

A photograph of the International Monetary Fund (IMF) building. The building features a modern design with a large, curved, metallic overhang above the entrance. The facade is composed of light-colored, rectangular panels. The words "INTERNATIONAL MONETARY FUND" are inscribed in dark, capital letters on the wall. To the right of the text is a small, circular emblem. The entrance area is paved with large, light-colored tiles. A person is standing near the entrance. The sky is clear and blue.

INTERNATIONAL MONETARY FUND



CORRUPTION AND DEBT

THE CASE FOR LEVERAGING U.S. DIPLOMACY FOR GOVERNANCE REFORMS IN IMF LENDING

AUGUST 2024



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Debt ratios among low-income and developing economies are quickly reaching levels that haven't been seen since the 1990s. Today, more than half of low-income countries are in or at high risk of debt distress due in large part to failures in debt treatment programs since the early 2000s.¹ Coupled with an increase in borrowing and higher interest rates, the problem is spreading: some experts estimate at least 25 percent of middle-income countries are now considered to be at risk of debt distress.²

The United States has a unique role in addressing the growing crisis. The International Monetary Fund (IMF) and World Bank headquarters are in the U.S., and the U.S. representatives to these international financial institutions (IFIs) have significant voting power based on size of the nation's investment. The Administration recognized this diplomatic influence, citing in the 2021 Strategy on Countering Corruption that: "The United

States will also advocate for greater attention on anti-corruption efforts in IFI programing, including stronger focus on anti-corruption reforms and capacity-building..."³ Through its many foreign aid programs with a newly prioritized focus on localization, the U.S. is strengthening relationships with in-country civil society organizations ("CSOs") and other advocates around the world.⁴ True partnerships with civil society and a commitment to elevate accountable governance can help ensure that IFI lending programs will accrue to the benefit of the people and allow for the building of inclusive and sustainable economies.

This briefing paper provides background on the level of debt distress, links between governance and the success of previous IMF programs, and recommendations for U.S. engagement with the IMF and the countries seeking funding.

OVERVIEW

The IMF is leading a new round of negotiations with debt distressed countries to commence new IMF loan programs. This is happening in a precarious global environment—even before factoring in the impact of the COVID-19 pandemic and the daunting challenge of climate change, the debt load in countries across the Global South was heading toward levels beyond their ability to simply "grow themselves out of it."⁵ Debt levels have been rising for more than a decade—from 2011 through 2019, debt increased 18 percent of GDP in a sampling of 65 developing countries and 27 percent of GDP in sub-Saharan Africa.⁶

As the proportion of countries at risk of default continues to rise, debt is becoming more expensive to service. A study by the ONE Campaign, an organization that focuses on the economic and social challenges facing low-income nations in Africa, estimates that African nations will pay an additional \$56 billion over the next five years due to the impact of rising interest rates on the cost of servicing their debt.⁷ Governments may be forced to cut

social spending and divert revenue to pay down their balances. Critical sectors like healthcare, education, and infrastructure will be deprived of needed investment. The diversion of funds is causing a backslide in progress toward meeting the United Nations Sustainable Development Goals.⁸ According to the United Nations Conference on Trade and Development, "3.3 billion people live in countries that spend more on interest payments [to service debt] than on education or health."⁹

A myriad of factors contributed to the failure over the past two decades of restructured and new financing to build sustainable economies, but none more central nor widespread than corruption. The lack of any meaningful governance reforms and enforceable accountability measures in loan agreements dating back to 2000 gave license to the theft and misuse of financing. When aid money is diverted from its intended purpose, the loss of development opportunity is tragic. Loans compound that tragedy by adding billions in unsustainable debt for generations to come.

¹ Guillaume Chabert, Martin Cerisola, & Dalia Hakura, "Restructuring Debt of Poorer Nations Requires More Efficient Coordination," IMF, Apr. 7, 2022, available at <https://www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination-elgium, the Czech Republic, Denmark, England and Wales, Finland, France, Germany, Hong Kong, Ireland, Italy, Luxembourg, Netherlands, New Zealand, Norway, Poland, Portugal, Romania, Slovakia, Spain, Sweden, and the United Arab Emirates>.

² Ghazal Ahmed, "25 countries with the Highest Debt to GDP Ratios," Yahoo Finance, May 18, 2023, available at <https://finance.yahoo.com/news/25-countries-highest-debt-gdp-002918661.html>.

³ "United States Strategy on Countering Corruption," White House, Dec. 2021, available at <https://www.whitehouse.gov/wp-content/uploads/2021/12/United-States-Strategy-on-Countering-Corruption.pdf>.

⁴ "Localization," USAID, available at <https://www.usaid.gov/localization>.

⁵ Marcello Esteveão and Sebastian Essl, "When the debt crises hit, don't simply blame the pandemic," World Bank, June 28, 2022, available at <https://blogs.worldbank.org/voices/when-debt-crises-hit-dont-simply-blame-pandemic>.

⁶ Ibid.

⁷ Amy Dodd and Jorge Rivera, "The Collateral Damage of Rising Interest Rates," ONE Campaign, Sep. 18, 2023, available at <https://data.one.org/data-dives/data-dive-the-hidden-impacts-of-rising-interest-rates/>.

