebted Poor Country (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI) launched in 1996 and 2005 respectively, the DSSI does not cancel the debt but instead provides temporary respite, which is to be repaid in full over 2022–2024 (with a grace period in 2021).

Many argue that the DSSI does not go far enough, as it does not include private or multilateral creditors. The G20 requested that MDBs consider a similar suspension of debt service payments over the suspension period. This proposal is supported by some bilateral official creditors and civil society groups (Eurodad, 2020; ONE Campaign, 2020) but opposed by others (Landers et al., 2020a; Oxfam, 2020). The MDBs argue that participating in the debt suspension would not be in the best interests of developing countries due to the adverse long-term impact on MDB lending volumes and borrowing costs. MDBs argue instead that they should focus on ramping up their lending to help countries cope with the crisis.

The objective of this paper is to assess the best way to deploy MDB assets to help lower-income countries respond to the global crisis triggered by the Covid-19 pandemic. Should MDBs participate in a debt suspension? If not, what are the prospects for providing substantial liquidity through new financing to face the crisis, and what does this mean for debt sustainability of the world's poorest countries? The paper focuses specifically on lower-income countries that borrow mainly from the concessional windows of MDBs. The role of MDBs to support non-concessional middle-income countries – including the option of ramping up lending dramatically by loosening restrictive capital adequacy policies (see Humphrey, 2020 and Landers et al., 2020b) – is not addressed here.

The rest of this paper is structured as follows. Chapter 2 provides an overview of the debt profile and vulnerabilities of the countries eligible for the DSSI. Chapter 3 provides an overview of the DSSI in terms of the potential savings and implementation. Chapter 4 looks in detail at the potential impacts of MDB participation in the DSSI. Chapter 5 considers the crisis financing programmes announced thus far by MDBs for lower-income countries and their implications for future MDB financing capacity as well as recipient debt sustainability. Chapter 6 concludes and proposes policy recommendations.

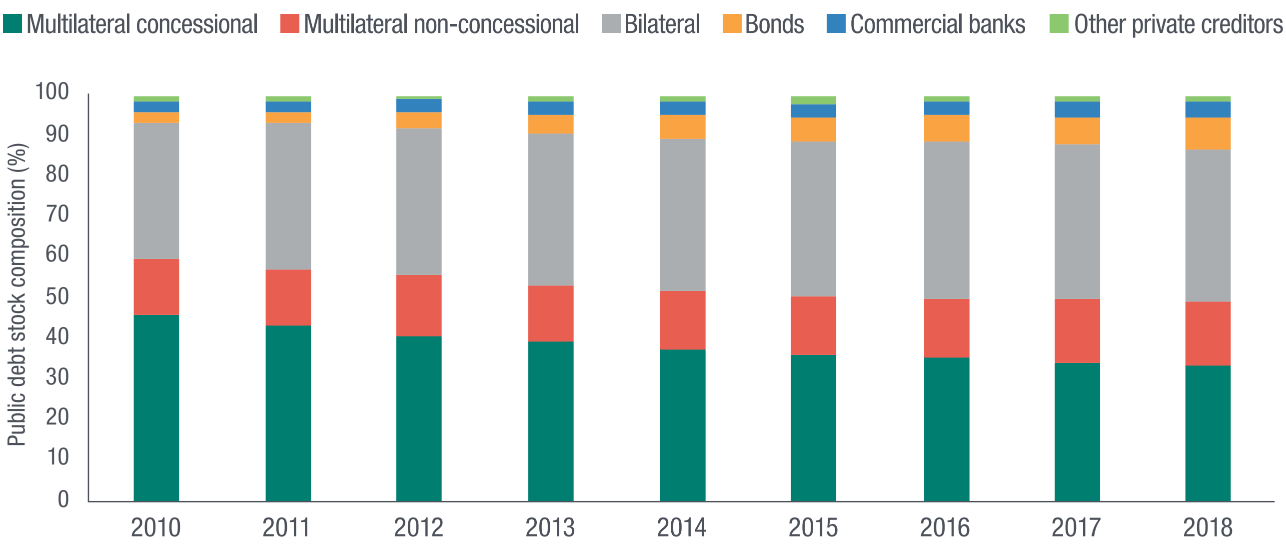
2 Debt profile of DSSI-eligible countries

This section analyses the external public debt profile of countries eligible to participate in the DSSI. This includes all International Development Association (IDA) countries and all Least Developed Countries (as defined by the United Nations). Although the debt standstill covers 77 countries, four[5] are in arrears to IDA and thus are ineligible. Data is unavailable for a further five countries.[6] Our sample therefore consists of 68 countries: 29 are low-income countries, 30 lower-middle-income countries and nine upper-middle-income countries. With the exception of Angola,[7] all of the countries are classified to receive concessional World Bank IDA financing (51 countries) or a blend of concessional and non-concessional financing (16 countries).

2.1 Evolving composition of external debt stock

The composition of the external debt stock has been changing since 2010 (Figure 1). Multilateral share of external public debt has been falling since 2010 but still accounts

Figure 1 Changing external public debt stock composition, DSSI-eligible countries



Notes: This figure is based on data for 68 DSSI-eligible countries. Data on actual debt stocks for end-2019 is not available.
Source: World Bank (2020c).

5 Eritrea, Sudan, Syrian Arab Republic and Zimbabwe.

6 Kiribati, Marshall Islands, Micronesia, South Sudan and Tuvalu.

7 Angola, a non-concessional recipient, is included because it is classified as a Least Developed Country by the UN, and thus eligible to participate in the DSSI.

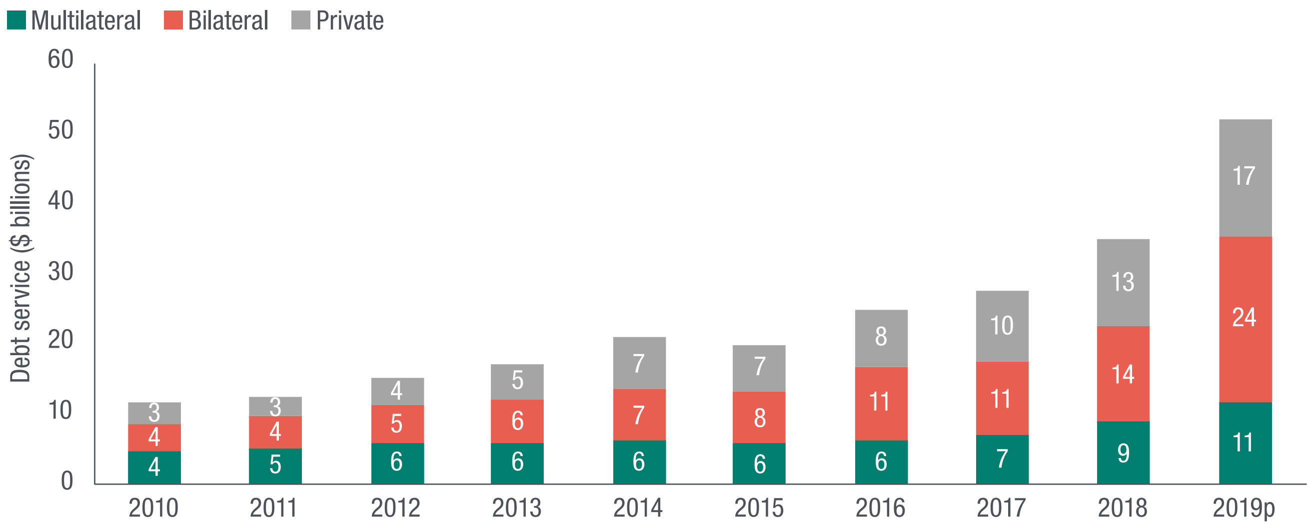
for roughly half of the stock in 2018. The concessional share of the multilateral debt stock declined by 12 percentage points between 2010 and 2018, standing at 34% in 2018. Private creditors (bonds, commercial banks and other), on the other hand, account for an increasing proportion, almost doubling from 6.4% in 2010 to 13% in 2018.

Debt service payments have increased rapidly over the last decade (Figure 2) due to the rapid accumulation of debt and the shift to less concessional sources of finance. Given that most of the MDB lending to DSSI countries is concessional (Figure 1), payments to multilateral creditors account for the smallest share of the debt service (25%) compared to payments to official bilateral creditors (39%) and private creditors (36%) in 2018. Conversely, private sector debt is on more expensive terms and as a result accounts for slightly more than a third of the total debt service in 2018 (despite only accounting for 13% of the debt stock).

2.2 Debt vulnerabilities are on the rise

Even before the pandemic, debt vulnerabilities in most DSSI countries were high. Almost 50% are at high risk of debt distress or already in debt distress (Table 1). However, even though the Covid-19 shock is expected to lead to economies contracting[8] and an increase in government indebtedness in 2020, the debt distress rating has deteriorated so far in only one country, Kenya.[9] The rating is unchanged for the other 40 countries[10] for which a new/revised Debt Sustainability Analysis (DSA) was conducted by the IMF and World Bank in March–June 2020.

Figure 2 Debt service of 68 DSSI countries



Notes: This figure is based on data for 68 DSSI-eligible countries. Data for 2010–2018 are actual while 2019 is a projection on debt stocks at end-2018.
Source: World Bank (2020c).

8 The economic impact of the pandemic on IDA countries is being felt through supply chain disruptions, lower commodity export prices, remittances, tourism and capital flows.

9 Kenya moved from moderate risk to high risk in light of the sharp decline in export growth and economic growth and larger budget deficits (IMF, 2020c).

10 Afghanistan, Bangladesh, Benin, Burkina Faso, Cabo Verde, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of the Congo, Côte d'Ivoire, Djibouti, Ethiopia, Gambia, Ghana, Grenada, Honduras, Kenya, Kyrgyz Republic, Liberia, Madagascar, Maldives, Mali, Malawi, Mauritania, Moldova, Mozambique, Nepal, Niger, Papua New Guinea, Rwanda, Samoa, São Tomé and Príncipe, Senegal, Sierra Leone, Solomon Islands, St. Vincent and the Grenadines, Tajikistan, Togo, Uganda, Uzbekistan.

DSAs, however, have been known to be overly optimistic (Mooney and de Soyres, 2017; IMF, 2017) and to some extent there is evidence of this optimism in these recent DSAs. Firstly, although a Covid-19 pandemic shock has been included in all the DSAs, the DSA is grounded in long-term economic projections that assume that the pandemic will be a temporary shock and that growth will rebound in the medium to long term. Secondly, for countries with strong access to international capital markets prior to the pandemic, for example Ghana and Kenya, the DSAs assume that they will regain access once global capital markets reopen to frontier market issuers and additional Eurobonds will be issued to meet financing needs and maintain a market presence (IMF, 2020c; 2020d). Market access is important given the spike in Eurobonds coming due for several African countries in 2024 and 2025. These repayments could potentially overwhelm some countries' ability to refinance their bonds, especially if sentiment towards emerging market is weak (Smith, 2020). Angola and Zambia[11] are most at risk in this group, having been vulnerable before Covid-19. Thirdly, for countries without market access, like Chad and Niger, their DSAs assume that the financing gaps will be closed with concessional financing that has not yet been identified (IMF, 2020e; 2020f).

