

ESG Implementation in Emerging & Frontier Markets: Lessons Cultivated from Sri Lanka and Beyond

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ESG Implementation in Emerging & Frontier Markets: Lessons Cultivated from Sri Lanka and Beyond

Ahmed Qaisi*

Crippling debt accrued within emerging and frontier market nations forces developing governments to enact policies contrary to the well-being of their overall economies. The influence of credit rating agencies as well as organizations like the World Bank and the International Monetary Fund (“IMF”) have handcuffed governments into implementing Environmental, Social, and Governance (“ESG”) policies that are unrealistic and unfeasible and have therefore caused detrimental societal impacts. This note examines how the application of ESG policies and governmental corruption resulted in Sri Lanka’s devastating economic collapse. Also scrutinized are those countries which have taken on debt but have managed well throughout slowing economic growth. At bottom, this note recommends that emerging and frontier markets move with caution when implementing ESG policies while credit rating agencies apply leniency when assessing sustainability measures. Moving beyond the top-down approach of the IMF and World Bank enables stable growth, which will benefit developing and developed economies alike.

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INTRODUCTION

In the last decade, due to increasing global health crises and unprecedented economic difficulties, Environmental, Social, and Governance (“ESG”) issues plunged into the limelight.¹ Many of the discussions taking place over ESG are reflected through corporate disclosures or the positive trend that implementing these policies can hold on the environment.² However, the question remains as to whether these seemingly positive ideas leave sovereigns within frontier and emerging markets between a rock and a hard place. Although developed countries maintain the robust infrastructures necessary to implement such changes, emerging and frontier markets which remain laggards are finding it difficult to cope with such altruistic measures.³

As a result of the increased scrutiny to uphold ESG standards, developing nations’ governments struggle to follow lending agencies’ demands to adopt measures that fail to consider the needs of that specific nation. The economies of sovereign borrowers in many emerging and frontier markets rely on the use of resources that may not align with the noble goals of the ESG movement. Forced application of ESG principles can lead to the upheaval of traditional practices, and thereby contributes to economic crises across developing economies.

Without the proper ESG implementation frameworks in place for these developing nations, the scrutiny should then be placed on the lending

¹ Rob Sharps, *In a Time of Crisis, ESG Comes to the Forefront*, LINKEDIN (Jun. 10, 2021), <https://www.linkedin.com/pulse/time-crisis-esg-comes-forefront-rob-sharps/>.

² *Id.*

³ See Joseph Feyertag & Judith Tyson, *How Do We Channel the ESG Investment Boom Towards Low-income Countries?*, OVERSEAS DEV. INST. (Sept. 15, 2021), <https://odi.org/en/insights/how-do-we-channel-the-esg-investment-boom-towards-low-income-countries/>.

agencies to adopt fundamental strategic change—followed by governments themselves. When lending agencies provide countries with ESG ratings, there should be a consideration for whether developing nations continue to use unsustainable practices not because they are unaware of the climate crisis but out of necessity. If these agencies are unwilling to take on a flexible approach with their assessments, then responsibility falls on the debtor or governments themselves. A government needs to audit the economic health of its industries and citizenry to ascertain the suitability of borrowing with ESG conditions attached. The example of Sri Lanka is telling. We observe a government overflowing with corruption attempting to adopt the altruistic measures of ESG without the proper infrastructure to do so, resulting in economic collapse.

I. A PRIMER ON EMERGING & FRONTIER MARKETS

We begin by defining the category of emerging markets. The FTSE Russell Index emerging market classification encompasses fifty-three countries across three subcategories: advanced emerging markets, secondary emerging markets, and frontier markets.⁴ Advanced and secondary emerging markets refer to those countries that share similar characteristics of a developed nation but are still short of full development.⁵ The category of advanced emerging markets is comprised of ten countries, including: Brazil, Mexico, Turkey, South Africa, and Thailand.⁶ The next category, secondary emerging markets, is made up of thirteen countries and includes: China, Egypt, Pakistan, India, and Qatar.⁷ Both advanced and secondary markets have rapid Gross Domestic Product (“GDP”) growth and industrialization, growing per capita income, increasing liquidity in debt and equity markets, and established financial system infrastructures.⁸ Frontier markets are those countries with less advanced capital markets and lower liquidity.⁹ The thirty nation-states that

⁴ *Emerging Markets: Introduction*, GLOBALEDGE, <https://globaledge.msu.edu/econ-class/emerging-markets>, (last visited Dec. 20, 2023).

⁵ *Id.*

⁶ *FTSE Equity Country Classification September 2022 Annual Announcement*, FTSE RUSSELL (Sept. 29, 2022), <https://research.ftserussell.com/products/downloads/FTSE-Country-Classification-Update-2022.pdf>.

⁷ *Id.*

⁸ *Emerging Markets*, GLOBALEDGE, <https://globaledge.msu.edu/econ-class/emerging-markets>, (last visited Dec. 20, 2023).

⁹ *Frontier Markets: Introduction*, GLOBALEDGE, <https://globaledge.msu.edu/econ-class/frontier-markets>, (last visited Dec. 20, 2023).

make up the frontier market classification include such countries as Ghana, Peru, Morocco, Sri Lanka, and Palestine.¹⁰

Frontier market countries have smaller, less developed economies. Their market provides many opportunities for foreign direct investment including demographic diversity, ability to mitigate risk, and high potential growth.¹¹ Particularly, frontier markets provide investors with possible diversification benefits.¹² And, low correlation between frontier markets and the world's economic policies prevent destabilization from global shocks.¹³ However, some risks arise like compromising political instability, relative illiquidity, currency fluctuations, and a lack of regulation.¹⁴

The current climate of economic uncertainty and distress puts increasing pressure on emerging and frontier sovereigns to become nimbler in order to avoid defaulting on already mounting debt.¹⁵ Even as stronger national economies will likely remain adaptable to slowing growth, rising debt, and soaring yields, smaller economies are and will be vulnerable to shocks.¹⁶

II. DEBT INSTRUMENTS AFFECTING EMERGING & FRONTIER MARKETS

As of 2022, public global debt rose to approximately three hundred trillion dollars,¹⁷ with approximately one-third of that total stemming from emerging market sovereigns.¹⁸ The emerging market share has been growing.¹⁹ Investors have been attracted by its bonds' rising credit quality

¹⁰ FTSE RUSSELL, *supra* note 6.