⁸ Elliott Harris and Chris Lane, "Debt as an Obstacle to the Sustainable Development Goals," United Nations, available at <https://www.un.org/pt/desa/debt-obstacle-sustainable-development-goals>.

⁹ "A World of Debt," United Nations Conference on Trade and Development, Jul. 2023, available at <https://unctad.org/publication/world-of-debt>.

In anticipation of a new wave of low- and moderate-income country financing agreements, the U.S. representative to the IMF should support, and recruit other investor nations to support, requirements to ensure that loan funds are used for their intended purposes such as projects that lead to inclusive economic progress.

A commitment to transparency and accountability is essential to preventing the misuse of funds. A proper framework might include open contracting standards, transparent budgeting processes, enhanced audits of state-owned enterprises (“SOEs”), asset declarations for public officials, and protections and resources for civil society to monitor progress, among others. As detailed below, data suggest these measures are linked to the likelihood of a loan program’s success in moving a country toward economic sustainability.

The IMF examines these issues in country-level Governance Diagnostics. These reports, prepared only when a country’s government volunteers to undergo the exercise, provide in-depth assessments of corruption risk and governance vulnerabilities across core state functions, and concrete, time-bound policy recommendations tailored to each country. Since 2018, 19 reports have been finalized, and of that number, 14 have been made publicly available. During the 2024 IMF and World Bank Spring Meetings, it was announced that 6 additional diagnostics are underway.¹⁰ While governance diagnostics are more infrequent, the IMF holds bilateral consultations between Fund staff and a member country typically each year. These “Article IV” consultations—

named after their inclusion in Article IV of the IMF Articles of Agreement—include discussions with both government representatives and civil society and serve as an “economic check-up” covering a wide array of topics from monetary policy to climate change. Financial Sector Assessment Programs (FSAPs), mandatory components of Article IV consultations for member countries with “systemically important financial sectors,” similarly focus on anti-money laundering and financial integrity issues.

In December 2023, the IMF published a review of their anti-money laundering and combatting the financing of terrorism (AML/CFT) strategy and pledged to “further deepen the integration of financial integrity issues in the Fund’s core functions through enhanced focus on AML/CFT issues that have macroeconomic impact,” including using conditionality when issues are found to be “critical to achieving program goals.”¹¹ Since adopting the strategy in 2018, the IMF has placed greater emphasis on fiscal integrity-related issues, incorporating 48 relevant conditions across 22 country programs, a three-fold increase from the period between 2014 and 2018. It’s worth noting this has occurred alongside an overall increase in conditionalities across all areas—financial-integrity related conditionalities are less than 6 percent of overall conditionalities in both the period analyzed before the adoption of the strategy, 2014–2018, and the following period, 2019–2023. While progress has been made, the Fund will need a sustained effort, in negotiations with borrowing governments and civil society, to develop frameworks for responsible and accountable spending.

HOW WE GOT HERE

In 1996, the IMF and World Bank launched the Heavily Indebted Poor Countries (“HIPC”) Initiative to provide debt relief to some of the world’s most impoverished countries. The HIPC and its supplemental Multilateral Debt Relief Initiative (“MDRI”) included several requirements designed for initiative participants to cut government spending and deregulate the private sector. To participate in the program, eligible countries had to meet certain criteria and commit to certain policy changes focused more on austerity and privatization than public sector improvements and integrity.¹²

With growing public momentum in the early 2000s to cancel debt—organized largely by the Jubilee 2000

movement with support from other non-governmental organizations (“NGOs”), activists, and celebrities—the HIPC was initially well received. However, the widespread support was short-lived.¹³ Longstanding critiques of the IFIs began to re-surface. In a 2011 interview with Nobel Laureate Joseph Stiglitz, the Global Policy Forum summarized his critique of the IMF and World Bank, writing:

...[imposing] a set of policies that promote “stabilization, liberalization, and privatization” of the economy, is damaging because of its emphasis on deregulation. Instead, policies should help countries develop “the right regulatory structure.” Ultimately,

¹⁰ “Capacity Development Talk: Governance Diagnostics for Performance and Accountability,” IMF, Apr. 19, 2024, available at <https://www.imfconnect.org/content/imf/en/annual-meetings/calendar/open/2024/04/19/183781.html>.

¹¹ 2023 Review of The Fund’s Anti-Money Laundering and Combating the Financing of Terrorism Strategy,” IMF, Dec. 5, 2023, available at <https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/12/05/2023-Review-of-The-Funds-Anti-Money-Laundering-and-Combating-The-Financing-of-Terrorism-542015>.

¹² *Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative*, IMF, 2023, available at <https://www.imf.org/en/About/Factsheets/Sheets/2023/Debt-relief-under-the-heavily-indebted-poor-countries-initiative-HIPC>.

¹³ “That Was the Year of Jubilee 2000,” U2, Dec. 27, 2000, available at https://www.u2.com/news/title/that_was_the_year_of_jubilee_2000_131/.

¹⁴ Lucy Komisar, “Interview with Joseph Stiglitz,” Progressive Magazine, Jun. 16, 2000, available at <https://progressive.org/magazine/interview-joseph-stiglitz/>.

there must be a greater adherence to democratic principles by the Bretton Woods Institutions.¹⁴

In other words, Stiglitz strongly critiques IFI conditionalities that reflexively assume the core problems in economically struggling countries involve the overregulation of the business sector. He argues that country outcomes would improve if the IFIs focused instead on the critical role of policies that promote open, transparent, participatory, and accountable governance in stabilizing economies and building shared prosperity.