Despite these somewhat optimistic assumptions, all the DSAs explicitly note that downside risks are elevated with macroeconomic and fiscal projections subject to high uncertainty. A longer-lasting and more severe pandemic would trigger an even deeper global recession and push debt levels beyond what can be sustained. In the case of Chad, currently at high risk of debt distress, the debt service-to-revenue ratio will rise sharply if downside risks materialise, and the authorities would need to identify additional measures and seek additional debt relief or financing (IMF, 2020e).

Table 1 Risk of external debt distress in DSSI-eligible countries

Low (*n*=12)	Moderate (*n*=21)		High (*n*=26)		In debt distress (*n*=6)
Bangladesh	Benin	Liberia	Afghanistan	Kiribati	Grenada
Cambodia	Bhutan	Mali	Burundi	Lao PDR	Mozambique
Honduras	Burkina Faso	Malawi	Cabo Verde	Maldives	Republic of Congo
Madagascar	Comoros	Nicaragua	Cameroon	Marshall Islands	São Tomé and Príncipe
Moldova	Democratic Republic of Congo	Niger	Central African Republic	Mauritania	Somalia
Myanmar	Côte d'Ivoire	Papua New Guinea	Chad	Micronesia	South Sudan
Nepal	Guinea	Senegal	Djibouti	Samoa	
Rwanda	Guinea-Bissau	Solomon Islands	Dominica	Sierra Leone	
Tanzania	Guyana	Togo	Ethiopia	St. Vincent and the Grenadines	
Timor-Leste	Kyrgyz Republic	Vanuatu	Gambia	Tajikistan	
Uganda	Lesotho		Ghana	Tonga	
Uzbekistan			Haiti	Tuvalu	
			Kenya	Zambia	

Note: A risk of debt distress is not available for all of the DSSI countries as they are only done for LICs.

Source: Most recent DSAs conducted by the IMF and World Bank.

11 Angola has a large IMF programme in place, while Zambia does not. Any IMF financial support to Zambia, including emergency financing, is contingent on steps to restore debt sustainability. The Government of Zambia has recently hired advisors to assist with its debt restructuring.

3 Understanding the DSSI: scope and implementation

On 15 April 2020, G20 finance ministers agreed to a 'debt service standstill' until the end of 2020 from all official bilateral creditors. A key objective of the DSSI is to allow lower-income countries to concentrate their resources on fighting the pandemic. This section analyses potential savings generated by the initiative, assuming participation from official bilateral creditors, private sector creditors and multilateral development banks. It also looks at the response to the initiative from eligible countries to date.

3.1 Debt service payments due in 2020 and 2021

Total external debt service due by the governments eligible to participate in the DSSI in 2020 (May to end December) and 2021 is roughly $29 billion and $40 billion respectively in nominal terms (World Bank, 2020b). Table 2 shows the breakdown of the debt service burden by region and creditor type: official bilateral, official multilateral and private sector. These numbers potentially underestimate the size of the debt service payments due in 2020 and 2021 (see Box 1) as a result of missing data relating to state-owned enterprise (SOE) guaranteed debt, other contingent liabilities and collateralised debt (OECD, 2020). These risks are particularly pronounced for loans from Chinese creditors, which lend heavily to SOEs and often involve collateralised terms (Horn et al., 2019). If these underreported flows are identified by the borrower and creditor in negotiations and included in the standstill, then the size of the standstill would be larger. The DSSI therefore calls for strong cooperation of all creditors to support comprehensive disclosure of public debt.

The DSSI currently only applies to debt service payments due to official bilateral creditors from 1 May to 31 December 2020. Assuming that all official bilateral creditors as well as eligible

Table 2 Debt service on external public debt due for 68 DSSI-eligible countries in 2020 and 2021 (US$ billions)

	2020			2021		
	Official bilateral	Official multilateral	Private	Official bilateral	Official multilateral	Private
East Asia and Pacific (11)	0.98	0.35	0.64	1.77	0.56	1.05
Europe and Central Asia (5)	0.35	0.49	0.07	0.62	0.73	0.09
Latin America and the Caribbean (8)	0.17	0.50	0.38	0.22	0.71	0.40
Middle East and North Africa (2)	0.20	0.15	0.00	0.28	0.22	0.00
South Asia (6)	3.33	2.72	1.80	4.78	3.95	1.69
Sub-Saharan Africa (36)	6.53	2.77	7.34	8.95	4.41	9.32
Total	11.55	6.98	10.22	16.63	10.57	12.56

Notes: Table is based on data for 68 DSSI-eligible countries. 2020 refers to World Bank projections for the suspension period, May–December 2020. Numbers of countries in each region are shown in brackets.
Source: World Bank (2020b).

Box 1 Limitations of external public debt data

To improve the transparency of the Debt Service Suspension Initiative (DSSI), the World Bank released data on the projected debt service due on public and publicly guaranteed debt for the DSSI-eligible countries (World Bank, 2020b). This data is disaggregated by three creditor types: official bilateral creditors, official multilateral creditors and private creditors. With the exception of the multilateral component, this data relies on data reported by country authorities and has several potential limitations that may underestimate the size of the total debt stock and debt service.

1. **Debt stock at end-2018:** The debt service projections in 2020 and 2021 are based on debt stock at end-2018, and therefore do not take account of any change in debt service that may arise from changes in debt stock after 31 December 2018. The contraction of new loans after end-2018 is likely to lead to an underestimation of the debt service burden, while any type of debt restructuring after this date – for example lengthening maturities or debt cancellations – is likely to lead to an overestimation.
2. **Weaknesses in debt recording and reporting at the country level:** With the exception of multilateral debt, projections for bilateral and private sector debt are based on information reported annually to the World Bank Debtor Reporting System by the national authorities of the relevant countries. Despite significant improvements in debt data, public debt statistics in most lower-income countries tend to inadequately capture debts to SOEs, contingent liabilities related to public–private partnerships, and collateralised debt. Some countries also suffer from hidden SOE debts as a result of deficiencies in the management and oversight of SOEs and deep-rooted governance challenges (IDA, 2019). In Mozambique, two state-guarantees issued in 2013 and 2014 by the Minister of Finance to SOEs – amounting to 9% of GDP at end-2015 – were not disclosed to the debt management staff and the public. In Togo, the government had a form of de facto government debt which was not reflected in official government debt statistics, amounting to 7% of GDP at end-2016.
3. **Underreporting of official bilateral debt owed to China:** Despite China being the largest official bilateral creditor for several lower-income countries, its lending is to a large extent opaque, with its authorities providing no disaggregated data on destination, amounts and terms. In addition, given that a substantial portion of this lending is to SOEs and is collateralised (Horn at al., 2019), the public debt statistics compiled by recipient countries – and hence the World Bank database – are likely to underreport borrowing from China.

countries participate, the estimated size of the standstill from these creditors is $11.55 billion in 2020[12] (World Bank, 2020b). For nine countries, this DSSI saving represents 1% or more of their 2019 GDP[13] (World Bank, 2020b). Based on the available data, China is also the largest bilateral creditor in terms of both debt stock and debt service, accounting for at least 50% of all official bilateral debt service in 31 eligible countries during the 2020 suspension period. A large share of the potential savings will therefore depend on China's cooperation. The G20 agreement also offers the possibility of maintaining the standstill up to 2021. Extension of the standstill to 2021 would amount to an additional delay of $16.63 billion in debt service to official bilateral creditors.

The private sector has also agreed to participate on a voluntary, case-by-case basis, producing its own Terms of Reference for private sector consideration of borrower requests within the

12 This is based on monthly projections for May–December 2020 using end-2018 public and publicly guaranteed debt.

13 Angola, Bhutan, Republic of Congo, Djibouti, Guinea, Lao PDR, Mauritania, Mozambique and Samoa.

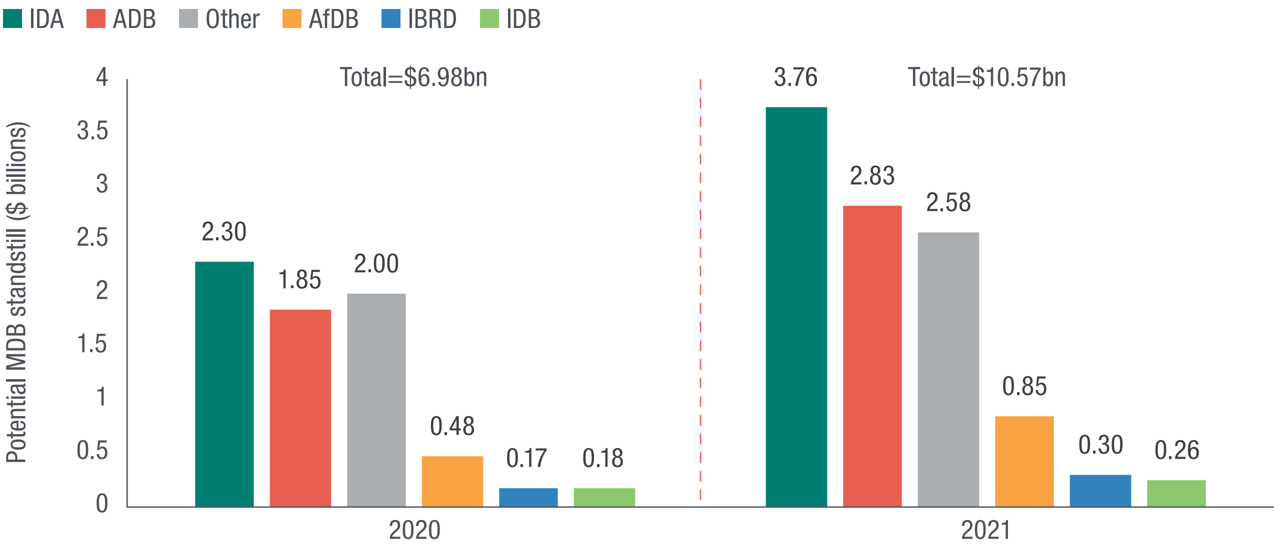
DSSI[14] (IIF, 2020a; 2020b). A complete standstill on debt service owed to private sector creditors will increase revenues available to IDA and blend countries by $10.22 billion in 2020 and $12.56 billion in 2021. These obligations to private creditors tend to be concentrated in a subset of DSSI-eligible countries. Over 25 DSSI-eligible countries have Eurobonds, with some $5 billion in debt service on these Eurobonds coming due between 1 May and end-2020 (IIF, 2020a).

There is a great deal of uncertainty about how private sector participation could be achieved in practice due to the DSSI's abstract terms and significant differences among in-scope countries as well as creditors. In regard to the former, there are some challenges around net present value (NPV) neutrality for the private sector. The IIF states that because forbearance on its own is NPV-negative, it must be combined with economic improvements, some seniority, or credit enhancements to achieve NPV neutrality (IIF, 2020a). In addition, there is a tremendous diversity of financing instruments and contract provisions, and a wide range of fiduciary considerations. The contract-by-contract approach favoured by the private sector rather than a blanket standstill also means at least a minority of these creditors may become holdouts.