¹¹ GLOBALEDGE, *supra* note 8.

¹² Orhan et al., *Impact of US Federal Reserve Policies on Frontier Markets*, in HANDBOOK OF FRONTIER MARKETS (Panagiotis Andrikopoulos et al. eds, 2016).

¹³ *Id.*

¹⁴ Ziad Daoud et al., *What If Emerging Markets Dodge the Default Wave?*, BLOOMBERG (Nov. 17, 2022, 5:53 PM), <https://www.bloomberg.com/news/articles/2022-11-17/what-if-emerging-markets-dodge-the-default-wave#xj4y7vzkg>.

¹⁵ *Id.*

¹⁶ *See id.*

¹⁷ *See* Victoria Masterson, *What Does 'Global Debt' Mean and How High is it Now?*, WORLD ECON. F. (May 16, 2022), <https://www.weforum.org/agenda/2022/05/what-is-global-debt-why-high/>.

¹⁸ *See* Rodrigo Campos, *Total Global Debt Dips, but Emerging Market Debt Hits Record High*, REUTERS (Nov. 17, 2021), <https://www.reuters.com/business/global-debt-dips-emerging-market-debt-hits-record-high-2021-11-17/>.

¹⁹ *Emerging Market Allocations: How Much to Own?*, MORGAN STANLEY (2021), https://www.morganstanley.com/im/publication/insights/articles/article_howmuchtoown_us.pdf ("Currently, emerging markets have a 26% share of global market cap, up from 19% in 2009.").

and, relative, to U.S. corporate and treasury bonds, higher yields. Yields on U.S. Treasury bonds have hovered between one and three percent for the past ten years, prompting investors to seek returns elsewhere.²⁰ Emerging market bonds yield eight to ten percent annually, with the occasional outlier yielding fifteen percent.²¹ But, as expected, these higher yielding instruments also pose a higher level of risk.²² Bonds from frontier markets, whose economies are at an earlier stage of development, pair the highest yields and risks. Frontier market bonds are debt securities issued by governments or companies in countries that are considered to be at an earlier stage of economic development than the more established, emerging markets.²³

These countries, such as Vietnam, Ghana, and Pakistan, often have higher yields on their bonds as a way to compensate investors for the increased risk associated with investing in less established markets.²⁴ The main attraction for investors in frontier market bonds is the potential for high returns.²⁵ Because these countries are at an earlier stage of economic development, they often have higher interest rates on their debt, which can lead to higher returns for investors.²⁶ Additionally, as these countries continue to develop and grow their economies, there remains potential for capital appreciation on the bonds.²⁷

Emerging market bonds, as with any sovereign bond issuance, allow a developing nation to sell bonds to an investor with the idea that the investor would capitalize on an interest rate while a nation would garner

²⁰ U.S. 10 Year Treasury, CNBC, <https://www.cnbc.com/quotes/US10Y>.

²¹ See Dan Shaykevich, *Why We're Bullish on Emerging Markets Debt*, VANGUARD (Aug. 1, 2022), advisors.vanguard.com/insights/articles/whywerebullishonemergingmarketetdebt; see also Marc Jones, *Analysis: In Emerging Markets, the Bulls are Back Again*, REUTERS (Nov. 23, 2022 10:12 AM), reuters.com/markets/emerging-markets-bulls-are-back-again-2022-11-23/.

²² Troy Segal, *Emerging Market Bond*, INVESTOPEDIA (June 30, 2022), <https://www.investopedia.com/articles/bonds/09/emerging-market-bonds.asp>.

²³ See Johannes Loeffstrand, *Are Frontier Markets Still the Great Untapped Opportunity?*, T. ROWE PRICE (Aug. 2022), <https://www.troweprice.com/institutional/us/en/insights/articles/2022/q3/are-frontier-markets-still-the-great-untapped-opportunity-na.html>.

²⁴ See Segal, *supra* note 22; see also *Emerging Markets by the World Bank*, ASIS, <https://www.asisonline.org/membership/asis-membership/emerging-markets/> (last visited May 13, 2024).

²⁵ See Loeffstrand, *supra* note 23.

²⁶ Spiegel & Schwank, *Bridging the 'Great Finance Divide' in Developing Countries*, BROOKINGS (Jun. 8, 2022), <https://www.brookings.edu/articles/bridging-the-great-finance-divide-in-developing-countries/>.

²⁷ See Kathy Jones, *Emerging-Market Bonds: Are Returns Worth the Risk?*, CHARLES SCHWAB (Apr. 3, 2024), <https://www.schwab.com/learn/story/emerging-market-bonds-are-returns-worth-risk>.

the ability to stimulate its domestic economy.²⁸ For the countries issuing the bonds, accessing international capital markets can help finance infrastructure and development projects, and support economic growth.²⁹ However, there are also significant drawbacks to investing in frontier market bonds.³⁰ These countries often have less developed legal systems and regulations, which can make it more difficult to protect the rights of investors in inherently riskier bonds.³¹ At the same time, the future performance of frontier market bonds can be difficult to predict due to political and economic instability. Sovereign credit risk also can be a factor. A government that is unable to meet its loan obligations would be at risk of default and therefore can hinder the possibility of foreign investment. Furthermore, investors may find it difficult to value and trade the bonds as these instruments demonstrate a lack of transparency and market illiquidity.³² In short, investors need to do their due diligence and be aware of the risk before investing in frontier market bonds.