In 1997, a year after the launch of the HIPC, the IMF released the guidance note “The Role of the IMF in Governance Issues,” defining the scope of involvement that the lender could take with a member country and approving guidelines for:

...a more proactive approach in advocating policies and the development of institutions and administrative systems that eliminate the opportunity for bribery, corruption, and fraudulent activity in the management of public resources.¹⁵

Pushing for good governance reforms was now within the IMF’s ambit, if the issues being addressed had significant macroeconomic implications. The policy even went so far as to state:

Financial assistance from the IMF in the context of completion of a review under a program or approval of a new IMF arrangement could be suspended or delayed on account of poor governance, if there is reason to believe it could have significant macroeconomic implications that threaten the

successful implementation of the program, or if it puts in doubt the purpose of the use of IMF resources.¹⁶

This language seemed promising, but the IMF would later backtrack, using starkly different language to describe their engagement in governance with low-income countries. A 2003 issue paper stated that:

...promoting accountability and transparency in the wider public sector, civil service reform, and the creation of an enabling environment for private sector development fall outside the scope of the Fund’s core responsibilities.¹⁷

While engagement with the HIPC Initiative has slowed in recent years, other programs offering debt relief have commenced. In May 2020, the G20 set up the Debt Service Suspension Initiative (“DSSI”) program with assistance from the IMF and World Bank. The program ran until December 2021, suspending \$12.9 billion in debt service for 48 out of 73 eligible countries.¹⁸ While the DSSI suspended debt issued by bilateral creditors, the IMF and World Bank contributed to the program’s implementation by monitoring spending and other transparency measures, including the disclosure of all public sector financial commitments by the debtor. After the DSSI concluded, the G20 Common Framework for Debt Treatments was created with the intent to similarly organize bilateral creditors around debt treatment for low-income countries.¹⁹ To be eligible for debt treatment under the Framework, a country must have an IMF-supported program, a requirement due, in part, to the IMF’s ability to work with a member country to develop new economic policies and implement reforms.

CURRENT CHALLENGE: A DEARTH OF DEMOCRACY

Through the HIPC and its supplemental MDRI, more than \$100 billion dollars’ worth of debt has been cancelled.²⁰ However, of the 38 countries that received or are pursuing debt relief through the HIPC and MDRI initiatives, all but two are currently ranked at a moderate to high risk of debt distress by the IMF.²¹ Twelve countries are at a high risk of debt distress, eighteen are at a moderate risk of debt distress, and six are actively in debt distress.²² And this problem is expanding beyond just HIPC countries—according to a 2022 analysis by the UK-based Debt Justice, 97 countries are in or at risk of at

least public debt distress.²³ Of this list, 54 countries are already experiencing a debt crisis, while the remaining 43 countries are at risk. There are several sovereign debt analyses, each with slightly different methodologies and results, but the recurrent finding across all the indices is the dangerously high level of default risk.

What do these countries have in common? Countries in or at risk of debt distress perform significantly worse in governance-related indices than those able to manage their debt. Countries in or at risk of debt distress scored

¹⁵ The Role of the IMF in Governance Issues: Guidance Note,” IMF, Aug. 1997, available at <https://www.imf.org/external/pubs/ft/exrp/govern/govern.pdf>.

¹⁶ Ibid.

¹⁷ Role of the Fund in Low-Income Member Countries over the Medium Term—Issues Paper for Discussion,” IMF, Jul. 21, 2003, available at <https://www.imf.org/external/np/pdr/sustain/2003/072103.pdf>.

¹⁸ “Debt Service Suspension Initiative,” World Bank, Mar. 10, 2022, available at <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>.

¹⁹ “Questions and Answers on Sovereign Debt Issues,” IMF, Apr. 8, 2021, available at <https://www.imf.org/en/About/FAQ/sovereign-debt#g20q2>.

²⁰ “Heavily Indebted Poor Countries (HIPC) Initiative,” World Bank, Jan. 11, 2018, available at <https://www.worldbank.org/en/topic/debt/brief/hipc>.

²¹ “Debt Relief Under the Heavily Indebted Poor Countries (HIPC) Initiative,” IMF, Feb. 2023, available at <https://www.imf.org/en/About/Factsheets/Sheets/2023/Debt-relief-under-the-heavily-indebted-poor-countries-initiative-HIPC>.

²² “List of LIC DSAs for PRGT-Eligible Countries,” IMF, Apr. 30, 2024, available at <https://www.imf.org/external/pubs/ft/dsa/dsalist.pdf>.