There are also complications on the side of the borrower. Some debtor countries are reluctant to request forbearance from the private sector over fears of hurting their market access (see Box 2). Access to capital will be needed between 2021 and 2024 to finance development and for refinancing, so that the countries can stay current on their debts.

Although the G20 agreement calls on MDBs to consider participating in the standstill, their participation is also fraught with difficulties for reasons explained in Chapter 4. Assuming these obstacles are overcome, a standstill by all MDBs would provide additional liquidity of $6.98 billion in 2020 and $10.57 billion in 2021. The vast majority of these payments are to IDA and the ADB, which account for 33% and 27% of the potential MDB standstill in 2020 respectively (Figure 3). The 2021 number is larger since some of the payments due in 2020 have already been paid, and hence would not be included in the DSSI starting from 1 May. Our estimate of $6.98 billion for 2020 is also larger than the $5.2 billion estimated in a briefing paper prepared by the MDBs. This may be because the MDB estimate was calculated for only 10 MDBs while our figure includes all multilateral creditors.

Figure 3 Breakdown of potential MDB standstill in 2020 and 2021 for 68 DSSI countries



Note: This figure is based on data for 68 DSSI-eligible countries.
Source: World Bank (2020b).

14 The Institute for International Finance (IIF), a US-based trade association representing the private creditor community with 450 members, has actively engaged with the initiative.

3.2 Implementation of the DSSI

As of 29 June 2020, 39 of the 73 eligible countries had indicated their desire to benefit from the implementation of the DSSI (World Bank, 2020b). Among these countries, 18 countries[15] signed a Memorandum of Understanding with the Paris Club (Paris Club, 2020). For those 18 countries, the total amount of deferred debt service due in 2020 is around $1.3 billion to date. The current lack of buy-in from some eligible countries is due to concerns over market access, conditions restricting non-concessional borrowings, unintended legal consequences and the composition of their debt stock (Box 2).

Box 2 Factors limiting debtor participation in the G20/Paris Club DSSI

While many commentators have welcomed the G20's action as an important first step in helping countries respond to the coronavirus crisis, there are several limitations of the initiative that potentially undermine its effectiveness. These include:

1. **Adverse impact on market access:** Some eligible countries have publicly stated that they will not apply to the DSSI due to concerns that participation might send a negative signal about their creditworthiness and lead to a deterioration in their credit ratings (beyond what would be expected during a severe global recession). Moody's has placed two participating countries (Ethiopia and Pakistan) on a negative watch, citing among other factors the G20's call for private sector creditors to participate in the DSSI on comparable terms (World Bank, 2020d). Furthermore, all three major credit agencies have stated that requesting private sector participation on G20-comparable terms could lead to a downgrade (although this might be temporary).
2. **Unintended legal consequences:** In some cases, existing financing contracts may contain contractual provisions that are breached by the country making a formal request for debt service suspension. Countries need to be aware of the unintended consequences of making such a request, and so should consult with their legal advisors and creditors to ensure that they understand the precise contractual terms of their debt stock (including any guarantees given) before submitting a formal request for suspension.
3. **Restrictive conditionality:** Under the DSSI, countries would not be able to contract further non-concessional debt during the suspension period other than in compliance with IMF and World Bank parameters. Although the initiative does not prohibit the incurrence of non-concessional debt under pre-existing contractual arrangements, it prevents the contracting of any new non-concessional public debt during the suspension period. Kenya has signalled that it would not request a standstill because of this and has instead approached official bilateral borrowers individually.
4. **Composition of debt stock and limited creditor participation:** Some governments see modest benefits of the DSSI because official bilateral creditors account for a small proportion of their debt service. There is also some uncertainty regarding the extent to which G20 creditors will participate in the standstill, particularly those (notably China) that are not a member of the Paris Club. These non-Paris Club creditors are supposed to waive debt payments bilaterally on the same terms under the deal with the G20. However, some official lending institutions from these creditor countries appear to be taking the view that the DSSI does not apply to them, or that it applies only with respect to a subset of DSSI-eligible borrowers, such as the 47 UN Least Developed Countries (World Bank, 2020d).

15 Mali, Dominica, Grenada, Nepal, Cameroon, Burkina Faso, Mauritania, Niger, Republic of the Congo, Pakistan, Chad, Ethiopia, Myanmar, Côte d'Ivoire, Comoros, Togo, Kyrgyz Republic and Guinea (in order of date).

The eligibility criteria for the DSSI have also been the subject of debates. DSSI eligibility is based on countries with low per capita incomes rather those which suffer most from the direct health impact of the virus, or its consequences on trade, tourism or other poverty-alleviating activities. This is partly because those impacts remain uncertain. Consequently, middle-income countries are excluded despite experiencing a considerable economic shock, particularly those dependent on tourism and commodity exports. Amidst this uncertainty, there have been calls to expand the initiative to all African countries (Okonjo-Iweala et al., 2020). This includes Algeria, Egypt, Libya, Morocco, South Africa and Tunisia, some which have been significantly impacted by the pandemic. South Africa's output, for example, is forecasted to contract 7.1% this year, the deepest contraction in a century (World Bank, 2020a). The private sector is likely to oppose an expansion of the DSSI coverage. In developing the private sector terms of references for the DSSI, the IIF stated that 'comments from IMF and Paris Club officials noting that there is no intention to make the DSSI broader in scope have also been helpful' (IIF, 2020c).

3.3 Summing up: the DSSI is good on paper, but is proving challenging to implement

The overall impact of suspending debt service due to official bilateral creditors for the eight months of this year is potentially quite significant for some countries and small for others. Angola and Pakistan alone account for 46% of the potential savings in 2020. Moreover, while the standstill may be a useful initiative in providing breathing space to recipient countries, the potential savings are small compared to scale of needs. Assuming all bilateral creditors participate and that the World Bank debt data is reliable, the median saving across the eligible countries is 0.5% of GDP, with nine of them projected to save over 1% of GDP (World Bank, 2020b). The suspension is also temporary, requiring recipients to repay the postponed debt service in full over a short period of time.

There are also several obstacles to effectively implementing the standstill as currently designed. This includes getting certain official bilateral creditors, particularly China, to participate fully in the initiative. Transparency is key to this. While Paris Club creditors have provided data on the volume of the debt service payments they have postponed on their website, this data is currently unavailable for non-Paris Club creditors. At the same time, the Paris Club data is not provided on a country-by-country basis, which undermines analysis of the effectiveness of the initiative. Better data should highlight the actual cash flow benefits to each of recipient countries over the suspension period, and from which creditors. This can help to sustain momentum behind the initiative. It can also incentivise more eligible countries to apply for the standstill if there is evidence that the relief being provided is significant. Unintended consequences resulting from participating in the initiative such as rating downgrades or legal challenges should also be properly documented and widely disseminated. In addition to improving the transparency of the initiative, countries need access to legal and financial advisors to ensure that they fully understand the pros and cons of the standstill based on their specific circumstances.

4 Should MDBs take part in the DSSI?

As part of the discussions around the DSSI, the G20 requested that the major MDBs consider the viability and advisability of also suspending debt payments to the MDBs themselves. The MDBs responded with a briefing paper maintaining that such a move was detrimental to the MDBs and, in the end, to borrowing countries themselves. The MDBs maintain that a debt repayment suspension would trigger a downgrade in their bond ratings, which would lead to higher borrowing costs and reduced lending capacity in coming years far out of proportion to the temporary relief provided to DSSI-eligible countries.

Although the G20 has not to date pursued the idea of an MDB debt suspension, the issue has not gone away. Including the MDBs in the DSSI has the support of parts of the UN system, as for example laid out in a United Nations Conference on Trade and Development report (UNCTAD, 2020) as well as a recent speech by UN General Assembly President Tijjani Muhammad Bande (United Nations, 2020), as well as civil society organisations like the ONE Campaign (2020) and Eurodad (2020). Among the G20, China has continued to press MDBs to join with bilateral creditors in offering debt suspension, a position reiterated by the Chinese Foreign Ministry spokesperson in a 13 May press briefing (China Foreign Ministry, 2020).[16] In response, on 28 May World Bank President David Malpass reiterated his view that 'the UN's call for MDB debt suspension would be harmful to the world's poorest countries' (World Bank 2020d).

This section explores the likely result of MDB participation in the DSSI, with a particular focus on the impact it would have on MDB bond ratings and their overall financial model.

4.1 The MDB position

The core of MDB opposition to suspending debt payments from DSSI-eligible countries is that it would undermine their 'preferred creditor treatment' (PCT). Briefly put, PCT means that MDBs are first in line to be repaid should a sovereign face external debt payment difficulties, before bilateral or private creditors. MDBs argue that PCT is a key underpinning of their AAA bond ratings, and that granting even a temporary suspension on debt payments would trigger a rating downgrade resulting in higher borrowing costs and lower future lending capacity. The G20 briefing paper – prepared by a group of 10 MDBs[17] – estimates that a debt suspension would provide temporary, one-time

16 Interestingly, the Asian Infrastructure Investment Bank (AIIB) – created by China, and with China as by far the largest shareholder – has joined other MDBs in opposing inclusion in the DSSI. Two European AIIB shareholder officials commented this could signal that AIIB is willing to take positions independent from official China policy and is developing its own institutional identity.

17 The MDBs contributing to the G20 note were: African Development Bank (AfDB), Asian Development Bank (ADB), Asian Infrastructure Investment Bank (AIIB), Council of Europe Development Bank (CEDB), European Bank for Reconstruction & Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank (IDB), Islamic Development Bank (IsDB), New Development Bank (NDB) and the World Bank Group.

liquidity relief of US$5.2 billion,[18] but would lead to a loss of US$12 billion in annual lending capacity for several years going forward, unless the MDBs subsequently regain their AAA rating. Instead, MDBs propose increasing grants and concessional loans to lower-income countries, which in net present value terms are more valuable than a temporary debt suspension that would later need to be fully repaid.