Although emerging and frontier market bonds will always be fraught with incredible risk, the emergence of these bonds ensure that developing nations implement robust fiscal and monetary policies.³³ In order to incentivize foreign investors and provide them with increased confidence and reliability, developing nations undertake sophisticated macroeconomic restructurings across the board.³⁴ By reducing trade barriers, deregulating industries, and privatizing state-owned enterprises, developing sovereigns can create an environment that entices investors while also benefitting local communities.

A. *Assumption of Risk: Inflationary Spending Limitations*

Inflationary spending limitations refer to the fiscal restraints or limits on government spending that are put in place to curb or control inflation. Inflation is a sustained increase in the general price level of goods and

²⁸ See Jill Christie et al., *Emerging Markets/Cross-Over High Yield: What Next?*, WHITE & CASE (Aug. 2, 2022), <https://www.whitecase.com/insight-alert/emerging-marketscross-over-high-yield-what-next>.

²⁹ See Gregory Smith, *Africa's Hard-Won Market Access*, INT'L MONETARY FUND (Dec. 2021), <https://www.imf.org/en/Publications/fandd/issues/2021/12/Africa-Hard-won-market-access>.

³⁰ See Mark P. Cussen, *The Difference Between Emerging and Frontier Markets*, INVESTOPEDIA (Jan. 29, 2022), <https://www.investopedia.com/articles/investing/092013/difference-between-emerging-and-frontier-markets.asp>.

³¹ See *id.*

³² *Id.*

³³ See *id.*

³⁴ *General Assessment of the Macroeconomic Situation*, OECD (2016), <https://www.oecd.org/economy/outlook/OECD-Economic-Outlook-June-2016-general-assessment-of-the-macroeconomic-situation.pdf>.

services in an economy over a period of time.³⁵ When inflation is high, the purchasing power of money decreases and the cost-of-living increases.³⁶ As a result, the economy as a whole struggles, with the consumers bearing the brunt of the negative impact.³⁷ Governments may apply a variety of monetary and fiscal policies in order to limit government spending and control inflation.³⁸

Excessive government spending is a major contributor to inflation.³⁹ Overspending inevitably occurs when a government attempts to reconcile a lack of cashflow, and therefore causes an increase in the money supply.⁴⁰ An increase in the money supply triggers an increase in demand, causing prices to rise.⁴¹ Higher wages also contribute to higher prices—for they cause producers to increase the prices of their products with the goal of hauling in more money.⁴² To counter this, governments implement budget deficit targets, which limit the amount of money the government can spend beyond its income.⁴³ Limitations on the amount of spending also help to curb inflation by reducing the amount of money flowing into the economy.⁴⁴

Another way to limit government spending and control inflation is through the implementation of price controls.⁴⁵ Price controls are government-imposed limits on the prices of certain goods and services

³⁵ *What is Inflation?*, MCKINSEY & CO. (Apr. 19, 2024), <https://www.mckinsey.com/featured-insights/mckinsey-explainers/what-is-inflation>.

³⁶ See Ceyda Oner, *Inflation: Prices on the Rise*, INT'L MONETARY FUND, <https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Inflation> (last visited May 13, 2024); see also Michelle Ulman, *How Inflation Affects Your Cost of Living*, INVESTOPEDIA, <https://www.investopedia.com/articles/personal-finance/081514/how-inflation-affects-your-cost-living.asp> (Oct. 26, 2023).

³⁷ See *id.*

³⁸ See Mark Horton & Asmaa El-Ganainy, *Fiscal Policy: Taking and Giving Away*, INT'L MONETARY FUND, <https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Fiscal-Policy> (last visited May 13, 2024).

³⁹ See *The Economics of Inflation and the Risks of Ballooning Government Spending*, U.S. CONG. JOINT ECON. COMM. (Oct. 6, 2021), <https://www.jec.senate.gov/public/index.cfm/republicans/2021/10/the-economics-of-inflation-and-the-risks-of-ballooning-government-spending>.

⁴⁰ See *Economic Effects of Reducing the Fiscal Restraint That is Scheduled to Occur in 2013*, CONG. BUDGET OFF. (May 2012), <https://www.cbo.gov/sites/default/files/112th-congress-2011-2012/reports/fiscalrestraint.pdf>.

⁴¹ See *id.*

⁴² *Id.*

⁴³ See Tom Sablik, *Do Budget Deficits Matter?*, FED. RESRV. BANK OF RICHMOND (2019), https://www.richmondfed.org/publications/research/econ_focus/2019/q2-3/federal_reserve.