²³ “Debt Data Portal,” Debt Justice, May 22, 2023, available at <https://data.debtjustice.org.uk/>.

an average of 37/100 in Transparency International's latest Corruption Perceptions Index ("CPI").^{24 25} In comparison, the average global score is 43/100. Only 26 of the 97 countries met or scored above 43/100. Similarly, the same 97 countries scored an average of 38.2/100 using the World Bank's Control of Corruption indicator, compared to the global average of 50/100.²⁶

Despite austerity and deregulation measures deemed "macrocritical" for loan success by the IMF, more loan programs and sovereign debt restructurings have failed than have been successful. Of 75 countries that have restructured debt since 1975, 59 percent of those countries have undergone multiple debt restructurings.²⁷ Reinforcing the above correlation between governance and debt sustainability, these countries also experienced relatively lower governance scores compared to those with one or no restructurings.²⁸

The international community is anticipating another round of new loan programs as a growing number of countries face uncertainty in meeting their payment obligations. A few examples are as follows: Ethiopia is in discussion with the IMF over a loan package, but a deal has not yet been secured.²⁹ Pakistan, which recently completed an IMF program worth \$3 billion, is now seeking a longer arrangement reportedly worth \$6 billion.³⁰ Ecuador recently reached an agreement for an Extended Fund Facility (EFF) program worth \$4 billion, and Egypt just signed a deal to increase their current program by \$8 billion.^{31 32} Ghana and Bangladesh are in the midst of IMF programs, worth \$3 billion and \$4.7 billion, respectively.^{33 34} Sri Lanka is also currently engaged in an IMF loan program and presents a test case on how issues of governance can be addressed in IMF agreements.

COUNTRY CASE STUDIES



Financial mismanagement and corruption among Sri Lankan leaders led to the collapse of the country's economy in 2022.

With domestic debt ballooning to an unsustainable \$42 billion dollars, the economic and social pressures of the COVID-19 pandemic and a total depletion of foreign currency reserves, the government defaulted on its foreign debt the same year.³⁵ Experts have labeled it as the worst financial crisis in the South Asian nation since its independence in 1948.³⁶

The Sri Lankan people have suffered tremendously.

Power outages, food and fuel shortages, and a dramatic rise in unemployment spurred widespread protests and led to the resignation of former President Gotabaya Rajapaksa. To address the unprecedented country crisis, the IMF approved in March 2023 a bailout package worth \$2.9 billion dollars through the Extended Fund Facility ("EFF") program to be disbursed in periodic payments over four years. The release of the payments is contingent upon the Sri Lankan government's ability to meet certain conditions (aka "structural benchmarks") required by the IMF and agreed to by the government.

The new program is the 17th IMF program that Sri Lanka has needed. Given the history of multiple loan programs, and the resulting lack of economic progress for the citizens of Sri Lanka, local civil society organizations

²⁴ The CPI is a ranking of 180 countries and territories around the world by their perceived levels of public sector corruption on a scale of 0 (highly corrupt) to 100 (very clean). The most recent CPI is available at: https://www.transparency.org/en/cpi/2023?gad_source=1&gclid=Cj0KCQjwgljy-BhCGARIsAK8LVLNW22TIKfop7f9oZzWqCAYtL4D04N_JBw_PcSt3gW2_SterQoOUuusaAivjEALw_wcB

²⁵ Antigua and Barbuda, Belize, Samoa, and Tonga, while in or at risk of debt distress, were not included in the CPI ranking due to a lack of data.

²⁶ Daniel Kaufmann and Aart Kraay, "Worldwide Governance Indicators," World Bank, Sep. 2023, available at <https://www.worldbank.org/en/publication/worldwide-governance-indicators>.

²⁷ Dr. Nishan De Mel, Verite Research presentation, September 2023.

²⁸ Ibid.

²⁹ Maxwell Akalaare Adombila and Rachel Savage, "IMF says still 'differences' with Ethiopia over new loan programme," Reuters, Apr. 19, 2024, available at <https://www.reuters.com/world/africa/imf-says-still-differences-with-ethiopia-over-new-loan-programme-2024-04-19/>.

³⁰ "Ronjoy Mazumdar, "IMF Says Loan Negotiations With Pakistan to Continue as Visit Ends," Bloomberg, May 23, 2024, available at <https://www.bloomberg.com/news/articles/2024-05-24/imf-says-loan-negotiations-with-pakistan-to-continue-as-visit-ends>.

³¹ Stephan Kueffner and Maria Elena Vizcaino, "Ecuador Bonds Jump on \$4 Billion Loan Agreement With IMF," Bloomberg, Apr. 25, 2024, available at <https://www.bloomberg.com/news/articles/2024-04-25/ecuador-reaches-four-year-4-billion-loan-deal-with-imf-staff>.

³² Samy Magdy, "IMF confirms increasing Egypt's bailout loan to \$8 billion," Associated Press, Mar. 30, 2024, available at <https://apnews.com/article/egypt-economy-imf-bailout-loan-e8bc6d1383e8d9b0dc325086c121a12b>.

³³ Ekow Dontoh, "Ghana on Track to Win IMF Approval for Eurobond Revamp," Bloomberg, May 21, 2024, available at <https://www.bloomberg.com/news/articles/2024-05-21/ghana-on-track-to-win-imf-blessing-for-delayed-eurobond-revamp>.

³⁴ Ruma Paul, "IMF board clears first review of Bangladesh's \$4.7 billion bailout," Reuters, Dec. 13, 2023, available at <https://www.reuters.com/world/asia-pacific/imf-board-clears-first-review-bangladeshs-47-billion-bailout-2023-12-12/>.

