World Bank's rating obsession will negate debt justice

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August 2020

The international financial system's reliance upon credit ratings – usually based on dubious premises – needs urgent rethinking. The Covid-19 pandemic is just one of the catastrophes leaving many low-income countries – and soon middle-income countries – unable to service foreign debts. Yet, the World Bank and IMF continue squeezing poor countries on behalf of commercial lenders, failing to provide the debt cancellations desperately needed.

The economic crisis is worsening. In sub-Saharan Africa, publicly-owed or -guaranteed foreign debt rose to nearly $500 billion by the end of 2018 (the last reliable point of comparative data), with the median at 56 per cent of GDP, a dangerous increase from 38 per cent a decade earlier. At least another $150 billion in foreign debt borrowed by corporations active in Africa must also be repaid from central banks' fast-dwindling foreign currency reserves. These figures soared in 2019, given the difficulty of repaying a barrage of Chinese loans.

The IMF, World Bank and other international financiers' role in the overlapping catastrophes of Covid-19, worsening ecological conditions, and excessive vulnerability to external shocks cannot be overstated given their neoliberal policy advice and pressure on state budgets, now making headlines for its devastating impacts on healthcare budgets (see *Observer* Summer 2020).

In April, the G20 announced a debt service suspension initiative (DSSI), enabling up to 77 developing countries to request a postponement of their debt payments until the end of 2020. The initiative has been widely criticised, including by Brussels-based European network Eurodad, as insufficient for merely suspending rather than canceling the debts. As the *Financial Times* (FT) reported in July, even this inadequate offer has fallen short, with only $5.3 billion in official bilateral debt repayments suspended this year. As the FT noted, "That is much less than the $11.5bn or more hoped for from official creditors…no countries have asked private creditors for similar treatment." The weak uptake can be explained by the exorbitant and totally undemocratic power of international credit ratings agencies (CRAs). According to a July FT article, CRA Moody's "took action against [meaning downgraded] Ethiopia, Pakistan, Cameroon, Senegal and the Ivory Coast" after they applied for the DSSI.

Meanwhile, both the Bank and IMF are following the 2009 crisis band aid script: A major fiscal boost to local and global economic demand (which also bails out influential banks and corporations), along with acknowledgement that monetary loosening may also be temporarily allowed.

Still, what's holding the World Bank back from properly addressing many countries' crises is its dogmatic refusal to cancel debt. This demand has been echoed by many, including 2019 Nobel Peace Prize laureate Abiy Ahmed, Ethiopia's prime minister, who wrote in the *New York Times,* "In 2019, 64 countries…spent more on servicing external debt than on health. Ethiopia spends twice as much on paying off external debt as on health…The dilemma Ethiopia faces is stark: Do we continue to pay toward debt or redirect resources to save lives and livelihoods?"

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While World Bank President David Malpass in July called on G20 finance ministers to extend the DSSI to 2021 and urged, "the G20 to open the door to consultations about the debt overhang itself," the Bank refuses to follow its own advice. This despite the fact that, according to a July report by civil society organisation (CSO) ONE, "as of mid-July 2020, the World Bank had received $1.7bn in debt repayments from DSSI countries, but committed only $1.9 billion in new funding for the response. Of this only $250 million was disbursed by the end of May."

The rating game

The Bank and IMF expect donor funds to flow into poor countries to assure their loans are repaid (usually they are atop any country's debt servicing list), instead of assisting in building state capacity to respond to the crisis. To make matters worse, the Bank refuses debt cancellation – preferring mere deferment of payments – to protect its AAA credit rating. In an April statement, Malpass argued that it is imperative that the Bank maintains its rating, so that it can continue to 'support' governments with additional loans.

This is dubious logic but retains a certain validity in establishment thought, because CRA Moody's offered three rationales for the Bank's AAA rating just before Covid-19 hit in January:

• High capital adequacy, underpinned by a robust risk management framework that contributes to very strong asset performance;

• Ample liquidity buffers and exceptional access to global funding markets;

• A large cushion of callable capital and very high willingness and ability of global shareholders to provide support.

The main factor pulling the Bank down at that point was its borrowers: the "Ba2" average credit rating of "largely developing middle-income sovereigns." But, noted Moody's, the Bank ensures "strong capital adequacy and limited concentration risk," resulting in "only 0.2% of total outstanding development assets qualifying as non-performing over the past three fiscal years." The Bank's 'robust risk management system', while great for its credit ratings, seems at odds with its development mandate, as it remains focused on financial risks to the detriment of financially riskier but developmentally beneficial investments.