⁴⁴ See *id.*

⁴⁵ Leslie Kramer, *How Do Governments Fight Inflation*, INVESTOPEDIA (Dec. 14, 2022), <https://www.investopedia.com/ask/answers/111314/what-methods-can-government-use-control-inflation.asp>.

implemented with the goal of controlling the overall level of prices in the economy.⁴⁶ However, price controls tend to have unintended negative consequences.⁴⁷ When prices are artificially low, producers may struggle, lose their incentive to produce goods and services, and shortages follow.⁴⁸ As a counterpoint, consumers may not be able to afford goods and services when prices are artificially high, which can lead to reduced demand.⁴⁹

Monetary policy also can be used to limit inflationary spending.⁵⁰ When, for example, the Federal Reserve, the central bank in the United States, raises interest rates, industry and consumer borrowing becomes more expensive. As the amount of borrowing is reduced,⁵¹ less money flows into the economy.⁵² Rate increases also make saving more attractive, further reducing spending and helping to curb inflation.⁵³

B. *Lending Conditions*

Recently, ESG standards have become increasingly important for financial institutions such as the World Bank and the International Monetary Fund (“IMF”).⁵⁴ These organizations, seeking to prepare for a more sustainable future, now only provide loans to sovereign borrowers in emerging and frontier markets to fund initiatives that are beneficial not only to a burgeoning economy, but a healthy environment as well.⁵⁵

The World Bank, which loans to governments to fund capital projects, places a strong emphasis on sustainable development and seeks out projects with positive environmental impacts and other social benefits.⁵⁶

⁴⁶ *Id.*

⁴⁷ *Id.*

⁴⁸ See Fiona M. Scott Morton, *The Problems of Price Controls*, CATO INST. (June 20, 2021), <https://www.cato.org/commentary/problems-price-controls>.

⁴⁹ *See id.*

⁵⁰ See Koshy Mathai, *Monetary Policy: Stabilizing Prices and Output*, INT’L MONETARY FUND, <https://www.imf.org/en/Publications/fandd/issues/Series/Back-to-Basics/Monetary-Policy>.

⁵¹ *See id.*

⁵² *Id.*

⁵³ Morton, *supra* note 48.

⁵⁴ See Rohit Goel et al., *Sustainable Finance in Emerging Markets: Evolution, Challenges, and Policy Priorities*, INT’L MONETARY FUND (Sept. 9, 2022), <https://www.imf.org/-/media/Files/Publications/WP/2022/English/wpica2022182-print-pdf.ashx>; see also Farah Hussein, *Engaging with Investors on Environmental, Social, and Governance (ESG) Issues*, WORLD BANK (Nov. 2020), <https://thedocs.worldbank.org/en/doc/375981604591250621-0340022020/original/WorldBankESGGuide2020FINAL.11.5.2020.pdf>.

⁵⁵ Goel et al., *supra* note 54, at 3.

⁵⁶ Hussein, *supra* note 54; see also *COVID-19 Financial Assistance and Debt Service Relief*, INT’L MONETARY FUND, <https://www.imf.org/en/Topics/imf-and-covid19/COVID-Lending-Tracker> (Mar. 9, 2022) (“Overall, the IMF is currently making about \$250 billion, a quarter of its \$1 trillion lending capacity, available to member countries.”).

The World Bank accordingly assesses potential projects' environmental and social impacts before providing funding.⁵⁷ The organization also requires borrowers to adhere to international standards for labor and human rights, seeking to ensure that its projects do not lead to forced eviction or other forms of displacement of people.⁵⁸ Projects that could potentially lead to significant damage of local communities or the environment are not approved for funding by the World Bank.⁵⁹

The IMF, which loans funds to governments for operations and projects, incorporates ESG considerations into its lending framework. The organization specifically creates sustainable bond categories with those bonds that are linked to sustainability or those that have ties to sustainability.⁶⁰ For example, as a means of promoting economic growth while also protecting the environment, the IMF may require countries to implement policies that are aimed towards reducing carbon emissions and promoting renewable energy.⁶¹ Additionally, the IMF, aiming to increase access to education and healthcare, requires countries to implement policies that promote social inclusion and reduce poverty.⁶²

Admittedly, ESG conditions have had wide-ranging positive impacts.⁶³ However, ESG has also been a source of tension. Borrower governments have grown frustrated with ESG conditions, viewing them⁶⁴ as an infringement on their sovereignty and resisting their implementation.⁶⁵

India provides a significant example.⁶⁶ The World Bank proposed a \$3.75 billion loan in 2011 to support the construction of the Sardar Sarovar

⁵⁷ See Hussein, *supra* note 54; see also *IMF Lending*, INT'L MONETARY FUND, <https://www.imf.org/en/About/Factsheets/IMF-Lending> ("Unlike development banks, the IMF does not lend for specific projects. Instead, the IMF provides financial support to countries hit by crises to create breathing room as they implement policies that restore economic stability and growth.").

⁵⁸ See *IMF Lending*, *supra* note 57.

⁵⁹ *Id.*

⁶⁰ Goel et al., *supra* note 54 ("Sustainability-linked bonds [are] bonds that use proceeds for pre-defined ESG related KPI, targets, and periodic appraisals.").

⁶¹ See *id.*; Sustainable-linked bond categories include: Green bonds, Green money market funds, social bonds, sustainable bonds, sustainability-linked bonds, and Green mortgage-backed securities.

⁶² See *id.*

⁶³ See *id.*; see Hussein, *supra* note 54; Helping to mitigate the negative impacts of carbon emissions, these conditions can promote sustainable development.

⁶⁴ See Anna Yukhananov, *IMF Loan Conditions Grow Despite Vows to Limit Them: study*, REUTERS (Apr. 2, 2014), <https://www.reuters.com/article/us-imf-conditions/imf-loan-conditions-grow-despite-vows-to-limit-them-study-idUSBREA311SZ20140402>.

⁶⁵ *Id.*

⁶⁶ See Steven A. Holmes, *India Cancels Dam Loan From World Bank*, N.Y. TIMES (Mar. 31, 1993), <https://www.nytimes.com/1993/03/31/world/india-cancels-dam-loan-from-world-bank.html>.