³⁵ Uditha Jayasinghe, "Sri Lanka parliament approves domestic debt restructuring plan," Reuters, July 1, 2023, available at <https://www.reuters.com/world/asia-pacific/sri-lanka-parliament-approves-domestic-debt-restructuring-plan-2023-07-01/>.

³⁶ Tamanna Salikuddin, "Five Things to Know about Sri Lanka's Crisis," United States Institute of Peace, July 15, 2022, available at <https://www.usip.org/publications/2022/07/five-things-know-about-sri-lankas-crisis>.

formed a coalition to review the latest IMF program requirements and call for reforms they felt were lacking but necessary for sustained success. The coalition grew to more than 100 CSOs from all regions of the country and was led by a core group of half a dozen activists and experts. As the program began, the coalition leadership met with the Sri Lankan IMF program team to raise concerns about both the lack of governance reforms and the voluntary nature of those that were listed in the program agreement. To highlight the problems and clearly detail specific policy reforms, in September 2023 the coalition released a governance diagnostic report containing an analysis of the root causes of the economic crisis along with a comprehensive set of 34 reform recommendations.³⁷

A month later, the IMF, in consultation with the Sri Lankan government, published their own Governance Diagnostic Report for the country. It was the first country in Asia to undergo this type of exercise.³⁸ That report provided an overview of the key governance challenges facing the country and 16 priority reform recommendations they viewed as necessary to address gaps in the legal framework to ensure proper oversight and monitoring mechanisms for the loan funds. Many of the IMF recommendations echoed provisions in the civil society report, such as the publishing of significant public procurement contracts and establishing a public, online conflict-of-interest registry for Sri Lankan officials. Other civil society recommendations such as measures to create oversight mechanisms for state ministries with high spending in procurement but low proportions of competitive bidding, among others, were not included.

In December of 2023, the IMF agreed to release the next tranche of funds to the Sri Lankan government. In a win for civil society, as a part of the agreement to release funds, the Sri Lankan government committed to move ahead with 14 of the 16 governance reforms. Establishing governance requirements (aka "Structural Benchmarks") for the release of future funds is an important step forward for the IMF. Monitoring progress towards the benchmarks and holding the IMF accountable for enforcing them are critical to ensure sustained success.



Zambia is facing a sovereign debt crisis, and like Sri Lanka, the problems are due in large part to a history of financial mismanagement

and corruption. In 2018, the UK, Ireland, Finland, Sweden, and UNICEF suspended all social welfare assistance due to graft allegations, including the embezzlement of \$4.7 million in aid through a scheme that stretched throughout the highest levels of Zambia's government.³⁹ This was a devastating loss for the Zambian people, where rates of poverty, inequality, and malnutrition are among the highest in the world.⁴⁰

While the nation's deficit has narrowed somewhat in recent years and corruption has begun to decline, ongoing concerns continue to plague the country.⁴¹ Zambia was the first African country to default on its external debt after the COVID-19 pandemic in November 2020. Soon after, the Zambian government applied for relief under the G20 Common Framework for Debt Treatments for low-income countries. By the end of 2022, Zambia's public debt amounted to \$33.4 billion, 119.6% of its GDP.⁴² In August 2022, the IMF board approved a 38-month, \$1.3 billion dollar loan under the Extended Credit Facility (ECF) program.⁴³ This will be Zambia's 13th IMF program, and the agreement was a key component in Zambia's ability to pursue debt restructuring with private creditors and bilateral lenders, like China.⁴⁴

As part of the ECF program, the IMF published a Governance Diagnostic Report for Zambia in January 2023.⁴⁵ Serious corruption risks were identified across all state functions, but the IMF highlighted risks in a few specific areas, including public financial management, procurement, the mining sector, and corporate ownership transparency. The IMF report included 12 priority recommendations that would strengthen state institutions and close loopholes that have long enabled waste and fraud.

Zambian President Hakainde Hichilema pledged to fight corruption in his inaugural address, declaring a "zero-tolerance" policy for graft. He acknowledged that

³⁷ Arjuna Parakrama, "Civil Society Governance Diagnostic Report," Transparency International Sri Lanka, Sep. 14, 2023, available at <https://www.tisrilanka.org/civil-society-governance-diagnostic-report-on-sri-lanka-2023/>.

³⁸ "Sri Lanka: Technical Assistance Report-Governance Diagnostic Assessment," IMF, Sep. 30, 2023, available at <https://www.imf.org/en/Publications/CR/Issues/2023/09/29/Sri-Lanka-Technical-Assistance-Report-Governance-Diagnostic-Assessment-539804>.

³⁹ Lucy Papachristou, "UK Pulls Aid to Zambia Over Corruption Report," OCCRP, Sep. 19, 2018, available at <https://www.occrp.org/en/daily/8598-uk-pulls-aid-to-zambia-over-corruption-report>.

⁴⁰ "IMF Executive Board Approves New Extended Credit Facility (ECF) Arrangement for Zambia," IMF, Aug. 31, 2022, available at <https://www.imf.org/en/News/Articles/2022/08/31/pr22297-imf-executive-board-approves-new-extended-credit-facility-arrangement-for-zambia>.

⁴¹ "2023 Corruption Perceptions Index," Transparency International, Jan. 2024, available at <https://www.transparency.org/en/cpi/2023/index/zmb>.

