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Criticism of Multilateral Development Banks' Operating Reflections During Covid-19 Pandemic

- From the Perspective of the Sovereign Debt

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Abstract: The problem of sovereign debt crises has a long history at the international level, especially in the face of global crises such as the global financial crisis of '08 and the recent COVID-19 pandemic. In the face of the negative social impacts of these emergencies, the state apparatus of each country needs help with relying on domestic channels such as tax revenues and investment returns to maintain efficient operations. It would, therefore, finance other countries in non-domestic currencies, and such a solution would exacerbate countries' sovereign debt crises. Countries have done well in restructuring their sovereign debt in response to sovereign debt crises, especially in Europe and Africa. The International Development Association provided some debt relief to those countries with fragile economies, but the crisis is still present today. In order to expand sustainable financing and maintain economic stability, new multilateral development banks have been established in some regions. These MDBs have been restructuring since the Great Depression, and their lending policies have indeed eased countries' sovereign debt crises to some extent. However, their financing rules have also influenced other countries' policies, making them widely criticised internationally. In the context of COVID-19, both the strengths and weaknesses of MDBs are exposed, so they still have a long way to go before they can become international institutions that can pay attention to disadvantaged countries and help them develop.

Keywords: Sovereign debt crisis, Multilateral development banks, Covid-19

1. Introduction

Three years have passed since the outbreak of the Covid-19 pandemic. In these three years, countries worldwide have faced unprecedented challenges to their entire social functioning systems, including healthcare systems, infrastructure, economic foundations, political governance and more. The most far-reaching of these is the impact at the economic level. Countries worldwide have entered a state of emergency in response to the crisis, with significant resources poured into public health and infrastructure development. However, because of the restrictions on trade, reduced market demand and lower capital flows in a state of crisis, the economies of all countries are in jeopardy. As it is difficult for countries, especially developing countries, to raise sufficient funds

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through domestic sources such as taxes and investment rewards to respond to sudden natural disasters and diseases or to set development policies such as protecting the environment, adjusting climate changes, upgrading infrastructure, promoting employment, financing from external sources becomes an effective way to bridge the funding gap. Sovereign debt, managed by the government of a country/state/non-national entity in a currency other than its own, is incurred by other countries for financing in the public interest.[1] There are many ways of acquiring external debt, either through official channels, such as multilateral/bilateral, or commercial channels, such as syndicated loans and sovereign bonds.[2] Developed countries can seek financing from commercial sources, but these are often closed to developing and low-income countries, which make up the vast majority. In this context, the more developing country-friendly access to finance provided by Multilateral Development Banks (MDBs) plays a significant role. This paper will look at the crisis response of MDBs during the pandemic from the perspective of sovereign debt.

The rest of the paper will be organized as follows: Section 2 will illustrate why the MDB system is meaning full. Section 3 will criticise the way MDB operates during crises and the drawbacks they have especially during Covid-19. And finally, conclude the authors' opinion toward the MDB system in the last part.

2. The importance of crisis response of MDB system

The MDB system is essential to deal with any sudden or protracted crisis. When MDBs first established, they primarily aimed to help industrial countries with their development problems. As these countries grew more robust than before, they could lend through a wide range of commercial channels with good assets, which were often more flexible and convenient in terms of procedures, less restrictive and freer in terms of conditions, and therefore more popular.[2] However, commercial sectors are too difficult to access for low-income countries because of the high risk coming alongside their poor economic condition. These countries can only use official channels such as the MDBs for financial assistance.[2] Against this backdrop, the target audience for MDB assistance is gradually changing to emerging economies. It is clear that as social attitudes evolve and the focus of global economic development changes, so does the role of MDBs in the international economy and their tasks. For example, the majority of MDBs now focus on financing projects such as gender equality, sustainable development, carbon emissions, climate extremes and energy shortages, reflecting the shift in the function of MDBs to promote peace, equality and development, with a greater focus on developing countries that are more adversely affected by emergencies. The IMF and the WBG are the most typical examples, providing more favourable financing than bilateral aid and commercial channels, such as loans at low-interest rates or even grants. The IMF's central objective is to regulate economic dislocations by providing loans to these developing and low-income countries to enhance their national credibility and resolve capital project crises.[2] Since 2019, global healthcare systems have been severely impacted by the pandemic, with people in developing and low-income countries suffering from weak healthcare systems and vaccine shortages, in addition to fragile financial systems due to restrictions on the movement of people's goods under national sequestration measures, and recessions in emerging economies whose economies are primarily dependent on non-high-end industries such as exports and tourism. In this context, the MDB's expanded lending in response to the crisis provided a respite for many developing and low-income countries.