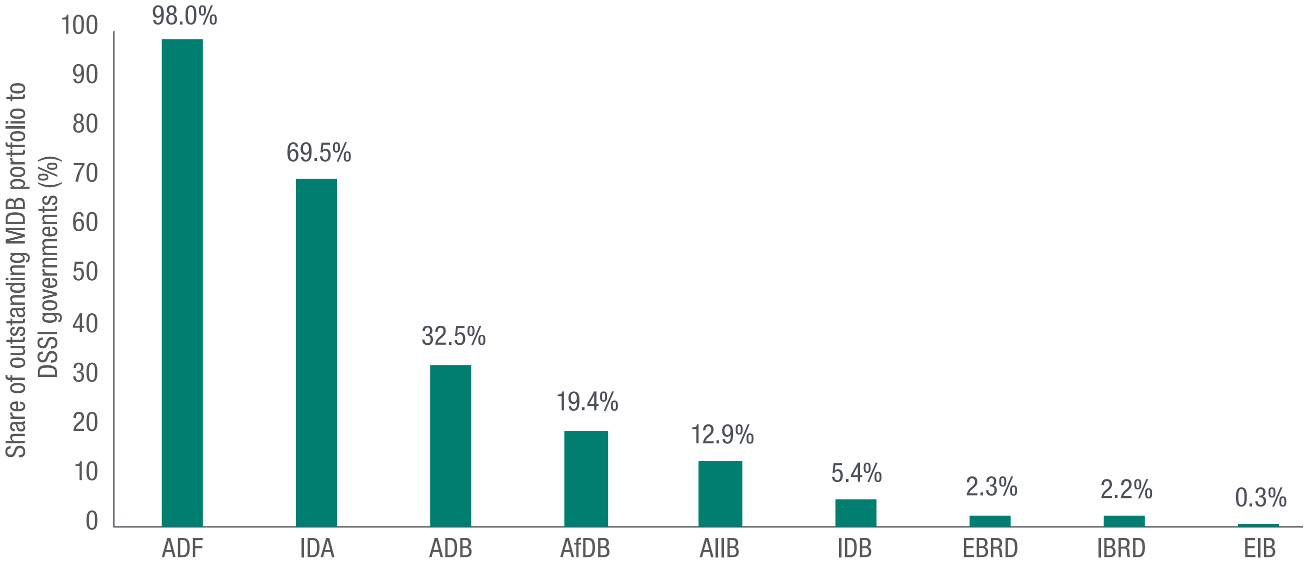
These estimates would seem to make a clear case for exempting the MDBs from engaging in debt suspension. At the same time, the estimates assume that (1) debt suspension would lead credit rating agencies to entirely eliminate any benefit from PCT as part of MDB bond ratings and (2) eliminating PCT would result in a downgrade of all MDB by at least one notch. As well, the estimates include increased borrowing costs for several MDBs that have only minimal exposure to the 77 countries in question (Figure 4). Hence, it is worth looking more closely at how rating agencies might react, rather than taking these estimates at face value.

4.2 How would ratings agencies evaluate an MDB debt suspension?

A close reading of the evaluation methodologies of the three major ratings agencies – Standard and Poor's (S&P), Moody's and Fitch – indicates considerable uncertainty in precisely how to quantify and weight PCT.[19] This is unsurprising, as PCT is an entirely informal concept, not written into any contract and with no legal basis. The superlative repayment record of sovereign borrowers to the major MDBs makes it evident that PCT does exist and is a key reason why the loan portfolios of MDBs are so much safer than those of commercial or even official bilateral creditors. Ratings agencies must therefore account for it when deciding on the riskiness of MDB bonds, but there is no obvious way to do so. Each of the three ratings agencies have taken a different approach, and in some cases has changed in recent years.

The more mechanical and transparent methodology of S&P makes it possible to project with a degree of confidence how DSSI

Figure 4 Share of outstanding MDB portfolio to DSSI governments (2018/19)



Notes: EIB represents sovereign loans to all non-EU countries (about 10% of total EIB lending), meaning sovereign loans to DSSI-eligible countries are lower. AIIB is based on commitments 2016–2019, as it does not release portfolio data by country. IsDB data not available.
Source: MDB financial statements: AIIB, ADB, EIB, EBRD and IDB December 2019; IBRD and IDA June 2019; ADF and AfDB December 2018.

18 This differs from the $6.8 billion figure from Chapter 3 as it includes only 10 major MDBs, not all multilateral creditors.

19 For a more thorough discussion of the MDB methodologies of all three major rating agencies, see Humphrey (2018).

participation would impact an MDB's ratings, and, in particular, PCT. The methodology states that 'We consider that government-led debt relief programs are tantamount to arrears' (S&P, 2019: 41). Therefore, a debt payment suspension to the MDBs of over 180 days would eliminate all PCT benefit for the MDB loan portfolios of the 77 countries, a point reiterated in two recent notes by S&P on the issue (S&P 2020a; 2020b). S&P rates an MDB in two main areas – the 'enterprise risk profile' and the 'financial risk profile' (Table 3). PCT is a sub-factor of both, but the ramifications of an MDB debt suspension on the enterprise risk profile is by itself sufficient to trigger a likely rating downgrade in five of the major MDBs (see Section 4.3 below for more on PCT's impact on the financial profile).

A debt payment suspension of over 180 days and the resulting loss of PCT for the affected countries would push down the 'policy importance' rating of AfDB, AIIB, ADB, IDA and IsDB by two notches from 'very strong' to 'adequate'. At that level, the highest possible enterprise risk profile would be 'strong' (Table 4). This puts a ceiling on the rating for these MDBs at AA/AA+, even if an MDB's financial risk profile is at its highest possible level (Table 3). An MDB's callable capital – a type of guarantee capital committed by shareholders in case of MDB need – cannot help in this case, as S&P takes callable capital into account only in strengthening an MDB's financial risk profile (S&P, 2019: 38), not the enterprise risk profile.[20] Because of the smaller

Table 3 Standard & Poor's matrix for MDB 'stand alone credit rating'

	Financial risk profile						
Enterprise risk profile	Extremely strong	Very strong	Strong	Adequate	Moderate	Weak	Very weak
Extremely strong	AAA	AAA/AA+	AA+/AA	AA/AA–	A+/A	A–/BBB+	BBB/BBB–
Very strong	AAA/AA+	AA+/AA	AA/AA–	A+/A	A/A–	BBB+/BBB	BB+/BB
Strong	AA+/AA	AA/AA–	A+/A	A/A–	BBB+/BBB	BBB/BBB–	BB/BB–
Adequate	AA/AA–	A+/A	A/A–	BBB+/BBB	BBB/BBB–	BB+/BB	B+/B
Moderate	A+/A	A/A–	BBB+/BBB	BBB/BBB–	BB+/BB	BB–/B+	B/B–
Weak	A–/BBB+	BBB+/BBB	BBB/BBB–	BB+/BB	BB/BB–	B+/B	B–
Very weak	BBB+/BBB	BBB/BBB–	BB+/BB	BB/BB–	B+/B	B–	B–

Source: S&P (2019).

Table 4 Standard & Poor's methodology 'enterprise risk profile' matrix

	Policy importance				
Governance and management	Very strong	Strong	Adequate	Moderate	Weak
Strong	Extremely strong	Very strong	Strong	Adequate	Moderate
Adequate	Very strong	Strong	Adequate	Moderate	Weak
Weak	Adequate	Moderate	Weak	Very weak	Very weak
Weak	Adequate	Moderate	Weak	Very weak	Very weak

Source: S&P (2019).

20 S&P also undertakes an unspecified 'holistic analysis' step toward the end of their methodology (S&P, 2019: 39), which can shift a rating by one notch in either direction. This could conceivably keep affected MDBs at AAA, but the subjectivity of the holistic analysis means MDBs cannot rely on it in their decision-making.

exposure of EBRD, EIB, International Bank for Reconstruction and Development (IBRD) and IDB to the DSSI countries, the loss of PCT for these country portfolios would not impact the policy importance score or lead to a rating downgrade.[21]

Fitch's MDB rating methodology (Fitch Ratings, 2020a) is somewhat less transparent than S&P, making it more difficult to evaluate with precision the impact of DSSI participation. PCT comes into play in only one place – the evaluation of the riskiness of each MDB's loan portfolio. Based on each MDB's track record of being repaid by sovereign borrowers, Fitch arrives at a PCT score. Depending on the score, Fitch gives up to three notches upgrade in the risk level of that MDB's loan portfolio – a substantial potential uplift. A recent note by Fitch confirmed that an MDB debt repayment suspension of more than 180 days would reduce an MDB's PCT score, depending on the size of its exposure to DSSI countries (Fitch Ratings, 2020b).

According to the most recent Fitch evaluations available, IBRD and IDB both receive the maximum three-notch uplift from PCT, while AIIB, ADB and EBRD receive two notches and AfDB only one notch. In light of the size of exposure to DSSI countries, the only MDB in real danger of a potential downgrade in the short term would be AfDB. This could be offset by AfDB's recent capital increase, should shareholders contribute as planned in 2020 and 2021.[22] IDA's rating would likely have also been affected, but it is not rated by Fitch. AIIB and ADB's PCT score would take a substantial hit, but their very high current capital adequacy levels and other rating strengths suggest that they would not be downgraded due to participation in the DSSI. The other major MDBs would be minimally impacted.

The methodology used by Moody's to evaluate MDBs is also difficult to model with precision due to ambiguities in how Moody's weights various sub-factors, including PCT, and sums them to arrive at a final rating. As with Fitch, Moody's arrives at an overall PCT score for an MDB based on its track record of repayment by sovereign borrowers. PCT can boost the average risk level of an MDB's loan portfolio as part of Moody's capital adequacy assessment by at most a one-notch increase, rather than three notches for Fitch (Moody's, 2019: 7). Hence, PCT is a much less important factor for Moody's compared to Fitch or S&P.

A recent note by Moody's indicates that, unlike the other two agencies, it would not see an MDB debt suspension as a major concern for PCT in the short term (Moody's, 2020). Moody's views MDB participation in the DSSI as driven by the MDB shareholders and thus not representing a reduced willingness to repay by borrower countries, which it sees as the conceptual basis of PCT. It seems very unlikely that a decline in PCT would lead any of the MDBs to face ratings actions by Moody's as a result of a debt repayment suspension for the 77 DSSI countries. However, an MDB's level of non-performing loans is a separate factor accounting for 20% of Moody's rating, and a debt repayment suspension could pressure the ratings of AfDB, ADB and IDA via the non-performing loan ratio. The boost given by callable capital under Moody's methodology means that this would realistically only be a ratings threat for IDA, which does not have callable capital.

Overall, the immediate, short-term impact of MDB participation in the DSSI would likely trigger a ratings downgrade in five of the major MDBs by S&P, and possibly also one MDB each

21 According to S&P (2020b: 11), the policy importance rating of the Central American Bank for Economic Integration would drop by two notches and the Caribbean Development Bank by one notch if they participated in the DSSI, likely leading to a downgrade from their current ratings of AA and AA+, respectively.

22 Although AfDB's capital increase was approved by shareholders, it must still be formally ratified by most member government parliaments. Ongoing disputes related to AfDB President Adesina could complicate those approvals, particularly for the US (Reuters, 2020a; BBC, 2020).

by Fitch and Moody's (Table 5).[23] An across-the-board downgrade for all the major MDBs would almost certainly not occur, but the ratings results would be nonetheless non-trivial. They would be likely to trigger higher funding costs for the MDBs, although the extent of the increase is uncertain (see Munir and Gallagher (2020) for one estimate). This increase in MDB funding costs would be paid for by a combination of higher loan charges to borrower countries and reduced MDB lending capacity in the coming years, although probably not to the extent suggested by the MDBs in their response to the G20.