Dam on the Narmada River.⁶⁷ The loan was intended to support the construction of the dam so that other funds could be allocated towards a sufficient relocation for people displaced by the project.⁶⁸ However, the project faced strong opposition from civil society groups who argued that the project would displace tens of thousands of people.⁶⁹ Ultimately, as the loan required the government to conduct a review of the project's impact on the displaced people, the World Bank eventually withdrew its backing due to the lack of agreement on the attached ESG conditions.⁷⁰

Ukraine provides a second example. In 2015, the IMF, as part of a cumulative \$17.5 billion aid package, granted Ukraine a \$5 billion loan.⁷¹ The organization, seeking to support economic reform and stability, conditioned the loan on the Ukrainian government implementing a number of structural reforms.⁷² The policies introduced included reducing subsidies for energy and raising the price of energy for households⁷³. Social anxiety, nervousness and even civil unrest resulted.⁷⁴ The government ultimately suspended the price hikes and reversed its decision at the request of its citizenry.⁷⁵

In both examples, it is clear that the ESG conditions attached to the World Bank and IMF loans caused tensions between the institutions and the countries seeking funding.⁷⁶ While ESG conditions can promote sustainable development, they can also create challenges for countries with limited resources.⁷⁷

⁶⁷ *See id.*

⁶⁸ *See id.*

⁶⁹ *Id.*

⁷⁰ *See* Keith Schneider, *World Bank Loan to India Lead to Water-Damaging Projects*, CIRCLE OF BLUE (Dec. 26, 2016), <https://www.circleofblue.org/2016/world/world-bank-loan-india-leads-water-damaging-projects/>.

⁷¹ Press Release, International Monetary Fund, IMF Executive Board Approves 4-Year US\$17.5 Billion Extended Fund Facility for Ukraine, US\$5 Billion for Immediate Disbursement (Mar. 11, 2015), <https://www.imf.org/en/News/Articles/2015/09/14/01/49/pr15107>.

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *See* Franck Düvell & Irina Lapshyna, *The EuroMaidan Protests, Corruption, and War in Ukraine: Migration Trends and Ambitions*, MIGRATION POL'Y INST. (July 15, 2015), <https://www.migrationpolicy.org/article/euromaidan-protests-corruption-and-war-ukraine-migration-trends-and-ambitions>.

⁷⁵ *See* Andrian Prokip, *Key Enemies of Energy Reforms in Ukraine*, WILSON CTR. (Sept. 9, 2020), <https://www.wilsoncenter.org/blog-post/key-enemies-energy-reforms-ukraine>.

⁷⁶ *See* Yukhananov, *supra* note 64.

⁷⁷ *See id.*

III. ESG PHILOSOPHY

ESG standards have emerged as a means to an end for attaining sustainable growth for producers and nations alike.⁷⁸ Certainly, there are sustainability challenges that are felt worldwide. These challenges include climate change, food insecurity, and waste management among many more—all of which are presenting new factors to consider for investors, producers, and nations.⁷⁹ The idea of sovereign social responsibility on a large scale began long before ESG came to the mainstream.⁸⁰ The movement, however, was originally tailored around political divestment.⁸¹ For example, in the 1960s, divestment campaigns were used as a method to oppose Apartheid South Africa, which imposed systematic rule based on racial segregation.⁸² As a result of political pressure from global players, the Apartheid regime in South Africa collapsed.⁸³

The term “ESG” was first used when United Nations Secretary General Kofi Annan asked major financial institutions to partner with the UN to identify ways to integrate environmental, social, and governance standards into financial markets.⁸⁴ Annan’s directive prompted a 2005 study titled “Who Cares Wins,” which coined the phrase “Environmental, Social, and Governance.”⁸⁵ The UN, paralleling sustainability measures enacted by corporations, then passed The Paris Agreement, an internationally binding treaty signed by 196 parties.⁸⁶ The Paris Agreement requested the signatory countries to cap their greenhouse gas emissions in order to speed the achievement of long-term temperature goals.⁸⁷

⁷⁸ See Betsy Atkins, *Demystifying ESG: Its History & Current Status*, FORBES (Jun. 8, 2020), <https://www.forbes.com/sites/betsyatkins/2020/06/08/demystifying-esgits-history-current-status/?sh=74948e962cdd>.

⁷⁹ *What is ESG?*, MSCI, <https://msci.com/esg-101-what-is-esg> (last visited Feb. 20, 2023).

⁸⁰ See *History of ESG*, PREQIN, <https://www.preqin.com/preqin-academy/lesson-5-esg/history-of-esg> (last visited Feb. 20, 2023).

⁸¹ *See id.*

⁸² *See id.*

⁸³ *See id.*

⁸⁴ *See id.*

⁸⁵ *Evolution of ESG: A Timeline*, BRECKINRIDGE CAP. ADVISORS (Aug. 12, 2021), <https://breckinridge-fs.s3.amazonaws.com/files/uploads/evolution-of-esg-timeline-2.pdf>.

⁸⁶ *Id.*; see *The Paris Agreement*, UNITED NATIONS CLIMATE CHANGE, <https://unfccc.int/process-and-meetings/the-paris-agreement/the-paris-agreement> (last visited Dec. 20, 2023) [<https://web.archive.org/web/20240227115442/https://www.msci.com/esg-101-what-is-esg>].