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While Moody's identified some threats to the Bank's rating in January, it wasn't worried, in part due to "increased future inflows of shareholder paid-in capital from the Bank's 2018 general capital increase." Moreover, the Bank's callable capital is a very comfortable 1.14 times the amount of the Bank's total outstanding debt. The Bank has no problem accessing fresh debt financing, with $54 billion in medium- and long-term securities issued in 2019. The Bank can borrow at the world's cheapest rates.

While Standard & Poor's rates the World Bank AAA/A-1+, it gives only four of the world's 200 largest commercial banks a AAA rating. More than a quarter of the rest now face a downgrade.

In any case, given their exceptionally dubious track records in places like South Africa, or their failed analysis of Lehman Brothers and AIG just before both collapsed in 2008, should these ratings agencies be trusted? Consider Moody's assessment of the International Bank for Reconstruction and Development (IBRD), the Bank's middle-income lending arm, in early 2020:

> "Although IBRD's borrowers are exposed to the negative impact of climate trends, the geographically diverse structure of the institution's development portfolio offsets this risk…. Moody's does not expect social risks… to impact its financial strength. Governance considerations are material. IBRD adheres to robust and conservative risk management practices, which Moody's believes limits the risks associated with its development lending to sovereigns in emerging and frontier markets."

In reality, climate chaos is such an extraordinary global-scale phenomenon that talk of a geographically-diverse 'offset' becomes laughable even in the medium-term. To deal with the crisis properly, the Bank – and all other financial institutions – will have to acknowledge vast 'stranded assets' of fossil investments that cannot be used. This includes, in South Africa, Eskom's coal-fired power capacity, which the Bank has been financing without regard to climate damage since 1951 (see *Observer* Spring 2019).

Moody's blasé view of the Bank's 'social risk' also ignores the ongoing wave of global protests. Coinciding with Moody's statement in January, the corporate consultancy Verisk Maplecroft pronounced, "The dramatic surge in protests in 2019 has swept up a quarter of countries in its tide and sent unprepared governments across all continents reeling." Even the IMF's April 2020 *Fiscal Monitor* recognised global protests, whose "similarities reflect deep-rooted issues, such as poverty, inequality, erosion of trust in established institutions, and perceived lack of representation." Predictably, however, the IMF lectured against state spending to resolve grievances.

As for 'governance,' the Bank's financing of both dictatorships and corruption permeates its portfolio. This dates, in

South Africa alone, to apartheid credits from 1951-67, and more recently includes bribery-riddled Eskom, and also the London mining house Lonmin just before the massacre of 34 of its platinum mineworkers in 2012 (see *Update* 82).

A good government would default on these obligations, and indeed a generally coordinated default on Bank and IMF loans is long overdue, after first being proposed by Tanzanian president Julius Nyerere and Cuban leader Fidel Castro in 1983.

Bank faces a "decline in asset quality" (including reputational)

Moody's January assessment of the Bank included a caveat regarding a scenario that emerged out of the blue just days later: "Downward pressure on the rating could occur in the event of substantial deterioration in capital adequacy, which could result from a rapid expansion in leverage combined with a decline in asset quality resulting from sovereign credit stress among its largest borrowing countries."

The IMF now has an additional 70 new Covid-19 loan programmes and a $1 trillion war chest, while the Bank has also used the crisis to ramp up lending, even though the AIDS epidemic demonstrated – two decades ago – that at least in poor African countries, new loans to deal with a public health crisis were inappropriate; instead, grants were needed.

There is no real hope of recovery, Carmen Reinhart, the Bank's new chief economist admitted, because the Bank's model of export-led growth cannot work: "I think COVID-19 is the nail in the coffin of globalization… [and] a legacy of this is going to be a more inward-oriented strategy in many parts of the globe." Certainly, as noted by African political economist Samir Amin, a version of delinking that would allow for more economic balance and less reliance upon global trade and foreign direct investment is required.

IMF Special Drawing Rights bait-and-switch

The demand for African debt cancellation was initially endorsed even by a confirmed neoliberal, African Union (AU) chairperson Cyril Ramaphosa, South Africa's president. In June, he backtracked, suggesting the AU agenda was simply, "a two-year debt standstill and a plan for the restructuring of both private and bilateral debt." His finance minister, Tito Mboweni, was part of the G20's 15 April agreement to establish the DSSI.

The IMF and Bank were even stingier. New IMF loans were available through the emergency Rapid Financing Instrument (RFI) and the low-interest Rapid Credit Facility. A modicum of debt relief is available in the Catastrophe Containment and Relief Trust (funded directly by rich countries). The World Bank offered only $14 billion in emergency financing, although it suggests $160 billion will be made available for new loans in the next 15 months. The Bank and Fund should cancel debts, thus allowing aid resources to go directly to desperate countries to restore their citizens' ability to survive.