One could argue that the results of S&P – just one out of three agencies, and with its own particular rating methodology – should not overly influence MDB decisions. However, it is worth noting that S&P is by far the largest of the three major agencies, with just over half of all government security ratings outstanding at end-2019, compared to a third for Moody's and just over 10% for Fitch (SEC, 2020). As a result, S&P has a strong influence on investor sentiment in capital markets. Further, many bond investors have internal rules specifying that they use the lower of an issuer's ratings in determining their investments, meaning a downgrade by just one agency can have an important impact on investor behaviour.

4.3 Impact of DSSI participation on MDB lending capacity during the crisis

MDB participation in the DSSI would have other negative impacts on the ability of MDBs to lend counter-cyclically beyond a potential rating downgrade. Because of the ongoing global downturn, the riskiness of MDB loan portfolios is increasing. As of the start of June 2020, the three major rating agencies have downgraded 14 (Moody's), 15 (S&P) and 18 (Fitch) sovereign countries that borrow from MDBs since the crisis began, with many other countries put on negative outlooks.

In response to the higher perceived riskiness of their portfolios, MDBs must allocate more of their risk capital to back up existing loans, reducing available lending capacity. This dynamic is pressuring the World Bank's IBRD and IDA windows as well as ADB, AfDB and IDB, while EIB and EBRD have seen limited impact thus

Table 5 Likely short-term ratings impact of MDB participation in the DSSI

	S&P	Fitch	Moody's
AfDB	Downgrade to AA/AA+	Downgrade to AA+?	None
AIIB	Downgrade to AA/AA+	None	None
ADB	Downgrade to AA/AA+	None	None
EBRD	None	None	None
EIB	None	None	None
IBRD	None	None	None
IDA	Downgrade to AA/AA+	Not rated	Downgrade to AA+?
IDB	None	None	None
IsDB	Downgrade to AA/AA+	None	None

Notes: ■ likely downgrade; ■ potential downgrade; ■ likely no impact.
Source: Author's elaboration based on rating agency methodologies and latest available MDB data.

23 AfDB's African Development Fund (ADF) concessional window does not have a credit rating – it is funded by donor contributions supplemented by repayments of past loans and allocations from AfDB's annual net income. All three ratings agencies indicated informally that they would not see ADF's participation in a debt suspension as a rating consideration for AfDB's non-concessional lending window, as the two are technically independent organisations with separate balance sheets (despite shared staff and administration).

far (Figure 5). The IDB in particular is facing a difficult situation. Apart from the recent Covid-related downgrades, three of the IDB's sovereign borrowers accounting for over 20% of IDB's sovereign portfolio at end-2019 – Argentina, Ecuador and Venezuela – are in some type of default status with all three rating agencies, which markedly increases the amount of MDB risk capital needed to back up these exposures.

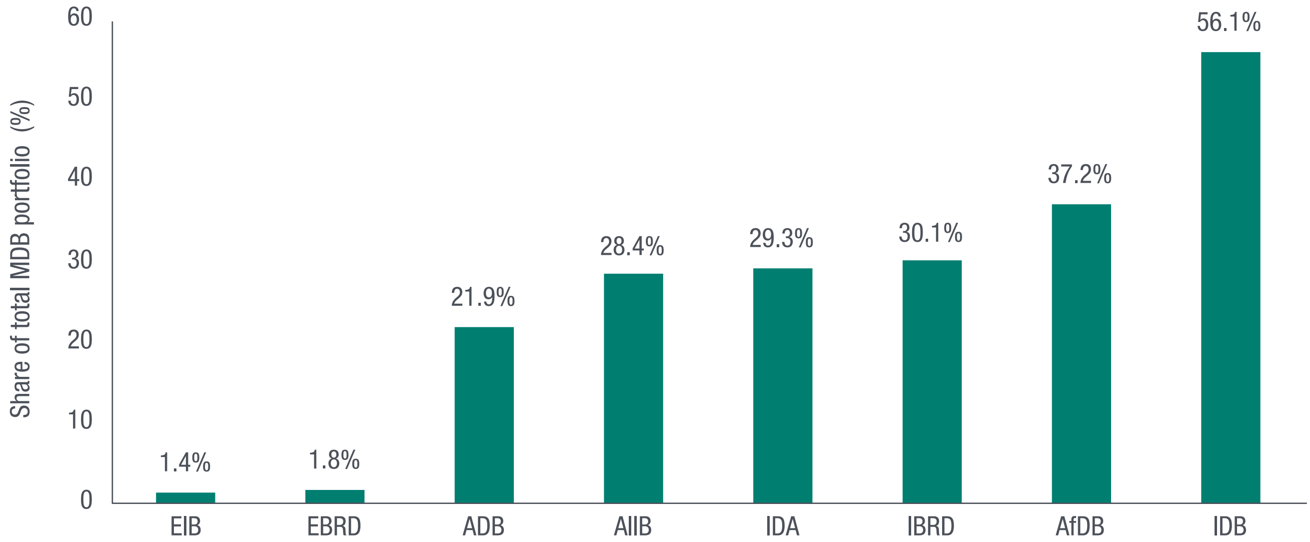
MDBs are hence facing a double hit: the need to ramp up counter-cyclical lending while declining portfolio quality is pressuring their capital adequacy. In this context, the reduction in PCT benefit from DSSI participation is all the more problematic. Lower PCT would mean an MDB's capital adequacy would weaken, thus reducing even further their ability to expand lending. For S&P, the impact of reduced PCT translates into billions of dollars of lending that would not be possible if the MDBs want to maintain their AAA rating. Even for an MDB like IDB, with a very small exposure to DSSI countries, the projection is a 1.8 percentage point drop in the S&P's capital adequacy ratio (S&P, 2020b: 11). This is equivalent to losing about US$2 billion in shareholder equity, or on the order of US$8 billion foregone loan portfolio capacity, in exchange for only about US$200 million in 2020 temporary debt payment suspension for the three DSSI countries. The impact on most other MDBs would be much higher.

4.4 Undermining PCT in the long term

MDB finance and risk teams also have deeper concerns that revolve around weakening PCT as a pillar of the MDB model over the medium and long term. 'We can go line by line through rating agency methodology,' said one risk official, 'but the more fundamental principle is, don't do things that start making agencies and investors ask questions about PCT, because it's a mainstay of our model.' The problem is that while PCT clearly exists – as demonstrated by the excellent repayment record of MDBs – no one has a clear idea of how to quantify PCT's contribution to MDB financial strength.[24]

As a result, MDBs are extremely wary about any move that would raise uncertainty about the strength of PCT. While an MDB debt payment suspension might not immediately trigger a downgrade, it could cause market players and ratings agencies to wonder if they are giving too

Figure 5 Share of MDB portfolios impacted by rating agency downgrades (January–June 2020)



Notes: AIIB, ADB, EIB, EBRD and IDB from December 2019; IBRD and IDA from June 2019; AfDB from December 2018. AIIB based on commitments 2016–2019 as it does not release portfolio data by country.
Source: MDB financial statements and rating agency reports.

24 The uncertainty around PCT is one aspect of the broader uncertainty about how investors should evaluate unique aspects of MDBs, including callable capital and the structurally high concentration of MDB loan portfolios (see Humphrey, 2018).

much credit for PCT. If MDBs suspend payments during this crisis, it could make it more likely to happen the next time a crisis comes. An MDB risk official said, 'There might be differing views out there over how quickly it [debt repayment suspension] might be seen to reduce our PCT, but the fact is that it is introducing doubt into the equation. Our view is that is never a good idea.'

The conceptual underpinning of PCT is that when a country faces difficulties, it will always pay MDBs back first. A debt suspension by MDBs could mean that countries continue to pay back private creditors while not paying back MDBs – exactly the reverse of what PCT is supposed to mean. A treasury official from another MDB noted that, 'You would end up with inverse PCT, which undermines the whole MDB sector and calls into question assumptions on which people base their views on why we are AAA.'

4.5 Summing up: MDBs should steer clear of the DSSI, but explain their reasoning better

The above analysis suggests that the short-term predictions of across-the-board rating downgrades were pessimistic in the MDB response to the G20. The true short-term impact would be likely to be non-trivial but on a smaller scale. Five MDBs would face a one-notch downgrade by S&P, and one each possibly downgraded by Fitch and Moody's. EBRD, EIB, IBRD and IDB would almost certainly not be downgraded by any of the major ratings agencies due to DSSI participation. The annual US$12 billion funding cost impact projected by the MDBs to the G20 was considerably over-stated.

In their response to the G20, MDBs did not address two other important impacts of DSSI participation. First, even if a debt suspension did not trigger an immediate downgrade, it would reduce each MDB's capital adequacy headroom by lowering the benefit ratings agencies give for PCT. This would restrict MDB capacity to lend counter-cyclically in the crisis, at a time when they are already facing capital adequacy pressure due to declining portfolio quality occasioned by downgrades to their sovereign borrowers. Second, an MDB repayment suspension would plant the seed of doubt in the minds of ratings agencies and investors about the entire concept of PCT and the reliability of MDBs. Because of uncertainty on how to evaluate MDBs in financial terms, that could dangerously weaken the MDB financial model in the medium and long term.

Overall, it is impossible to avoid concluding that the relatively limited amount of relief provided by a MDB debt repayment suspension along the lines of the DSSI – a one-time temporary relief of US$5.2 billion in 2020, which would need to be fully repaid in 3–4 years – is far outweighed by the restrictions it would cause to MDB lending capacity and the long-term dangers to the MDB financial model.

Beyond this critical point, other arguments also incline against MDB participation in the DSSI:

- Countries receiving debt suspensions are not necessarily those countries most affected by the Covid-19 crisis. Temporary debt relief is a blunt instrument designed to provide immediate liquidity to the poorest and/or most fragile countries. This contrasts with the HIPC debt relief and the MDRI, which were designed specifically to address the growth-limiting impact of debt overhang. The broader issue of debt suspension or relief is best separated from the response of MDBs to the current crisis.
- The G20 and others have urged private creditors to participate in the DSSI, but actual progress appears very limited thus far. Should that remain the case, it is possible that the additional liquidity space from MDB involvement in the DSSI would be used to repay those private creditors rather than mitigating the impacts of the crisis in participating countries.
- Participation in any type of debt repayment suspension could damage the access of DSSI countries to private credit by reinforcing stereotypes that these countries cannot cope in a crisis. A number of lower-income countries have worked very hard to gain access to international capital markets in recent years and may not want to risk that for a limited, one-time relief on MDB debt repayments. Private capital flows will be essential for economic recovery and sustainable growth in the years to come.

4.6 Options for MDBs to provide debt relief without triggering arrears

It would be possible to structure another type of arrangement in which MDBs provide temporary debt repayment relief and are compensated by shareholders in such a way that it would not be interpreted as arrears by ratings agencies. The IMF has used such an arrangement, although on a small scale. The IMF's Catastrophe Containment and Relief Trust, a donor-funded programme of debt relief for LICs, to provide grants to 27 countries since April 2020. Amounting to $243 million, these grants are used to pay off debt service to the Fund (IMF, 2020a). Fundraising is ongoing to provide additional debt service relief for a full two years to the poorest member countries, which will require about $1.4 billion (IMF, 2020b).