⁴² "Zambia: Second Review Under the Arrangement Under the Extended Credit Facility," IMF, Dec. 20, 2023, available at <https://www.imf.org/en/Publications/CR/Issues/2023/12/20/Zambia-Second-Review-Under-the-Arrangement-Under-the-Extended-Credit-Facility-Requests-for-542876>.

⁴³ Teresa Nogueira Pinto, "Zambia's painful path to economic recovery," Geopolitical Intelligence Services, Dec. 13, 2022, available at <https://www.gisreportsonline.com/r/zambia-debt/>.

⁴⁴ Joseph Cotterill, "Zambia agrees \$1.4bn bailout with IMF," Financial Times, Dec. 3, 2021, available at <https://www.ft.com/content/1188e8e0-b6e6-4e1b-9233-6eae5a682bd8>.

⁴⁵ "Zambia: Technical Assistance Report-Diagnostic Report on Governance and Corruption," IMF, Jan. 10, 2023, available at <https://www.elibrary.imf.org/view/journals/002/2023/003/article-A001-en.xml>.

“reckless borrowing and profligate corruption had gutted the economy” in an op-ed published by Bloomberg in 2023.⁴⁶ The IMF reinforced this message in their 2023 Article IV consultation with the country, urging that “strengthening economic governance and addressing corruption vulnerabilities should remain a central aspect of reform...”⁴⁷

With a legacy of years of corruption and mismanagement of public funds, Zambia’s success hinges on the government’s ability to strengthen fiscal controls and address corruption vulnerabilities. At the close of 2023, the IMF completed their second review of Zambia’s progress under the ECF program and approved a disbursement of roughly \$187 million in funds.⁴⁸ The IMF reaffirmed that governance and structural reforms are “key to promoting private sector development and economic diversification,” specifically mentioning the need for procurement transparency, corporate ownership transparency, public access to information, and combating corruption.⁴⁹

LEBANON



Lebanon’s economic collapse in 2019 led the World Bank to rank it among the most severe financial crises since the mid-nineteenth

century.⁵⁰ For years, the economy had been propped up by what experts describe as a Ponzi scheme, orchestrated by the now-sanctioned former governor of Lebanon’s central bank.⁵¹ Decades of corruption and financial mismanagement led to a liquidity crisis, and commercial banks unlawfully locked out depositors from accessing or withdrawing funds in their accounts. In 2020, the government failed to meet its obligation on a \$1.2 billion bond, the first sovereign debt default in the country’s history. Since then, inflation hit triple digits, the economy contracted by roughly 40 percent, and the local currency dropped 98 percent in value.⁵² This financial

shock plunged Lebanon into a humanitarian crisis—an estimated 80 percent of the population now lives below the poverty line.⁵³

In 2022, the IMF reached a staff-level agreement for Lebanon to enter a four-year EFF program with access to \$3 billion in financing. An additional \$10 billion from other creditors is available but conditioned on Lebanon’s ability to meet the IMF requirements. The reform plan contained in the agreement is built around five key pillars, one of which focuses on strengthening the country’s governance, anti-corruption, and AML frameworks.

A concerted effort by Lebanese civil society, including Transparency International Lebanon, has effected positive change in some areas. For example, civil society successfully pushed for the adoption of the Illicit Enrichment Law that requires, among other reforms, certain public officials to declare their interests and assets. But despite recommendations by civil society, the declaration registry is not public, and Lebanon has failed to make progress toward implementing the full suite of reforms necessary to unlock the funding. Experts warn that Lebanese officials eventually must implement reforms or face continued economic chaos.⁵⁴

EL SALVADOR



El Salvador experienced an economic rebound following the COVID-19 pandemic. The GDP grew by 2.7 percent in 2023.⁵⁵

However, the country’s public debt-to-GDP ratio has also been on the rise, creating a fiscal environment deemed by the IMF as “unsustainable.”⁵⁶ In January 2023, President Nayib Bukele’s government narrowly avoided defaulting on an \$800 million bond. The payment was made, but only after significantly reducing already low international reserves and utilizing limited sources of domestic and international debt.

⁴⁶ Hakainde Hichilema, “Zambia’s President: ‘You Cannot Eat Democracy,’” Bloomberg, Mar. 28, 2023, available at <https://www.bloomberg.com/opinion/articles/2023-03-28/debt-restructuring-is-no-recipe-for-democracy-says-zambia-president-hichilema?embedded-checkout=true>.

⁴⁷ “IMF Executive Board Concludes the 2023 Article IV Consultation with Zambia and Completes the First Review Under the Extended Credit Facility Arrangement,” IMF, Jul. 13, 2023, available at <https://www.imf.org/en/News/Articles/2023/07/13/pr23262-imf-executive-board-concludes-article-iv-consultation-with-zambia-and-review-under-ecf>.

⁴⁸ “IMF Executive Board Completes Second Review Under the Extended Credit Facility for Zambia and Approves US\$187 Million Disbursement,” IMF, Dec. 20, 2023, available at <https://www.imf.org/en/News/Articles/2023/12/20/pr23468-zambia-imf-exec-board-completes-2nd-rev-ecf-ap-proves-us187m-disbursement>.

⁴⁹ Ibid.