⁸⁷ *Id.*

ESG ratings are derived from assessments which examine a country's environmental, social, and governance standards.⁸⁸ The purpose of attaching an ESG rating to a country is to help investors and policymakers understand the risk-reward ratio of an investment.⁸⁹ Certain investors may prioritize placing their money in those places which emphasize sustainable growth. From the perspective of a policymaker, the rating helps to identify sustainability weak points and allows a government to prioritize areas of improvement.⁹⁰

ESG rating criteria breaks the three sectors of ESG into multiple factors for assessment.⁹¹ First, the environmental portion, which seeks to improve sustainability and resource efficiency, evaluates energy consumption, pollution control, climate change initiatives, and waste management.⁹² For example, greenhouse gas emissions and energy efficiency are measured by carbon dioxide emissions per unit produced and energy used per cubic meter.⁹³ Second, the social aspect of ESG, which aims to establish equitable societies and respect for human rights, is evaluated through gender and diversity policies, safety and quality controls, human rights and labor standards, and privacy and data security.⁹⁴ To use labor standards as an example, a government would assess hours worked, wages, earned, and general wellbeing.⁹⁵ Third, the governance standard seeks to hold policymakers and other leadership roles accountable with a focus on transparency.⁹⁶ This metric is evaluated by reference to self-serving behavior like overall emission and pollution, accountability, and legislative practices.⁹⁷ Although the standards differ slightly, the idea that corporations must take actions that are in the best

⁸⁸ See Janet He & Fan Wu, *Sovereigns and ESG: Taking a Stance in a Complicated World*, JP MORGAN (Nov. 2022), <https://am.jpmorgan.com/content/dam/jpm-am-aem/global/en/insights/portfolio-insights/fixed%20income-sovereigns-and-esg-full-whitepaper.pdf>.

⁸⁹ See *id.*

⁹⁰ See *id.*

⁹¹ Witold Henisz et al., *Five Ways the ESG Creates Value*, MCKINSEY & CO. (Nov. 14, 2019), <https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value>.

⁹² *Id.*

⁹³ R. Boffo et al., *ESG Investing: Environmental Pillar Scoring and Reporting*, OECD PARIS (2020), <https://www.oecd.org/finance/esg-investing-environmental-pillar-scoring-and-reporting.pdf>.

⁹⁴ See Jamie Molnar, *ESG 101: What Does Social in ESG Mean?*, ONETRUST, <https://www.onetrust.com/blog/esg-101-what-does-social-in-esg-mean/> (last visited May 13, 2024).

⁹⁵ See *id.*

⁹⁶ See Heinsz et al., *supra* note 91.

⁹⁷ *Sovereign ESG Data Framework*, WORLD BANK, <https://esgdata.worldbank.org/data/framework?lang=en> (last visited May 13, 2024).

interest of shareholders is similar to a country's government taking actions that are in the best interest of their people.

A. *Positive Outcomes of ESG Implementation*

Before taking a look at the perverse effects on developing nation-states caused by ESG policies, we first balance our presentation by looking at their positive outcomes—outcomes realized in countries that can afford to implement fundamental change. European countries have paved the way in making progress.⁹⁸ At the front of the pack are Iceland, Denmark, and Norway—countries whose success in these areas was established long before The Paris Agreement.⁹⁹

Countries that have seen a positive impact since the appearance of sustainability legislation are the United Kingdom, South Korea, and Greece.¹⁰⁰ According to *MIT Technology Review*, “[t]he United Kingdom has become particularly aggressive in directing investment toward its clean energy transition: nearly 36% of the country’s power came from clean sources in the third quarter of 2021 with the ambition to make it 100% by 2035.”¹⁰¹ As a result of implementing such ambitious initiatives, the United Kingdom now finds itself amongst the global green leaders.¹⁰² Worth noting, however, the United Kingdom currently boasts a robust infrastructure with the ability to enact wide-ranging sustainability practices.¹⁰³

In a different part of the world, South Korea has also become a pioneer in sustainability innovation.¹⁰⁴ Again, referencing the *MIT Technology Review*, South Korea’s success is “[t]hanks to their world-beating green intellectual property contributions (South Korea leads the world in green patents) and notable increases in pivoting infrastructure spending toward clean and green projects.”¹⁰⁵ Finally, Greece, still in economic recovery

⁹⁸ Andrea Willige, *Which Countries are Achieving the UN Sustainable Development Goals Fastest*, WORLD ECON. F. (Mar. 20, 2017), <https://www.weforum.org/agenda/2017/03/countries-achieving-un-sustainable-development-goals-fastest/>.

⁹⁹ *Id.*

¹⁰⁰ Inger Andersen et al., *The Green Future Index: a Ranking of 76 Economies on Their Progress and Commitment Toward Building a Low-carbon Future*, MIT TECH. REV. INSIGHTS (2022), <https://mittrinsights.s3.amazonaws.com/GFI22report.pdf>.

¹⁰¹ *Id.*

¹⁰² Victoria Masterson, *These Are the Countries Best Prepared for a Green Future*, WORLD ECON. F. (Apr. 8, 2022), <https://www.weforum.org/agenda/2022/04/green-future-index-2022/>.

¹⁰³ See Robert King, *From ambition to implementation*, THE ECONOMIST (Jan 17, 2023), <https://impact.economist.com/sustainability/net-zero-and-energy/from-ambition-to-implementation>.

¹⁰⁴ *Id.*

¹⁰⁵ Andersen et al., *supra* note 100.

mode, earmarked more than thirty percent of its eighteen billion-euro recovery fund package for clean energy transition efforts.¹⁰⁶

Within the emerging market landscape, Brazil has garnered the ability to combat climate change through several sustainability initiatives.¹⁰⁷ The South American country has set a target to reduce its greenhouse gas emissions by thirty-seven percent from 2005 levels by 2025 and forty-three percent by 2030.¹⁰⁸ Brazil also has made it a priority to promote energy efficiency by attempting to reduce deforestation.¹⁰⁹ Hydroelectric power has become a major player in Brazil, accounting for more than sixty-six percent of electricity generation.¹¹⁰ Concurrently, however, Brazil also faces significant challenges.¹¹¹ The region continues to lose large areas of forest-cover each year as a result of increasing deforestation despite efforts to combat illegal logging, agricultural expansion, and mining.¹¹²

Moving onto positive outcomes within frontier markets, Bangladesh has made significant efforts in recent years with a focus on addressing issues related to environmental degradation.¹¹³ One key initiative is the Bangladesh Climate Change Trust Fund (“BCCTF”), which was established in 2010 to institutionalize national climate finance.¹¹⁴ The BCCTF provides funding for a variety of projects, including those related to water management, coastal zone management, and renewable energy.¹¹⁵ According to the World Bank, approximately eight million people in coastal Bangladesh are vulnerable to flooding and sea-level rise resulting

¹⁰⁶ *Id.* at 17.