This appears to be a bait-and-switch strategy, drawing poor countries deeper into world financial circuits, which ultimately do them harm. While several progressives agree that poor countries would benefit from a new round of SDR issuance, Indian political economist Prabhat Patnaik offers more nuanced observations:

> "SDRs alone would not help much unless … two additional measures [are taken]: one, a moratorium on all external debt payments for at least a year; and two, capital controls imposed by these countries to stem the outflow of finance. If these two additional measures are imposed, then the *entire* additional foreign exchange coming their way through

Photo: Vernaccia

LX Factory, Lisbon, Portugal.

> SDRs can be used to pay for additional necessary imports."

South Africans run to the IMF, tripping *en route*

The argument in favour of South Africa's $4.3 billion IMF loan agreed at the end of July fails to consider the medium- to long-term term implications, given the unfolding economic, social and ecological crises.

South Africa faces a foreign debt crisis in the coming years, and like Argentine activists demanding a debt audit, South Africans wonder whether all that foreign debt is legitimate. How many parastatals borrowed from the World Bank and other institutions whose credits were demonstrably corrupt? The Bank's $3.75 billion loan for the Medupi coal-fired power plant, or the Chinese Development Bank's $1.5 billion loan to purchase Chinese locomotives riddled with bribery, are only the most extreme examples. A debt audit should therefore be mandatory, prior to any further servicing of foreign debt.

The IMF RFI won't go far to repay South Africa's debt. While RFIs are not formally attached to conventional policy conditionality, the Treasury would be "required to co-operate with the IMF to make efforts to solve... balance of payments difficulties," which would likely entail more export-oriented policies.

Moreover, an IMF loan won't be cheap, even at the 1.1 per cent interest rate advertised, given the local currency's decline. Due to the phasing out of many exchange controls, the country has experienced surges in both financial inflows and outflows, while the profits, dividends and interest payments to non-resident bond and equity holders create massive pressures on the current account. This situation locks South Africa into paying unusually high interest rates to attract financial inflows. Repaying more dollar-denominated debt creates greater dependence on this financial investment as well as fast-shrinking exports, to raise the forex to service that debt. These structural problems make it difficult to break from the country's export-orientated path and dependence on financial inflows.

At the same time, the deep socio-economic crisis, coupled with the need to urgently transition to a wage-led, low carbon economy, will require a massive redistribution of wealth including a wealth tax and higher corporate taxes, the mobilisation of domestic resources at regulated interest rates, prescribed assets and use of the Reserve Bank to print money. Yet, the Treasury regularly opposes such policies, in-line with the views of the CRAs, IMF and World Bank. This rung true again in mid-April, after Moody's fired off a memo advocating Mboweni consolidate the fiscal deficit, which would be rewarded with a 'stable' instead of 'negative' rating. Treasury happily followed suit. As it did following the IMF's January 2020 surveillance report, which, "encouraged the authorities to implement strong fiscal consolidation and state-owned enterprise (SOE) reforms… accompanied by decisive structural reform measures to boost private-sector led, inclusive growth."

Once again, in mid-July, a leading Treasury bureaucrat confirmed that the new IMF letter of intent is, "based on the commitments to fiscal consolidation." The official bragged of IMF-approved "expenditure cuts of $13.7 billion over the next two years [and] a commitment to freeze public-sector wages for 2020-21."

Other Emerging Markets are going through similar hell, as IMF rhetoric about fiscal expansion to fight the Covid-19 crisis is over-ruled by CRAs intent on downgrading their bonds.

Euromoney magazine's sovereign risk rating service is illustrative, reporting in early July,

> "79 countries have seen their total risk scores downgraded since Q1… many sovereign borrowers across sub-Saharan Africa with commodity exposures, tightened access to finance, domestic political problems and a rising tide of foreign debt [are high risk]."

The international financial conditions are worse than any in living memory, and hark back to a 2013 statement to the United Nations by the G77+China, which identified CRAs as a core component of the debt sustainability problem.

While the IMF's posturing about addressing indebted countries' plight may seem to be more generous, their work remains hand-in-glove with CRAs and neoliberals within the home country. Though fiscal expansion is desperately needed to prevent the global economy from crashing, the contradictions between IMF research and public relations spin on the one hand, and policy recommendations and loan conditionality on the other, remain as vicious as ever.

August 2020

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The Bretton Woods Project is an ActionAid-hosted project, UK registered charity no. 2774467, England and Wales charity no. 274467, Scottish charity no. SC045476. This publication is supported by a network of UK NGOs, the C.S. Mott Foundation, the William and Flora Hewlett Foundation and the Rockefeller Brothers Fund.

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