⁵⁰ “Lebanon Sinking into One of the Most Severe Global Crises Episodes, amidst Deliberate Inaction,” World Bank, June 1, 2021, available at <https://www.worldbank.org/en/news/press-release/2021/05/01/lebanon-sinking-into-one-of-the-most-severe-global-crises-episodes>.

⁵¹ Raya Jalabi, “The Magician: Riad Salameh and the Plundering of Lebanon,” Financial Times, Aug. 20, 2023, available at <https://www.ft.com/content/8a5a27b9-2f08-415f-b1a3-4d9850fd7575>.

⁵² “2023 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Lebanon,” IMF, June 29, 2023, available at <https://www.imf.org/en/Publications/CR/Issues/2023/06/28/Lebanon-2023-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-535372>.

⁵³ Justin Salhani, “Lebanon’s economic crisis endures, as does the EU’s ‘fear’ of refugees,” Al Jazeera, May 18, 2024, available at <https://www.aljazeera.com/news/2024/5/18/lebanons-economic-crisis-endures-as-does-the-eus-fear-of-refugees>.

⁵⁴ “IMF Staff Concludes Visit to Lebanon,” IMF, Sep. 15, 2023, available at <https://www.imf.org/en/News/Articles/2023/09/14/pr23315-lebanon-imf-staff-concludes-visit-to-lebanon>.

⁵⁵ “The World Bank in El Salvador,” World Bank, April 3, 2024, available at <https://www.worldbank.org/en/country/elsalvador/overview#:~:text=In%202021%2C%20El%20Salvador%20economy,of%202.7%20percent%20in%202024>.

⁵⁶ “El Salvador’s Comeback Constrained by Increased Risks,” IMF, Feb. 16, 2022, available at <https://www.imf.org/en/News/Articles/2022/02/15/cf-el-salvadors-comeback-constrained-by-increased-risks>.

El Salvador entered negotiations with the IMF in 2021 over a \$1.3 billion loan. The talks have been slow and difficult, stalling at times due to criticisms of President Bukele's attacks on the rule of law, limitations on speech and civic participation, and a rollback of government transparency. That same year, President Bukele removed the country's attorney general and five high-ranking judges to consolidate power. He terminated El Salvador's engagement with an anticorruption commission formed in collaboration with the Organization of American States (OAS) and proposed legislative reforms that would severely restrict the Access to Public Information Law, such as declaring most public information as reserved or confidential, extending confidentiality to public purchases or investments deemed as "strategic," and extending confidentiality to asset declarations by public officials.⁵⁷

CONCLUSION

The data show that low- and moderate-income countries with unsustainable debt underperform across multiple governance-related indices. Pulling countries out of the debt trap and building sustainable economies requires lenders to ensure that financing is not diverted to corrupt public officials for private gain.

The IMF recognizes that good governance and financial integrity can be macrocritical to achieving economic goals, but their commitment to push governance reforms with consequences for noncompliance remains unclear.

Most notably, the IMF vocally opposed El Salvador's adoption of Bitcoin as legal currency due to instability and the associated money laundering risks.⁵⁸

As other options for financing dwindle, negotiations have resumed, and the IMF described their engagement with the country as "very productive" in October 2023.⁵⁹ President Bukele added that he expects an agreement to be finalized in the coming year.

Without comprehensive reforms to ensure the proper use of financing, El Salvador remains at risk of a future default. In 2020, researchers found substantial evidence that a \$389 million loan to mitigate the economic impacts of the COVID-19 pandemic, granted by the IMF, was largely ineffective due to corruption and the misuse of funds.⁶⁰

Given the links between debt distress and poor governance, the U.S. should advocate and recruit allies to advocate for the IMF to prioritize the assessment of governance issues and incorporate relevant reforms both at the outset of every loan agreement and throughout the program.

As a significant investor with the IMF, the U.S. has an important role to play in moving the Fund to prioritize governance as a key feature of future loan programs. Some specific recommendations for the U.S. to promote to the IMF:

⁴⁷ "IMF Executive Board Concludes the 2023 Article IV Consultation with Zambia and Completes the First Review Under the Extended Credit Facility Arrangement," IMF, Jul. 13, 2023, available at <https://www.imf.org/en/News/Articles/2023/07/13/pr23262-imf-executive-board-concludes-article-iv-consultation-with-zambia-and-review-under-ecf>.

⁴⁸ "IMF Executive Board Completes Second Review Under the Extended Credit Facility for Zambia and Approves US\$187 Million Disbursement," IMF, Dec. 20, 2023, available at <https://www.imf.org/en/News/Articles/2023/12/20/pr23468-zambia-imf-exec-board-completes-2nd-rev-ecf-ap-proves-us187m-disbursement>.

⁴⁹ Ibid.

⁵⁰ "Lebanon Sinking into One of the Most Severe Global Crises Episodes, amidst Deliberate Inaction," World Bank, June 1, 2021, available at <https://www.worldbank.org/en/news/press-release/2021/05/01/lebanon-sinking-into-one-of-the-most-severe-global-crises-episodes>.

⁵¹ Raya Jalabi, "The Magician: Riad Salameh and the Plundering of Lebanon," Financial Times, Aug. 20, 2023, available at <https://www.ft.com/content/8a5a27b9-2f08-415f-b1a3-4d9850fd7575>.