¹⁰⁷ Lisa Viscidi, *Brazil was a Global Leader on Climate Change. Now it's a Threat*, FOREIGNPOLICY (Jan. 4, 2019, 3:14 PM), <https://foreignpolicy.com/2019/01/04/brazil-was-a-global-leader-on-climate-change-now-its-a-threat/>.

¹⁰⁸ *Brazil Pledges to Cut Carbon Emissions 37% by 2025*, THE GUARDIAN (Sept. 28, 2015), <https://www.theguardian.com/environment/2015/sep/28/brazil-pledges-to-cut-carbon-emissions-37-by-2025>.

¹⁰⁹ *See id.*

¹¹⁰ *Id.*

¹¹¹ *See* Viscidi, *supra* note 107.

¹¹² *Id.*

¹¹³ *See* A.C. Smith et al., *Nature-based Solution in Bangladesh: Evidence of Effectiveness for Addressing Climate Change and Other Sustainable Development Goals*, FRONTIER ON ENV'T SCI. (Nov. 22, 2021), <https://www.frontiersin.org/articles/10.3389/fenvs.2021.737659/full>.

¹¹⁴ Md Kamruzzaman, *Introduction to the Bangladesh Climate Change Trust Fund*, DHAKA TRIB. (June 13, 2015), <https://www.icccad.net/dhaka-tribune-articles/introduction-to-the-bangladesh-climate-change-trust-fund-2/>.

¹¹⁵ Mousumi Pervin & Sheikh Moinul Islam Moin, *Climate Finance Governance in Bangladesh: Synergies in the Financial Landscape*, INT'L INST. FOR ENV'T AND DEV. (Apr. 2014), https://www.jstor.org/stable/pdf/resrep01574.pdf?refreqid=fastly-default%3A58332edf5cf93b8a74e5acc03e98d24c&ab_segments=&origin=&initiator=&acceptTC=1.

from cyclonic storm surge.¹¹⁶ To combat storm surge, flooding, and cyclones, Bangladesh established the Integrated Coastal Zone Management project that aims to protect and manage the country's coastal areas, which are particularly vulnerable to the impacts of climate change.¹¹⁷ The project includes a variety of components, including the development of early warning systems, the construction of sea walls and other coastal protection measures, and the establishment of community-based disaster management committees.¹¹⁸

But, like Brazil, Bangladesh has problems that stymie progress towards a sustainable future.¹¹⁹ The garment industry stands out in this regard.¹²⁰ The garment factories in the country are often located in densely populated areas and pollute local waterways with textile dyes and other chemicals.¹²¹ Regulations are loose and significant health and environmental problems have resulted in local communities.¹²² Although these problems persist, the Bangladeshi government has instituted new regulations and international organizations have provided support and training to improve environmental performance as well as working conditions in factories.¹²³

B. *Negative Outcomes of ESG Implementation*

Although it is true that sustainability policies positively influence nations to lower carbon emissions and strengthen governmental practices, these measures also leave certain markets vulnerable to negative

¹¹⁶ *The Cost of Adapting to Extreme Weather Events in a Changing Climate*, WORLD BANK (Dec. 2011), <https://documents1.worldbank.org/curated/en/716231468014361142/pdf/678450NWP0Box3000BDS28ClimateChange.pdf>.

¹¹⁷ Ministry of Water Resources, *Integrated Coastal Zone Management Plan Project Towards Formulation of the Poverty Reduction Strategy Paper for Bangladesh*, WORLD BANK (Feb. 2004), <https://www.worldbank.org/en/news/press-release/2024/03/28/addressing-environmental-pollution-is-critical-for-bangladesh-s-growth-and-development>.

¹¹⁸ *Id.*

¹¹⁹ See generally Mehrin A. Mahbub, *Addressing Environmental Pollution is Critical for Bangladesh's Growth and Development*, WORLD BANK (Mar. 28, 2024), <https://www.worldbank.org/en/news/press-release/2024/03/28/addressing-environmental-pollution-is-critical-for-bangladesh-s-growth-and-development>.

¹²⁰ See SM Najmus Sakib, *Garment Industry in Bangladesh Struggles to Contain Pollution*, ECO-BUSINESS (Jan 19, 2023), <https://www.eco-business.com/news/garment-industry-in-bangladesh-struggles-to-contain-pollution/>.

¹²¹ Editorial Board, *Garment Factories in Bangladesh Still Have Massive Safety Problems*, WASH. POST (Oct. 23, 2014), https://www.washingtonpost.com/opinions/bangladesh-still-needs-safer-conditions-in-garment-factories/2014/10/23/925d37f8-563a-11e4-892e-602188e70e9c_story.html.

¹²² Sakib, *supra* note 120.