Besides, the different agencies in the MDB system have similar but different functions during the Covid-19 pandemic, and all play a pivotal role. Due to their various aims, different MDBs have different priorities for crisis management and approaches to crisis management and post-pandemic recovery during a pandemic. The World Bank Group (WBG), for example, focuses its attention and funding on the vast breadth and depth of the resources it can mobilise, drawing on how it handled

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past crises caused by disease, taking the maximum convention of the needs of countries worldwide and focusing on the most widespread and urgent needs at different stages. As part of the WBG, International Development Association (IDA) funds the poorest countries during Covid-19 by providing substantial grants, low-interest loans and debt relief. In the 4th Quarter of Fiscal Year 2020, IDA committed and restructured US$17 billion, with Development Policy Financing accounting for 66% and Investment Project Financing for 28%.[3] Although its lending is less than during the 2008 financial crisis, this large volume of low-interest loans and grants has gone a long way towards addressing the immediate needs of low-income countries.

The AIIB differs from the WBG in that while it has funding programmes for low-income countries, it focuses more on the needs of its Member States - most of which are developing countries. It established a CRF after 2019 when the Covid-19 crisis suddenly outbreak. AIIB established Crisis Recovery Funding (CRF) explicitly to mitigate Covid-19's financial, economic and public health impacts on its members and clients and provide financial support to recover from the crisis.[4] The programme, which has provided a total of US$13 billion in financing since its inception until February 2022, has been inflated again to US$20 billion and extended until the end of 2023, with a total of 57 approved financing projects related to post-pandemic recovery, representing 27% of all financing projects since the establishment of the AIIB and the most significant investment.[5] The most significant project financed by the CRF is Economic Resilience/PBF, with 24 financing applications approved, representing about 42% of the total financing of the CRF; Finance/Liquidity, with 15, or about 26%; and Public Health, with 18, or about 32%. These data show that the AIIB places the most significant emphasis on financing projects with long-term impacts, such as strengthening national infrastructure after the epidemic, promoting employment and addressing climate issues. In addition, the AIIB's Special Fund Window for Less Developed Member (SFW) also awarded several Special Funds Grants to AIIB members that are also classified by the World Bank as International Development Association-only countries, with a total of approximately US$39.7 million in financing,[6] which is not the most significant part of the AIIB's operations. In addition, unlike IDA, which focuses more on Policy Financing, SFG is all project lending rather than policy-backed lending.

In short, while both agencies mentioned above aim to mitigate and help recover from the crisis, the AIIB's services cover all Bank members who meet the eligibility criteria. In contrast, the IDA's services targeted on world's poorest countries. AIIB's services focus mainly on economic recovery and public health infrastructure projects, while IDA's assistance is more comprehensive than the AIIB's. It covers all three phases of the pandemic, namely the “relief stage” for emergency economic and social support, the “restructuring stage” for health systems, and the “resilience recovery stage” for sustainable development.[3] Its projects also cover all four thematic pillars of WBG crisis response: saving lives; protecting the poor; ensuring sustainable business growth; and rebuilding better.[7] AIIB is more project-based financing, which tends to set more stringent criteria to reduce risk and ensure a return on investment, with a detailed analysis of economic and technical financial viability before financing. Conversely, IDA is more policy-based financing, with relaxed economic and technical hardware conditions and lower thresholds suitable for low-income countries. However, this type of financing often comes with a political 'conditionality' for the recipient country and can largely influence its policies, bringing it lots of criticism. In addition, various organisations such as AfDB, ADB and IBRD exist. Besides the aforementioned "project finance", "development policy finance", and "grants and technical assistance", they also have “guarantees”, which focus on the private sector. As can be seen, the different agencies have different focuses, each meeting the primary needs of their member states so that the response to the pandemic is best suited to the needs of their members and reaches a wide range of countries worldwide.