⁵² "2023 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for Lebanon," IMF, June 29, 2023, available at <https://www.imf.org/en/Publications/CR/Issues/2023/06/28/Lebanon-2023-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-535372>.

⁵³ Justin Salhani, "Lebanon's economic crisis endures, as does the EU's 'fear' of refugees," Al Jazeera, May 18, 2024, available at <https://www.aljazeera.com/news/2024/5/18/lebanons-economic-crisis-endures-as-does-the-eus-fear-of-refugees>.

⁵⁴ "IMF Staff Concludes Visit to Lebanon," IMF, Sep. 15, 2023, available at <https://www.imf.org/en/News/Articles/2023/09/14/pr23315-lebanon-imf-staff-concludes-visit-to-lebanon>.

⁵⁵ "The World Bank in El Salvador," World Bank, April 3, 2024, available at <https://www.worldbank.org/en/country/elsalvador/overview#:~:text=In%202021%2C%20El%20Salvador's%20economy,of%202.7%20percent%20in%202024>.

⁵⁶ "El Salvador's Comeback Constrained by Increased Risks," IMF, Feb. 16, 2022, available at <https://www.imf.org/en/News/Articles/2022/02/15/cf-el-salvadors-comeback-constrained-by-increased-risks>.

⁵⁷ "El Salvador: Step Backward for Transparency in Proposal to Reform Access to Public Information Law," Civicus, July 27, 2021, available at <https://monitor.civicus.org/explore/el-salvador-step-backward-transparency-proposal-reform-access-public-information-law-14w9/>.

⁵⁸ "IMF urges El Salvador to remove Bitcoin as legal tender," BBC News, Jan. 26, 2022, available at <https://www.bbc.com/news/world-latin-america-60135552>.

⁵⁹ Jorgelina Do Rosario and Rodrigo Campos, "IMF says recent El Salvador mission was 'very productive,'" Reuters, Oct. 13, 2023, available at <https://www.reuters.com/world/americas/imf-says-recent-el-salvador-mission-was-very-productive-2023-10-13/>.

⁶⁰ "El Salvador: A Recipe for Corruption," Transparency International, Aug. 11, 2020, available at <https://www.transparency.org/en/blog/el-salvador-bloated-budgets-and-little-oversight-a-recipe-for-disaster>.

RECOMMENDATIONS

- 1.** Ensure that governments receiving loans make specific, measurable, and time-bound commitments as part of the loan agreements, with consequences for noncompliance.
 - + While these commitments should be tailored to each country's specific needs, made in consultation with local civil society organizations, there are measures considered baselines for proper governance worldwide. Beneficial ownership registries, transparent and competitive public contracting, asset declarations for public officials, a strong AML/CTF regime, robust oversight by independent government entities and civil society organizations, and independent judiciaries are among the features that will dramatically increase the odds for a successful loan program that leads to economic stability and shared prosperity.
- 2.** Produce more governance diagnostics as part of loan programs, urging governments to agree to the exercise. Incorporate the recommendations of the diagnostics as commitments. Continue to leverage Article IV consultations and Financial Sector Assessment Programs (FSAPs) to elevate anticorruption and financial integrity issues among their broader economic and policy analysis.
- 3.** Engage in-country civil society organizations (CSOs) and local experts throughout loan programs. Consult these CSOs at the outset of negotiations to help inform IMF staff assessments of loan program priorities, provide updates to and request input from the CSOs during the program development process, and ensure sufficient access to information and resources for CSO monitoring of commitment implementation, without threats or other retaliation by governments if there are honest critiques raised by the CSOs.
- 4.** Clearly state expectations. Improve transparency by including on the IMF country pages a list of the "prior actions" and "structural benchmarks" included in current loan programs. Also, pursue a consistent approach to assessing government implementation and linking findings to surveillance and lending transparency.
- 5.** Hold governments accountable to those expectations. Ensure that governments credibly carry out commitments, refraining from issuing waivers of non-observance for benchmarks related to governance and financial integrity due to lack of political will, and publish audits promptly.
- 6.** Publicly report on the progress of implementing the governance commitments that governments make as part of the loan agreements.

Debt can provide a country with resources to build the economy or finance recovery from crises. But too much debt can crush economic development and saddle generations with unsustainable financial burdens. As a result, transparency is a critical component of managing sovereign debt. In April 2024, Transparency International and the National Democratic Institute released a checklist for debt transparency.⁶¹ The major recommendations are:

- + Clear and comprehensive definitions of sovereign debt to avoid hidden obligations and unknown burdens;
- + Public independent audits of the debt;
- + A written public strategy outlining the country's plans for using the loan funds and moving toward a sustainable economy;
- + The creation of a single office to oversee, manage and publicly report on progress toward the debt strategy;
- + Public online and accessible disclosure of the debt by amounts and creditors; and,
- + Independent oversight by parliaments and civil society including opportunities to participate in decisions about debt.

⁶¹ "Debt Disclosed: A Civil Society Checklist for Debt Transparency and Accountability," Transparency International and the National Democratic Institute, Apr. 10, 2024, available at <https://www.ndi.org/publications/debt-disclosed-civil-society-checklist-debt-transparency-and-accountability>.

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