The MDBs could attempt to create a similar type of trust fund arrangement to the Catastrophe Containment and Relief Trust, should willing donors be found. The purpose would be to transfer sufficient resources to lower-income countries to repay their MDB loans. The trust fund could be structured to have a portion later repaid into the trust fund. However, the added value of creating a new trust fund structure over simply transferring resources bilaterally from willing donors to lower-income countries is unclear. To function on a meaningful scale, a trust fund would also need to encompass all the major MDBs engaged in DSSI countries, which would take time to coordinate. While the idea has been discussed among MDB shareholders, it does not appear likely to move ahead in the near future.

Another option, discussed in a recent JP Morgan analysis of the DSSI (Reuters, 2020b), would be for DSSI-eligible countries to repay their debt as planned, but have MDBs immediately turn around and disburse those paid amounts back to the borrowers in the form of new loans. The analysis suggests that this 'work-around' would reduce the risks of adversely affecting MDB ratings. While this last point is true, overall the proposal is effectively the same as what the MDBs are already doing – providing fresh loans to lower-income countries. The resources MDBs have projected to make available to concessional borrower countries are already predicated on repayment of their existing loans. Hence, the added benefit of such a scheme seems minimal or nil.

5 Accelerating MDB lending to lower-income countries: what is possible?

Rather than suspending debt repayments, MDBs argue that they can best serve DSSI-eligible countries by increasing the flow of grant resources or highly concessional loans – that is, loans at very low or zero interest rates that are repaid over 40 or 50 years. This poses two problems. First, grant and concessional resources are funded mainly by donations from wealthy countries.[25] Hence, the capacity of MDBs to increase concessional lending is limited in the absence of major new donor support. Second, loans at even concessional terms may pose a threat to the debt sustainability of lower-income countries. This section explores those issues.

5.1 Ramping up concessional financing to face the crisis

The major MDBs have said that they collectively have the capacity to provide $90 billion in grants and concessional lending in 2020 in response to the Covid-19 crisis. A high share of these resources is being provided via general budget support loans and under temporarily accelerated approval procedures, in the interests of getting liquidity to recipient countries as fast as possible (see Annex 1 for details).

While $90 billion sounds impressive, a closer look reveals that MDBs are for the most part ‘front-loading' concessional resources to address the Covid-19 crisis – that is, using more resources in the short term than had originally been planned (Table 6). This strategy is an appropriate response to the crisis, but it raises questions about the level of concessional and grant resources available to the world's poorest and most vulnerable countries from 2021 onward, particularly if the crisis extends.

The World Bank's IDA committed $50 billion in concessional resources up to June 2021, by far the largest of the announced financial packages – about $15 billion for April–June 2020 and $35 billion for FY2021 (about a 60% increase compared to FY2019).[26] The total IDA19 lending envelope for 2021–2023 is about $79 billion, meaning expected lending in FY2021 represents 44% of the total resources available for FYs 2021–23. This suggests a very steep drop-off in resources in FY2023. The situation is even more problematic because IDA recipients automatically receive more grant financing as their fiscal situations deteriorate due to debt sustainability concerns. Because of the crisis, grant funding will almost certainly increase in the coming years, which will deplete IDA resources even faster. IDA will therefore face the prospect of either dialing back on lending during the latter part of the IDA19 period, or seeking new resources.

Ramping up bond issues is one option to obtain IDA new resources. IDA received a bond

25 Further resources come from the repayment of past concessional loans, transfers from the annual net income of non-concessional MDB windows, and more recently a limited degree of bond financing by the World Bank's IDA.

26 The World Bank's fiscal year runs from July to June.

rating in 2017[27] and is still establishing itself in the capital markets, but it has the ‘shadow’ of the World Bank’s IBRD over it, and IBRD has a tremendously strong track record and reputation as a global bond issuer. The very strong performance of an early June IDA bond issue – only its third ever, and at a time of massive uncertainty in global markets – underlines the appetite of investors for IDA debt. However, IDA bonds raise funds at market rates, which restricts the ability of IDA to offer concessional financing or grants. One option could be to use bond issues to provide resources on non-concessional terms (similar to IBRD), as a temporary liquidity measure. While this could help lower-income countries face the crisis, it would also have debt sustainability implications.

The other main option is to seek new resources from donors. This would mean either a supplemental replenishment to top up IDA19 or advancing the schedule for the IDA20 replenishment round. According to officials from two European donor countries, discussions are already beginning on the feasibility of more donor resources for IDA. World Bank President Malpass also raised the possibility at the end of May in a letter to US and international legislators (Reuters, 2020c). However, raising donor resources will run into the fiscal and political difficulties of international aid budgets at a time when advanced countries themselves are facing severe economic downturns.

AfDB’s ADF concessional window has announced a $3.2 billion package, two-thirds of which is front-loaded resources from the ADF15 replenishment round just completed in December 2019, while the remainder is from ‘possible ADF cancellations’ (AfDB, 2020a: 15).

Table 6 Concessional resource packages in response to the Covid-19 crisis

	Announced package	2019 approvals	New resources?	Resource implications
World Bank (IDA)	$50 billion in 15 months (to June 2021)	$21.9 billion (FY2019)	$1.3 billion from Crisis Response Window. Remainder front-loading IDA19 resources committed for 2021–2023	Accelerate bond issues, although pricing implications uncertain. Discussions expected on supplemental/early IDA20 replenishment to avoid drop-off in lending in FY2022/23
AfDB (African Development Fund)	$3.2 billion for 2020	$1.1 billion (2018)	No. $1.8 billion is front-loaded ADF15 resources; remainder is to come from ‘possible ADF cancellations’	Unclear. Obtaining donor resources for ADF 15 (planned to last 2020–2022) is ongoing – no discussions yet on supplement/ early ADF16 replenishment
ADB (Asian Development Fund)	$2.4 billion total for 2020 ($1.8 billion concessional lending; $400 million grants; $17 million trust funds	$4.5 billion	$704 million due to change in permitted use of emergency reserve fund to include health emergency; $50 million in trust fund resources. Remaining amount is as planned pre-crisis	Donor pledging for ADF13 scheduled to run Sept–Dec. 2020. No change expected in target levels (about $4 billion, similar to ADF12)

Notes: Above lending is entirely to public sector borrowers.

27 As part of IDA18 negotiations, the organisation was in 2017 given authority to convert its financial model to a hybrid of donor-funded concessional window with bond market-funded MDB. This was motivated in part by the successful ‘merger’ of the concessional windows of ADB and IDB into their main non-concessional windows, resulting in a de facto huge capital increase (especially for ADB) in 2016. Both IDA and AfDB’s ADF window could not pursue such a strategy as they still support a high number of active borrowers, and also because of certain legal issues. IDA opted for a hybrid model instead, while ADF still follows the donor-supported model.

ADF15 amounts to $7.6 billion and is intended to cover the 2020–2022 period. Unlike IDA, ADF has no ability to raise resources on the markets, meaning it is constrained by the amount of resources agreed during the ADF15 negotiations. Hence, the front-loading is likely to lead to sharp restrictions on its ability to provide financing to Africa's poorest countries in 2021 and 2022. Prospects of raising more donor funds are limited at this point. 'AfDB is worried right now whether countries will even pay up commitments they have made in December,' said an official from one ADF donor government. 'The first concern is to pay in the previous replenishment, before they think about asking for more.'

ADB offers varying degrees of concessional terms to 25 countries, the majority of which are small island nations (ADB, 2020a). Of the larger concessional recipients, seven receive a mix of concessional and non-concessional lending. As part of its Covid-19 response, ADB announced a programme of $2.4 billion in concessional lending for 2020, of which $702 million is fresh resources from a reserve emergency fund (ADB, 2020b). The remainder is not substantially different from what was projected for 2020. While this means the package will have little impact on ADB's concessional lending capacity going forward, it also means the bank is not substantially stepping up support to lower-income countries in the crisis. The replenishment round for ADB's concessional resources is due to get underway in September 2020 and conclude by December. The replenishment is expected to be similar to the $4 billion raised in the previous round.

5.2 Debt sustainability implications of accelerated lending and prospects for permanent debt relief

Increased MDB lending as described above and a debt standstill like the DSSI provide much-needed breathing space to lower-income countries but do not address solvency concerns. Given that debt risks in developing countries were already high prior to the pandemic (as noted in Section 2.2), ramped up lending could aggravate these risks and trigger a protracted debt crisis for many developing countries.

The lending practices and policies of the major MDBs are designed to safeguard debt sustainability to some extent. First, several MDBs automatically adjust the terms of their assistance to debt sustainability risks. IDA uses a traffic light system based on the joint World Bank–IMF's Debt Sustainability Framework for its 59 IDA-only countries. Countries deemed to be at high risk or in debt distress ('red' light) receive 100% grants, medium risk ('yellow' light) receive 50% grants and 50% credits, and low risk ('green' light) receive 100% credits and zero grants. Based on this system, 20 IDA countries currently receive all their IDA resources in grants, 18 countries receive half in grants and the other half in concessional loans and 18 receive 100% IDA credits.[28] AfDB and ADB also use the Debt Sustainability Framework or a similar framework to determine the share of grants and loans in its assistance to each lower-income country. However, as noted in Section 2.2, the most recent DSAs are based on overly optimistic long-term projections. It is therefore imperative that DSAs are updated on a regular and comprehensive basis during these uncertain times and that more attention is paid to other early warning signals such as rapidly rising debt service ratios relative to public spending on health, reduced access to international capital markets and downgrades by rating agencies.

Second, MDB concessional lending is on highly favourable terms compared to other sources of debt financing.[29] Concessional loans carry low interest rates and very long repayment periods. For example, IDA credits have a zero or very low interest charge and repayments are stretched over 30 to 38 years, including a 5- to 10-year grace period, depending on the country. As a result, recipient countries repay much less than they borrowed in inflation-adjusted or NPV

28 Three countries are not eligible for grants: Eritrea, Sudan and Syrian Arab Republic.

29 58% of multilateral debt service goes towards payments on concessional loans, compared to only 14% for bilateral loans on average between 2016 and 2018 (Lee et al., 2020).

terms. New concessional lending and grants are therefore much more beneficial to IDA countries in NPV terms than every dollar of a standstill, which must be repaid in future years at full NPV. Hence, should MDBs be able to ensure positive net flows of concessional lending, it would be a clear win for lower-income countries in financial terms over an MDB debt payment suspension – especially if MDBs provide more concessional resources in the crisis than these countries would have received in normal years.

Third, MDB lending can potentially mitigate the negative impact of the pandemic on growth and debt sustainability if used to support fiscally sustainable policy responses that help businesses and households. For example, IDA operations in Burkina Faso, Nigeria and Mongolia are providing quick liquidity while supporting reforms to address growth constraints, many of which are exacerbated by the crisis. Evidence since 2008–2009 suggests that fiscal multipliers – the effect of a $1 change in spending or a $1 change in tax revenue on the level of GDP – have been higher over the past 10 years than previously thought and are higher during recessions. This suggests that borrowing from MDBs to finance fiscal support measures can be an effective way to increase output in the short term and protect debt sustainability, assuming it is used prudently and productively (for example, public investments in infrastructure or social protection schemes). When designing fiscal measures, MDBs need to work closely with governments in understanding their specific circumstances and constraints as well as the reforms needed to shore up public finances and help them maintain a sustainable debt path.