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3. Criticism of crisis response to MDBs

MDBs play a significant role in crisis resolution, but criticisms also exist because they operate under the control of capital and political power. Firstly, the majority shareholders influence MDBs' policy-making. The MDB system was born out of the Bretton Woods system, of which the WBG and IMF are essential components of the BWI. They are rooted in the soil of colonialism and the power of decision rests in the hands of a few developed industrial countries. Other MDBs born in the same era include AfDB, ADB and others, and the new banks that have emerged since then have largely inherited the forms of the past. Their common feature is that the major shareholders have a significant say in their business. MDBs usually take the form of a weighted vote based on shareholdings, usually determined by economic strength or capital subscriptions, to determine their policy. In most cases, the majority shareholders, a small number of economically powerful countries, have a significant say in their operations due to their solid economic strength. According to the latest IDA voting rights report, the seven countries holding the most significant shares in the IDA are the United States, Japan, the United Kingdom, Germany, Saudi Arabia, France and China, with these largest shareholders holding almost 40% of the voting rights, which means that these seven countries alone have 2/5 of the voting rights. At the same time, the remaining 182 member states enjoyed the rest 3/5 of the voting rights.[8] However, during this period, the IDA's main business was to support the world's poorest countries' fighting against the Covid-19 crisis, helping them recover from the pandemic and pursue sustainable development. [3] It was the 182 countries taking the most advantage from those financing, but they had no voice in their profits. In a word, the fact that a few countries not directly related to IDA's operations are taking control of IDA's policy-making shows the management asymmetry. Developed countries, which are in control of the decisions, cannot empathise with the needs of developing countries. Financing projects that meet their interests only sometimes meet the needs of developing countries. These factors make it impossible to maximise the effectiveness of MDBs financing.

Secondly, MDBs can impact member states' policies and are suspicious of interfering with the sovereignty of other countries. For example, when MDBs provide sovereign loans to recipient countries, they will impose specific "conditionality" on the recipient countries. WBG provided a large amount of financing during Covid-19. Development policy financing, which accounts for the most significant proportion, is a kind of policy-backed lending. Policy-backed lending is a loan with policy conditions. In order to obtain financing, the recipient country will adjust its policies to match the financing terms. However, these policy conditions are only sometimes conducive to economic recovery and are only sometimes appropriate for some recipient countries. For example, the IMF adopted fiscal austerity measures for countries that did not have strong alliances with the U.S. - one of the most widely criticised forms of conditionality. This "conditionality" was so widely criticised that Oxfam International called for the PRSP Review, which calls for simplifying and limiting conditionality, to propose the abolition of fiscal austerity and other structural adjustment-type conditions such as trade liberalisation and deregulation.[9] Another example is the technical support provided by MDBs to recipient countries. Once MDB approves these assistances, Applicants can receive technical support from the donor. By providing technical assistance, MDBs can influence infrastructure development and the development and implementation of economic policies in the recipient country. Technical assistance is also a straightforward way of intervening in the policy-making of the recipient countries. Moreover, MDBs each have a set of institutional guidelines, which usually adopt international standards and best practices. The 2016 AIIB, for example, follows the blueprint of the original MDB agreement's mandate, structure and governance.[10] This set of institutional rules, which applies to all member countries, is adopted by individual member countries and, with such mutual influence, leads to worldwide policy convergence. Although policy convergence facilitates international cooperation, different countries' economic and social situations differ. Since the "one size fits all" policy does not exist, some countries that do not apply these policies might suffer. Finally, policy-making is a matter of national sovereignty. The inviolability of a state's sovereignty is a fundamental principle of international law. It is not always appropriate for MDBs to interfere directly or indirectly with exercising other states' sovereignty through donor behaviour. At the same time, their interventions may not align with these countries' primary needs and should therefore be appropriately limited.

