No More Hidden Debts!

By:

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Surely the most egregious corruption offense of the decade is Mozambique's "hidden debt" scandal. According to a January 2019 U.S. indictment, executives of the Lebanese shipbuilding company Privinvest and Swiss banking giant Credit Suisse paid senior Mozambican officials tens of millions of dollars to approve loans for a coastal protection service, a tuna fishing fleet, and a shipyard to maintain the vessels. The scam produced little more than a cluster of overpriced boats rusting in the Maputo harbor while saddling the citizens of one of the world's poorest countries with billions in debts they cannot repay.

The key to the scam was that the loans were hidden. Then Minister of Finance Manuel Chang and his accomplices were paid not only to approve the loans but, contrary to Mozambican law, to keep them secret – from the national audit office, the parliament, and Mozambique's citizens. As the Constitutional Council affirmed in a landmark case, Mozambique law mandates that all government loans be disclosed approved by parliament. Because those conditions were not met, the court ruled the loans were invalid under Mozambique law.

Sadly for the citizens of Mozambique, the court's ruling is of little value. For the terms of the secret loans provided they would not be subject to Mozambican law. It thus seems all but certain the government will be forced to honor them – at enormous cost to current and future generations. One hidden debt scandal is enough. It is time for the international community to make ending secret debts and other forms of "irresponsible lending" a priority. To begin, borrowing countries must crack down on officials who ignore debt transparency and parliamentary approval laws. Offenders should be subject to stiff fines and long jail sentences, and any assets they realized from a scheme confiscated.

But countries whose banks and other financial institutions extend irresponsible loans must act too. Here are five steps they should take to discourage irresponsible loans and force those who extend them to pay for the damages they cause.

1) **The Basel Committee on Banking Supervision should issue an international standard requiring complete transparency in loans to sovereign governments**.

The Committee sets standards that its 28 members, national agencies which regulate lending practices in the 28 most important capital exporting nations, agree to observe. The transparency standard should require not only disclosure of the full terms of any loan to a government or government-entity but the business case for extending the loan. In addition to loans in any form (bonds, notes, loan participation agreements, and the like), disclosure requirements should extend to any loan guaranteed in whole or part by a sovereign. The requirement should extend to all public-private partnerships no matter whether the sovereign is a borrower, explicit guarantor, or not.

2) **The financial regulatory agencies in all capital exporting nations should write the Basel Committee standard into their regulations.**

The Committee sets the international standard, but it is the banking regulator in each country that makes them binding on financial institutions in their country. The agencies should do so at once. The regulations implementing the standard should provide for significant fines, as much as three times the amount of the loan, for a violation of the standard. As the Mozambique scandal shows, hidden debts can work enormous harm on the world's most vulnerable

citizens. Stiff fines are needed to deter hidden or irresponsible loans.

3) **New York state and the United Kingdom should amend their laws to provide any loan extended in violation of the Basel Committee's international standard is void.**

Virtually all sovereign loans and debt securities provide that any dispute about the terms will be resolved under either New York state or U.K. law. To put real teeth into the transparency requirement, the laws of these two jurisdictions should provide that a loan that violated it was unenforceable. The amendment should apply retroactively with a reasonable period, no longer than six months, for existing loans to be brought into compliance. If lenders and governments begin substituting the laws of other jurisdictions for New York or U.K. law, the laws of those jurisdictions should be amended too. And civil society and parliament in the borrowing country should demand an immediate explanation for the substitution.

4) The African Development Bank, the IMF, the World Bank, and other international financial institutions should advocate for the development and adoption of an international standard on irresponsible lending.

These institutions should sponsor research on the need for an international standard and the harms caused by its absence. They should use their convening powers to push regulatory agencies in the countries in which they operate to adopt rules imposing the standard on all financial institutions in those countries as a further safeguard against irresponsible lending. The standard would also provide parliaments, audit offices, and citizens a way to judge the soundness of a loan their government proposes to take out.

5) The laws of capital exporting countries should be amended to permit citizens of countries harmed by an irresponsible loan to bring an action for damages.

The Mozambique scandal shows how much damage irresponsible lending can cause. A citizen or a class of citizens injured by an irresponsible loan should be able to pursue a civil suit for damages against the responsible government officials and lender or lenders: i) in the country where one or more of the lenders is headquartered, ii) the country where one or more of the branches or

subsidiaries that extended or approved the loan is located, or iii) in any country where the lender or lenders have a substantial presence.

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