IDA and other MDBs are also exploring options for providing lending on non-concessional terms on a temporary basis to countries that currently do not have access to non-concessional financing windows. Although one of the conditions of the DSSI is that participating countries do not incur new non-concessional debt during the suspension period, it allows some flexibility if this new financing is under the DSSI or in compliance with limits agreed under the IMF Debt Limit Policy or World Bank Group policy on non-concessional borrowing. While providing non-concessional loans can increase debt vulnerabilities, it may be a sensible policy option for the subset of DSSI countries considered to be at low or moderate risk of distress. Non-concessional loans would still be substantially cheaper for IDA borrowers than commercial financing. Moreover, IDA is strengthening its debt-related policy framework through a more proactive and systematic engagement on addressing debt sustainability at the country level with the new Sustainable Development Finance Policy that comes into effect on 1 July 2020.

Nonetheless, averting debt crisis in several highly indebted countries will require solutions that go beyond increasing concessional financing from MDBs and providing a debt standstill, but do not go as far as debt forgiveness. Countries that are highly indebted but do not have unsustainable debt burdens could consider debt swaps. This would involve the creditor cancelling a debt at its nominal value. In return, the debtor invests part of the cancelled amount in development projects according to conditions previously agreed by both parties. Official bilateral creditors could also apply IDA terms to their current and future credits to lower-income countries, extending grace periods, lengthening average maturities and lowering average interest costs, as proposed by Lee et al. (2020).

In some countries, the coronavirus has added financial stresses on top of those created by existing high external debt levels, and as a result significant debt restructuring to reduce debt service burden is likely to be required. The HIPC Initiative and MDRI provide the historical precedent of cancelling debt in response to accumulation of unsustainable, developing-country debt. As described in Box 3, the MDRI offered full debt relief for eligible debt from the World Bank's IDA, the IMF, AfDB and IDB. Organising a new debt relief initiative now would be difficult for a variety of reasons, including moral hazard considerations in light of the recent HIPC/MDRI initiatives and the increasingly complex creditor landscape with creditors less organised under existing debt resolution frameworks. New semi-official financiers like China's policy banks, which have expanded massively to lower-income countries, would need to be brought on board for any debt relief initiative to be meaningful. Private creditors have also multiplied in recent years, and any debt relief must seek comparable treatment for private creditors to ensure that any debt relief is not used to pay off one set of creditors rather than being used to restore a country's financial situation.

Given current geopolitical constraints and the absence of a multilateral legal framework for sovereign debt restructuring, improving the existing architecture for sovereign debt restructuring is critical. In order to encourage creditors to provide debt relief, debtors could make creative use of collective action clauses and other developments in bond markets since the early 2000s to overcome obstacles associated with restructuring private sector debt. Debt contracts could also systematically include relevant state-contingent elements, whereby repayments are paused if the borrower faces a difficulty in repayment due to a trigger event (such as a second wave of the pandemic). Another creative solution involves amending the sovereign immunity laws in the US and the UK – the jurisdictions whose laws govern most emerging market sovereign bonds – to permit the courts to halt lawsuits against countries where the IMF concludes that normal debt service is impossible given the current crisis.

5.3 Summing up: accelerated MDB lending is essential, despite the risks

Although the MDBs have touted impressive-sounding amounts of resources to help lower-income countries face the immediate impacts of the Covid-19 crisis, this support still falls well short of what these countries need to mitigate damaging socioeconomic downturns in the coming 1–2 years. In most cases, MDB concessional financing is only marginally above the 'business as usual' scenario. Additional resources over and above normal levels – notably in the case of the World Bank's IDA, and also to a degree from AfDB's ADF – is mainly from front-loading resources from future years. While this makes sense to address urgent needs, it also would lead to a restriction in concessional financing in 2021 and 2022 unless additional measures are taken.

The automatic 'traffic light' system employed by the major MDBs to allot grants or concessional loans depending on debt sustainability will help reduce the danger of debt distress as a result of increased crisis financing. Nonetheless, countries now classified as in low risk of debt distress, and hence receiving concessional or a blend of concessional and non-concessional terms, could find themselves in debt difficulties in coming years, particularly if macroeconomic conditions remain depressed for longer than currently anticipated. Despite this danger, it is essential to transfer MDB resources quickly to avoid lasting socioeconomic damage and to enable a faster recovery.

The existing problems of public debt in lower-income countries coupled with the urgent need for more financing to tackle the Covid-19 crisis will inevitably lead to questions about whether economic growth in these countries is once again being stifled by heavy debt burdens. As was eventually concluded in the protracted run-up to HIPC and MDRI, this debt overhang will need to be addressed if the international community does not want to allow these countries to fall into a trap of high debt, low investment and economic stagnation. With the rise of new lenders to lower-income countries – especially China, as well as a greater array of private investors than in the past – structuring a new debt relief initiative will be more complex than in the past. In the meantime, sovereign debt restructurings are likely to proceed on case-by-case basis. Given that a poorly executed debt restructuring can perpetuate a crisis for years or even decades, improving the international architecture for sovereign debt restructuring is critical.

Box 3 HIPC and MDRI: a brief history of debt relief

In 1996, the World Bank and the IMF launched the Heavily Indebted Poor Country (HIPC) Initiative in response to accumulation of unsustainable, developing-country debt in the 1970s and 1980s. The key objective of the initiative was to reduce the overall debt stock to a predetermined level within a reasonable period of time in a coordinated effort of multilateral, bilateral and commercial creditors, including also non-Paris Club members, with the ultimate goal of eliminating the debt overhang as a constraint to economic growth and poverty reduction. Its launch represented a major departure from past practice, in that, for the first time, debt relief was offered on multilateral debt. The Initiative was enhanced in 1999 to provide faster, deeper and broader debt relief and to strengthen links between debt relief, poverty reduction and social policies.

In 2005, recognising that countries that had graduated from HIPC were struggling to make progress towards the UN Millennium Development Goals, a second phase of debt relief was launched. This is known as the Multilateral Debt Relief Initiative (MDRI), which offered full debt relief for eligible debt from the World Bank's IDA, the IMF, the African Development Fund and the Inter-American Development Bank held by LICs that have completed the HIPC process.

To date, 37 countries – 31 of them in Africa – have received debt relief for which they were eligible through HIPC and MDRI. Eritrea and Sudan are potentially eligible for debt relief but have not yet started the process. Combined, MDRI and HIPC have provided around $99 billion in debt relief.

6 Conclusions and policy recommendations

The purpose of this paper is to consider how MDBs can best bring their financial strength to bear in helping the world's most vulnerable countries face liquidity shortages triggered by the Covid-19 pandemic. Overcoming the steep economic downturn and social impacts in the short term and protecting development gains over the longer term require efforts on many fronts, but counter-cyclical financing is unquestionably essential, and lower-income countries are desperately short on that. With the IMF reaching the limits of its capacity and donors facing strains of their own, using MDBs' financial strength to provide short-term liquidity in the face of the crisis makes sense. However, MDBs were designed to provide long-term development finance, and supplying liquidity support puts strains on their financial and operational model.

The over-riding message of the paper's analysis is that **MDBs should not engage in the G20-led Debt Service Suspension Initiative (DSSI), and instead focus their energy and resources on ramping up the fast provision of fresh concessional resources to lower-income countries.**

Including MDBs in the DSSI is at first glance a tempting proposition, since they account for a substantial share of the debt payments made by the DSSI-eligible countries in 2020 and 2021. Suspending MDB debt payments would immediately free up $5–7 billion in liquid resources for the DSSI-eligible countries in 2020, and another $10–11 billion should the DSSI be extended into 2021. This would seem to be a considerable gain, particularly for countries with limited fiscal space and a substantial debt service burden. However, a closer look at the trade-offs makes it clear that such a move would be ill-advised for all parties involved, for several reasons:

- Participating countries would gain a one-time delay in MDB debt repayment, which would need to be paid over the course of 2022–2024 in full in net present value terms, according to DSSI stipulations. Hence, the benefit of MDB involvement in the DSSI would only be temporary.
- The costs in terms of lost financing capacity to all developing countries – not just DSSI-eligible countries – would be far higher. Ratings agency methodologies mean that DSSI participation would lead to MDBs losing a portion of their 'preferred creditor treatment' (PCT), which would have several negative impacts on MDBs.
  - Five major MDBs (ADB, AfDB, AIIB, IDA and IsDB) would probably lose their AAA ratings from S&P in the short term by participating in the DSSI, and possibly one each from Moody's and Fitch (IDA and AfDB, respectively). This would increase the costs of the loans they provide to borrowers and reduce the size of their loan portfolios in coming years.
  - The loss of PCT would immediately reduce the capital adequacy 'headroom' of all participating MDBs, restricting their ability to lend counter-cyclical loans by tens of billions of dollars each, even if they were not downgraded. This is particularly problematic in times of crisis when MDBs are already facing capital adequacy pressures resulting from sovereign downgrades.
  - Granting debt suspensions in the current crisis would weaken the confidence of ratings agencies and bond investors in the entire concept of PCT, a critical underpinning of the MDB financial model.

In short, the negative impacts of MDB involvement in the DSSI in both the short and long term would far outweigh the one-time, limited benefits it would bring. It would be far more beneficial to lower-income countries for MDBs to focus on providing fast net-positive transfers of concessional resources.

6.1 Policy recommendations

MDBs and the DSSI:

- Shareholders should support the MDB position of not participating in the DSSI, for the reasons laid out above.
- MDBs could do a much better job of explaining the reasons why this is the case, as some shareholders who are generally inclined to support the MDB position remain unconvinced by their response to the G20. This requires better educating shareholders and external stakeholders on aspects of the MDB financial model and the role of ratings agencies.
- Options for suspending debt payments while avoiding triggering arrears and rating agency actions do not appear to offer substantial gains on either ramped-up MDB lending (see below) or direct bilateral contributions from willing donors to lower-income countries.