Furthermore, sovereign debt itself is a double-edged sword. Governments' appropriate acceptance of external debt can promote social stability and economic development and enhance the government's credibility. Conversely, if a government becomes so indebted that it goes bankrupt, it can damage the credibility of the government and discourage future borrowing. As the world is an interconnected whole, the insolvency of one government can often affect the economy of an entire region and, if not controlled in time, create a high risk of global economic disruption. Many sovereign debt crises begin with government insolvency. Overburdening governments with debt can lead to an inability to pay for public goods such as healthcare and education facilities, leading to social instability and threatening global economic recovery. Sovereign debt crises are not uncommon in history as the sovereign indebtedness of some governments increases whenever the world faces economic crises, wars, or natural disasters. Examples include the Russian government's bankruptcy in 1998, the Argentine government's bankruptcy in 2002 and the European debt crisis that began with the Greek sovereign debt crisis in 2009. Then there is the extensive government borrowing in response to and recovery from the pandemic depression following the 2019 outbreak detailed earlier. AIIB, which set up a CRF specifically in response to the crisis, has provided $13 billion in investments;[5] IDA, as part of the WBG, has provided $82 billion in financing for countries around the world in response to the pandemic.[3] The increase in financing is a side-effect of the increase in lending by countries. Typically, a country's debt burden must match its future repayment capacity to play a role in better economic stability and development to be considered sustainable debt. According to the World Bank report, the total government debt growth rate as a share of gross domestic product in 2020 is approximately five times the average of the last ten years.[11]

In the case of Africa, for example, where low-income countries concentrate, they have a very fragile economic ecology. All along, in the event of emergencies such as climate change, environmental damage, disease epidemics, financial crises, etc., these countries have been experiencing a contraction in demand from Western countries, their most important export markets,[12][13] resulting in lower economic gains from foreign trade. The current pandemic is no exception to this rule, as not only has market demand fallen, but the various lock-down measures taken by countries to curb the spread of the virus have directly restricted exports. However, this has not led to a reduction in domestic spending but has increased expenditure in response to the crisis, such as an increase in domestic spending on healthcare facilities during the pandemic and an increase in investment in electronic applications to track population movements. An economic downturn has accompanied the increase in debt. Emerging economies such as China and India, whose GDP did not fall during the 08 global financial crisis, saw their economies decline for the first time in 60 years,[14] while their external debt increased during the pandemic. Not to mention the African region. The latest IMF Debt Sustainability Analyses for these countries show that nine counties are already in debt distress, and 60 are at risk of a debt crisis, among which 88.3% have a medium to high risk of debt distress.[15] Many low-income countries already have unsustainable debt burdens that are difficult to repay.

MDBs have tried hard to address the sovereign debt crisis caused by heavy government borrowing, but it has yet to be effective. On the one hand, there are doubts about the effectiveness

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of the measures taken in response to the sovereign debt crisis. The most typical measures taken to reduce the government's debt burden are the reduction of interest rates on loans, the provision of grants and debt restructuring. The former are preventive measures taken before the onset of a sovereign debt crisis. Some scholars have clarified the importance of providing these low-income countries with low-interest loans and grants.[12][16] However, concessional lending has declined in recent years,[17] and none of the MDBs functioned well during the pandemic, with all but AIIBs lending less than they did during the 2008 financial crisis.[14] Moreover, AIIB was established in 2016, a time after the global financial crisis, and therefore does not allow for a comparison. The latter mostly occur after a sovereign debt crisis has occurred. In most cases, when governments cannot repay their sovereign debt, MDBs are left to negotiate a modification to the loan term or restructure the loan to a more favourable interest rate for the lending country.[1] In cases where governments cannot repay their loans, while the final negotiated restructuring of claims often favours the government, the reduced credibility of the government can create difficulties for its future access to development finance through borrowing. In other words, these countries are still vulnerable in the international economy and end up paying for MDB's poor business decisions. On the other hand, there needs to be an effective accountability mechanism for MDBs when their operations go awry. Their counter-cyclical role makes them behave oppositely to other commercial financial institutions when global capital is not working well. They do not reduce financing but expand it, increasing MDBs' risk exposure.[18] At the same time, MDBs have their own operating regulations but no uniform code to govern their financial behaviour. As a result, there was no way to punish them for inappropriate financing when the risk turned into an actual crisis that plunged global equity and bond markets into chaos. The end result of these weak responses and weak accountability systems is that sovereign debt is a frequent occurrence and when it does occur, it is difficult to contain the damage.

