REPUBLIC OF CYPRUS
MINISTRY OF FINANCE

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Ms. Yuefen Li
Independent Expert on debt and human rights
UNO Geneva

Dear Ms. Yuefen Li,

Call for contributions: Debt relief, debt crisis prevention and human rights: the role of the credit rating agencies

Kindly let us, first of all, acknowledge your restless efforts to deal diligently with the impact of public debt on human rights, including the role of the Credit Rating Agencies (CRAs) especially in the current Covid-19 landscape and the socio-economic challenges that it entails.

Further to your call for contributions regarding the above subject with a view to preparing a thematic report for the 46th session of the Human Rights Council, the Ministry of Finance of the Republic of Cyprus wishes to share with you the following views and reflections.

The covid-19 has indeed afflicted humanity suddenly with very severe consequences and an adverse impact on societies and the world economy. It has dislocated supply chains and negatively affected aggregate supply and demand in an acute manner exposing weaknesses in most economic sectors, but particularly in the health, and educational systems, and the labour market.

Despite signs of reversal of globalization following the 2008-2010 financial, economic and debt crises, the impact of globalization of the preceding decades has proven that it has brought with it not only positive externalities and gains, but also the collateral damage emanating from the flare-up of the epidemic and its quick eruption into a pandemic with deleterious and harmful effects across the globe.

During this unfortunate and ongoing process (until an effective vaccine is developed), the poorer and less-privileged sections of societies all over the planet are bound to suffer worse consequences in terms of increasing unemployment, lower incomes and rising inequality and poverty, unless effective and well-targeted measures are taken.

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Indeed, it is in this spirit that the Government of the Republic of Cyprus has approached the pandemic crisis. Compared to other countries, Cyprus has been tackling the crisis successfully so far, including the current level of preparedness for what seems to be a second wave of the pandemic. In particular, the Cyprus Government acted in a timely and efficient manner with the early introduction of a comprehensive framework of measures and actions to minimize the repercussions of the health crisis. The government intervened directly and in a coordinated manner, with an all-embracing and coherent support program of social, economic and financial management of the crisis that encompassed interventions supporting the employment of workers, adversely affected due to the initial lockdown and strengthening the liquidity of companies and the market in order to prevent unnecessary bankruptcies. Specifically, during this period, the incomes of employees and companies in almost the entire range of economic activity, including the vital health sector were directly supported with forward-looking horizontal interventions. A social protection net was created, covering workers, parents, as well as vulnerable and other specific groups of the population.

As a result of the active measures that raised government spending and the loss of revenues, the initially projected surplus in the overall and primary fiscal balance moved into negative territory, while the public debt, already on a healthy downward trend jumped above the 100% of GDP benchmark but still remained within sustainable levels.

It is precisely on this very point that the Ministry of Finance of the Republic of Cyprus shares your concerns about the role of CRAs during the current covid-19 crisis, given their track record prior to the initial 2008 financial crisis and the rebound in the extreme opposite direction following the ensuing economic and debt crises. So far, at least in the case of Cyprus, there was no downgrade other than a change from a positive to a stable rating outlook amid the ongoing covid-19 pandemic crisis. However, the Damoclean sword of a rating downgrade hangs over the rating of economies across the world in case the pandemic shock persists much longer than initially expected, with further adverse and sizeable impact on fiscal finances from a protracted recession, unless the CRAs demonstrate the required flexibility and diligence without, of course, compromising their independence of opinion. In this context, we would like to submit the following comments and suggestions:

i. Further regulation of CRAs is needed: for example, when they downgrade a Sovereign on the basis of negatively wrongful projections they subsequently hesitate and seriously delay a corresponding upgrade for offsetting their prior false rating decision. They do not even report or register their mistakes. In general, CRAs tend to adopt the worst-case scenario possibly in an effort to avoid the risk of producing more favourable credit ratings than what is proven to be justified ex-post.

ii. Enhanced regulation of a CRA's Prime Analysts is considered to be necessary: in particular, as a rule, CRAs maintain separate rating Departments (and Teams) for the ratings of Sovereigns and the ratings of the Banking system. However, in practice, as a matter of course, there is cooperation between these Departments, initially and inevitably by exchanging information among themselves. In this framework, which seems reasonable, there is always an inherent risk that the Head of one Department (Prime Analyst) acquires immense influence on the Prime Analyst of the other Department and consequently (through this process), he/she has an enormous power in influencing the decisions of both rating Committees. One way to overcome this risk (i.e. the risk of having the same person, effectively, formulating the rating decisions of the CRA for a long time for both the Sovereign and the Banking sector of a specific country), is to introduce a legal obligation on the CRAs to rotate the Prime Analysts on a regular basis and for a specified term, among different geographical regions (different groups of countries).

iii. More competition among CRAs is needed: a typical example is the case of the EU where there is a number of more than thirty local or international CRAs, EU registered or certified, but only the four (4) global CRAs are used formally within the Eurosystem. As a consequence, Eurozone Member States are technically obliged to appoint (i.e. to solicit) CRAs from the group of those 4 CRAs that are used by the ECB. Strengthening competition may lead to more objective rating decisions and, at the same time, rationalize solicitation fees charged on borrowing States.

iv. Moreover, an effective way of mitigating the effects of foreign debt and other related international financial obligations of States on the full enjoyment of all human rights, especially economic, social and cultural rights, would be to enlist the assistance of the Bretton Woods twin multilateral organizations, i.e. the World Bank/IBRD and the International Monetary Fund. These could follow the example of the European Union (EU) and the decisive measures taken by it in order to assist its Member States in the form of the Recovery and Resilience Fund, as the key recovery instrument at the heart of the Next Generation EU (NGEU) and the SURE Program / Instrument that provides financial resources in the form of loans to member states to help them combat the negative economic and social impact of the coronavirus on employment. Along these lines, AAA borrowing on the part of the above-mentioned International Institutions and on-lending could be made available to developing or low and middle-income countries, at fiscally-sustainable interest rates, not for the repayment of existing debt but rather for creating fiscal space in order to deal with the impact of the current crisis, in a way that would protect human rights, without imposing hard economic adjustment programs on the borrowers and without challenging the methodology of the CRAs.

In conclusion, it is acknowledged that the Covid-19 health crisis and its permeating repercussions have demonstrated the all-important role of national governments and state investment in public goods in order to diffuse the benefits of positive externalities: in fact, the pandemic has shown how important a physically healthy population is, in the interest of safeguarding a healthy economy. With policymakers having sailed into uncharted waters and areas, it is believed that governments will have to assume a more collectivist role in terms of strategic production, like the provision of health services, in addition to preventing vulnerable social groups from falling into inequality and poverty traps. However, this requires the existence of fiscal space and the relaxation of upper limits on public debt. At a supranational level, the outspoken advocacy and convincing public support and recommendations for handling issues like the public debt and the impact of the pandemic crisis on human rights, as well as the role of CRAs, can complement sovereign action and accelerate the return to normality for the benefit of mankind.

In this respect, looking forward, the pertinent thematic report under preparation very aptly touches upon these issues in the current circumstances and is bound to make a substantive contribution towards a more cooperative and understanding world.

(P. Tilliros)
for Permanent Secretary
Ministry of Finance