MDB liquidity provision through scaled-up lending:

- The aim should be for MDBs to increase lending to lower-income countries well above what had been originally programmed for 2020 and 2021. While the World Bank's IDA is stepping up concessional financing in response to the crisis, neither AfDB nor ADB have shown similar ambition. ADB in particular should seek creative ways to increase its support, in light of its very strong financial position.
- Shareholders should push all MDBs operating in DSSI-eligible countries to clarify which portion of their emergency programmes are fresh resources, reprogrammed existing resources and front-loaded funding originally intended for future years. Shareholders should also insist MDBs spell out the precise implications of these emergency lending programmes on the capacity of MDBs to provide continued resources in 2022 and beyond.
- The process of building political support for early replenishments of the two main concessional lending windows – the World Bank's IDA and the AfDB's ADF – should begin now, as it is evident that more resources will be necessary in advance of the normal replenishment round schedules.
- It is imperative that World Bank–IMF DSAs be updated often during these uncertain times and that more attention is paid to other early warning signals such as rapidly rising debt service ratios relative to spending on health, reduced access to international capital markets and downgrades by rating agencies.
- MDBs should consider temporarily relaxing restrictions on non-concessional lending to lower-income countries to provide emergency liquidity to support crisis response. This would allow IDA and the non-concessional MDBs to leverage their bond issuance capacity. While this does pose risks in terms of future debt sustainability, the urgent need to help countries avoid economic destruction and a much longer and more painful recovery suggests that the first priority should be liquidity transfer.
- Alternatively, or in combination with the above, IDA and ADB could rethink the way they combine donor and market-funded resources to arrive at pricing packages for concessional borrowers in a way that stretches donor resources more efficiently without increasing the risk of debt distress.
- Ramped-up usage of budget support lending and streamlined procedures to accelerate the approval and disbursement of MDB resources are appropriate and should be continued on a temporary basis.

Medium-term considerations:

- Debt relief initiatives that go beyond a temporary standstill require deeper thought and building of political support, including diplomatic efforts to bring non-traditional lenders (notably China) and the private sector on board to fully address the problem. In light of pre-existing debt vulnerabilities combined with the ramped-up concessional and non-concessional lending needed to counteract crisis impacts, a targeted debt relief initiative is critical to avoid systematic defaults, and discussions should begin now.
- Given the challenges of mounting a comprehensive debt relief initiative in a timely manner, improving the international architecture for sovereign debt restructuring remains critical. This includes continuing efforts to improve market-based approaches to restructuring, such as improved contractual terms and greater use of state-contingent debt instruments, and extension of national legislation to limit litigation by uncooperative creditors.
- MDB management and shareholders should engage in a root-and-branch rethink about MDB financial capacity and capital adequacy. A particular focus should be on how to give MDBs reserve financial capacity to ramp up quickly in the face of future regional or global crisis, while at the same time (1) not threatening their financial stability and (2) not over-committing scarce capital resources that would sit idle during normal times. This could include repurposing MDB callable capital, a unique type of guarantee capital totalling hundreds of billions of dollars across the major MDBs but which currently is of only minimal use to MDBs (Humphrey, 2017), as a type of emergency mechanism to be leveraged in the event of a crisis.

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Annex 1 Temporary measures to accelerate MDB financing

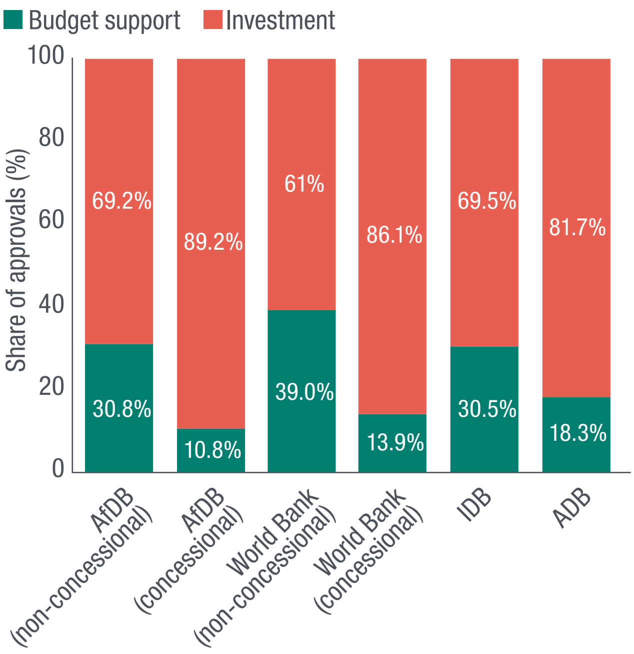
Beyond the total amounts of financing made available to address the impacts of the Covid-19 crisis, shareholders of the major MDBs have authorised a series of temporary measures to help the MDBs provide emergency resources more quickly. MDB project approvals and disbursements are well known for being lengthy and bureaucratic, which is obviously not well suited to the current crisis. The new measures are intended to help overcome delays and transfer resources quickly to recipient countries. In most cases the measures apply to both concessional and non-concessional operations for all the MDBs and are intended to remain in effect until the end of 2020 or mid-2021.

Budget support

Budget support lending – also known as policy-based lending or development policy lending – is especially important for liquidity provision in times of crisis. Unlike project lending, budget support goes directly into a borrower government's general budget accounts, and is not targeted to a specific expenditure. Originally considered the province of the International Monetary Fund, the major MDBs began offering budget support during the 1980s, and it has since remained an important component of their operations (Figure A1). MDB non-borrower shareholders tend to favour project lending and have placed restrictions on how much budget support lending each MDB can undertake and link it to an agenda of policy reforms on the part of the recipient government.

In the face of the Covid-19 crisis, shareholders at all the major MDBs have agreed to loosen these restrictions on budget support lending (Table A1). This is sensible, as these loans can be prepared quickly and disburse large amounts of resources immediately to recipient countries, with no need for lengthy and complicated oversight and procurement procedures of project loans. MDBs are in some cases utilising an existing multi-year series of budget support loan programmes as vehicles to add resources for the crisis, even if the policy content may be unrelated, as a way to

Figure A1 Share of budget support approvals, 2008–2018 average



Source: MDB annual reports 2008–2018.

accelerate approval and disbursement. MDBs also have greater leeway to fund current government expenditures (like salaries) with their lending, rather than purely investment spending as is normally the case. This facilitates support for social spending like cash transfers, which is badly needed to offset the economic impact on the poor.

Administrative procedures

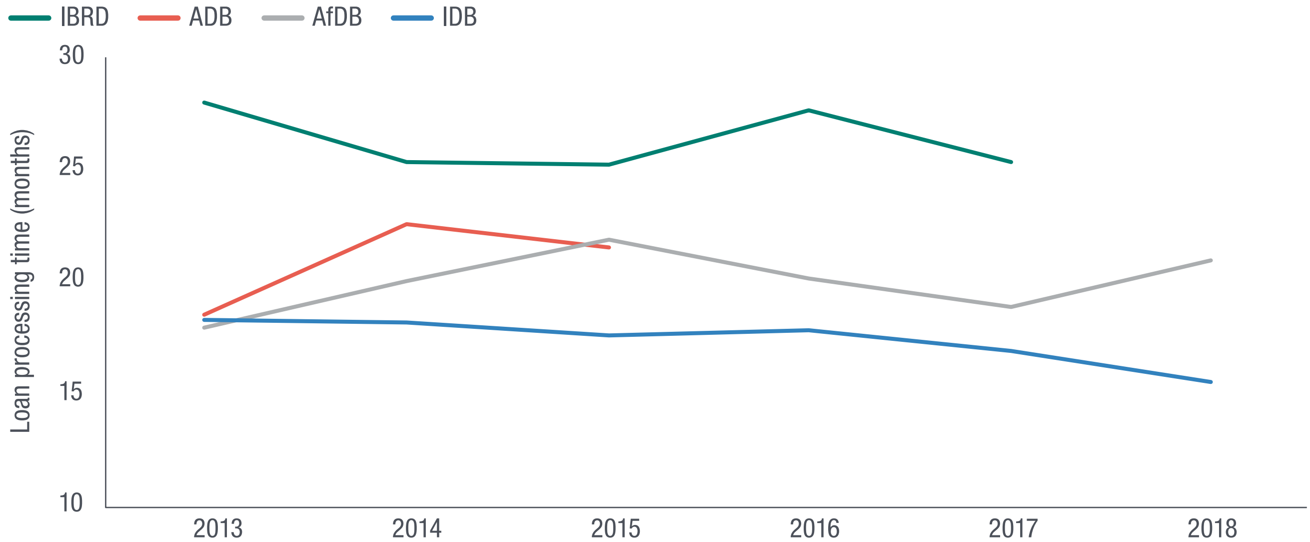
The length of time required to move an MDB loan project through the full approval process to begin disbursement has for years been a topic of considerable complaint by borrower countries. Despite some efforts at improvement, projects at the World Bank took over two years on average to move from concept to first disbursement (Figure A2). These timeframes are unacceptable in a global crisis, and MDBs have pushed for streamlined procedures. While shareholders recognise this need, some non-borrowers have been reluctant to give MDB management a totally free hand. 'We understand that the MDBs need to move quick,' said one non-borrower official. 'But at the same time there needs to be a minimum of social, environmental and financial standards.'

The result is that shareholders have agreed to allow MDBs a high degree of freedom to approve and disburse loans during the first phase of the crisis dealing with the health emergency, with relatively little oversight. Most loans are approved on a no-objection basis without board review, although shareholders in most cases still can request a board review if they have particular questions. The results have been dramatic, with for example the first batch of World Bank loans for the crisis moving to first disbursement in about one month over March–April 2020. As MDBs

Table A1 MDB budget support lending limits

	Normal limit	Crisis limit
ADB	20% approvals	Up to 50% approvals for 2020
AfDB	15% approvals	30% approvals; higher permitted on board approval
AIIB	Not permitted	Up to 50% of crisis package, but always as co-financier with ADB or World Bank
IDB	30% approvals	40% approvals
World Bank	No formal limit, but normally meant to remain below 25% approvals	No formal limit, but likely to be up to or exceeding the 50% level following the 2008/09 global financial crisis

Figure A2 Loan processing time to first disbursement (sovereign loans)



Notes: Data is not precisely comparable. IDB measurement starts with 'project profile', AfDB and World Bank begin with 'concept note,' and ADB begins with 'fact finding' and ends with 'first contract' (rather than 'first disbursement'). After 2015 ADB only reports times to board approval, not to first contract. ADB includes only investment loans; all others include investment and budget support loans together.
Source: World Bank (2018); ADB (2014–2016); AfDB (2013–2018b); IDB (2013–2018).

move more toward mitigating the socioeconomic impacts of the crisis, shareholders have requested a greater degree of oversight, but still accelerated compared to normal procedures. In most cases, accelerated procedures will come up for a review by shareholders within a year, at which point they will either be renewed, revised or terminated.

Several of the procedural innovations triggered by the Covid-19 crisis show promise and might be considered on a permanent basis. Some MDBs have begun experimenting with templates for loans in particular sectors, which can be adapted to specific contexts and greatly reduce staff preparation times. IDB has begun using what it calls 'prototypes' in health and even some types of budget support, bringing down the time needed for board approval to weeks instead of months. Delegating more authority to management to approve certain types of loans and/or increasing 'absence of objection' procedures has increased during the crisis. The huge reduction in MDB staff travel and rise in virtual meetings occasioned by the Covid-19 crisis may be an opportunity to rethink the standard business procedures. This reduces MDB administrative costs, climate footprint and reduces the time commitment of government officials to meet with MDB teams on mission. The virtual meetings of MDB boards have also worked smoothly, which calls into question whether resident boards are actually necessary (AIIB, CAF, EIB and NDB all operate without resident boards).

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