Finally, there is also a threat to the credit rating of MDBs themselves by the large number of loans they provide in times of crisis. The higher the credit rating, the better the financial terms that MDBs can offer their clients, and therefore the credit rating of MDBs is essential for their overall operation.[17] However, during the Covid-19 pandemic, on the one hand, MDBs lent heavily to aid developing countries, leading to a significant reduction in their idle loans; on the other hand, MDBs invested in developing countries with poor economic prospects and therefore risked having difficulties in repaying the loans they granted.[19] Rating agencies have also warned MDBs that, for example, continued delays in debt payments by the poorest countries could threaten their status as senior creditors and lead to downgrades.[19][20] Although, historically, there have been few instances of sovereign loans not being repaid and losses have been minimal, following the bankruptcies of the Russian and Argentine governments in 1998 and 2002, the new regimes have often refused to repay the loans of the old governments[1] and, even when they have, the restructured claims have not been on as favourable terms for MDBs as in the past. In such cases, it is vital to guarantee priority creditor treatment (PCT) for MDBs. While guaranteeing PCT treatment may incentivise them to reduce their idle loans even more, it is only by guaranteeing priority creditor treatment for MDBs that the credit rating of MDBs can be better secured, thus ensuring that MDBs can continue to receive investment and remain in good standing.[19] It could be argued that providing substantial ongoing support to the poorest countries and maintaining the credit rating of MDBs is a contradiction, especially in terms of COVID-19. However, the macro economy of the international community as a whole is a combination of different regions that are closely interrelated, and maintaining the critical role that MDBs play during a crisis in supporting countries with weak economies, ensuring that the recipient countries weather the crisis smoothly, maintaining the stability of fragile economies and creating good prospects for economic development, is the only way to guarantee the status and credit rating of MDBs as priority creditors, and thus ensure their role in maintaining This is the only way to ensure that MDBs' senior creditor status and credit rating can be guaranteed, and thus ensure its role in maintaining stable and healthy macroeconomic development.

4. Conclusion

The MDB system has played an important role since its inception, but it has also been subject to many criticisms. The early MDBs have a history of colonialism and have been unable to escape the soil of capitalism and colonialism, with the countries that first developed with the system always holding the power of decision. It is clear from how they operated that they were controlled by a small number of economically powerful countries. The new banks that have been established since then have primarily inherited the operating model of the earliest banks and are, therefore, resistant to these harmful factors. At the same time, however, these banks were in the business of serving the well-being of humanity, focusing on the underprivileged and developing countries, and providing financial assistance and technical support to help these countries overcome their difficulties and develop better. Credit rating is, in the author's view, a promising watchdog. Nevertheless, the current Credit Rating Agency is more of an agency that monitors the financing behaviour of MDBs than it is an agency that provides guidelines for capital investment. This is a common problem with international economic institutions at present, where there is more oversight than effective enforcement. The Covid-19 pandemic has brought out both the strengths and weaknesses of MDBs. Hopefully, in the future, the MDBs will continue to play their role of stabilising and regulating the macro economy, creating a more suitable environment for economic development while also paying more attention to the implementation of the recommendations of the supervisory bodies and the accountability system after wrong decisions. In this way, the original purpose of the MDBs can be better realised, and their power can be truly brought into play.

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