¹²³ *Id.*

outcomes.¹²⁴ The Netherlands is a notable and surprising example. ESG standards there led to social unrest.¹²⁵ The Dutch, famous for their highly productive agricultural industry, are one of the world's largest dairy exporters.¹²⁶ Unfortunately, the enactment of ESG regulations came at a cost to Dutch farmers due to ammonia pollution produced by cow manure.¹²⁷ In 2018, the European Court of Justice ruled that the Netherlands' weak environmental policies must be strengthened to reduce air pollution.¹²⁸ In response, government officials revealed plans that required a reduction of nitrogen emissions by fifty percent by 2030.¹²⁹ Such a dramatic policy measure threw Dutch farmers into a panic, worrying that their businesses would be untenable.¹³⁰ Disregarding the uproar and taking definitive measures to comply with European Union policy, the Dutch government laid out plans to buy out hundreds and possibly thousands of farms.¹³¹

Farmers organized large-scale protests in response to the proposed reductions. The protests included the blockade of highways, tractors being driven through city centers, strikes, and disruptions at various food markets and slaughterhouses.¹³² Support for farmers grew and the protests gained significant attention.¹³³ The farmers remain dissatisfied with the government's response, demanding more support in the mode of subsidies, as well as flexibility to adopt new regulations.¹³⁴

Similarly, in Germany, the rapid integration of ESG standards created overwhelming and unintended negative consequences.¹³⁵ Specifically,

¹²⁴ See generally Ciara Nugent, *Farmer Protests in the Netherlands How Just How Messy the Climate Transition Will Be*, TIME (July 29, 2022, 10:45 AM), <https://time.com/6201951/dutch-farmers-protests-climate-action/>.

¹²⁵ *Id.*

¹²⁶ Laura Reiley, *Cutting-edge Tech Made this Tiny Country a Major Exporter of Food*, WASH. POST (Nov. 21, 2022, 2:48 PM), <https://www.washingtonpost.com/business/interactive/2022/netherlands-agriculture-technology/>.

¹²⁷ Nugent, *supra* note 124.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *See id.*

¹³¹ Diederik Baazil, *Netherlands to Buy Out Farmers Amid Pushback Over Nitrogen Goals*, BLOOMBERG L. (Nov. 25, 2022, 11:27:08 AM), <https://www.bloomberglaw.com/document/RLWQE7DWRGGE>; James Crisp, *Netherlands to Close up to 3,000 Farms to Comply with EU Rules*, TELEGRAPH (Nov. 28, 2022, 4:02 PM), <https://www.telegraph.co.uk/world-news/2022/11/28/netherlands-close-3000-farms-comply-eu-rules/>.

¹³² Anna Holligan, *Why Dutch Farmers are Protesting over Emissions Cuts*, BBC (July 29, 2022), <https://www.bbc.com/news/world-europe-62335287>.

¹³³ *See generally id.*

¹³⁴ *See generally id.*

¹³⁵ *See generally* Kerstine Appunn, *The History Behind Germany's Nuclear Phase-out*, CLEAN ENERGY WIRE (Mar. 9, 2021), <https://www.cleanenergywire.org/factsheets/history-behind-germanys-nuclear-phase-out>.

Germany's phase-out of nuclear power triggered a domino effect.¹³⁶ After the 2011 Fukushima nuclear disaster in Japan, the German government commenced the "Energiewende," a policy determined to decrease the country's reliance on fossil fuels and increase its reliance on renewable energy sources, such as wind and solar power. Germany also decided to phase-out of nuclear power.¹³⁷ This phase-out resulted in higher prices for consumers, along with heavy job losses in the energy sector.¹³⁸ Citizens voiced their concerns about the affordability of energy for low-income households and questioned whether the consequences are worth it for the consumer.¹³⁹

Emerging economies, which lack the infrastructure to handle the rapid escalation of ESG standards, feel significantly harsher effects. Scenes portrayed in Indonesia are illustrative.¹⁴⁰ The Southeast Asian country struggles mightily to implement ESG policies, particularly in regard to environmental issues.¹⁴¹ The country is home to a large number of coal mines, which development of has led to significant deforestation and a loss of biodiversity.¹⁴² Additionally, there are warranted concerns about air and water pollution, as well as issues with illegal logging.¹⁴³ Furthermore, the country has been criticized for its failure to take sufficient action to combat illegal fishing and thereby protect the rights of indigenous communities.¹⁴⁴

The Indonesian government's efforts to protect areas densely populated with peatland and reduce deforestation has led to conflicts with local communities and indigenous groups whose livelihoods depend on those areas for income and resources.¹⁴⁵ International pressure to reduce greenhouse gas emissions caused the government to change its policies regarding the restrictions on land use.¹⁴⁶ Specifically, the government imposed a moratorium on new licenses for palm oil and mining concessions in protected forest areas.¹⁴⁷ Put into place in 2018, these

¹³⁶ See generally *id.*

¹³⁷ See generally *id.*

¹³⁸ See generally Todd Gillespie, *German Power Price Halves in Three Days on EU Crisis Plans*, BLOOMBERG (Sept. 1, 2022), <https://www.bloomberg.com/news/articles/2022-09-01/german-power-price-halves-in-three-days-on-eu-crisis-plans>.

¹³⁹ See generally *id.*

¹⁴⁰ See generally Samiha Shahreen, *Vanishing Act: Deforestation in Indonesia*, EARTH (Feb 2, 2022), <https://earth.org/vanishing-act-deforestation-in-indonesia/>.

¹⁴¹ See *id.*

¹⁴² See generally *id.*

¹⁴³ See *id.*

¹⁴⁴ See generally Muhammad Syukron Anshori, *Indigenous Peoples of Indonesia: Calling for Recognition and Respect*, UNSW SYDNEY, <https://www.humanrights.unsw.edu.au/research/commentary/indigenous-peoples-indonesia-recognition-respect>.

¹⁴⁵ See *id.*

¹⁴⁶ See *id.*

¹⁴⁷ See *id.*

policies aim to protect Indonesia's remaining forests and peatlands by containing the expansion of palm oil plantations.¹⁴⁸ The moratorium has been extended multiple times.¹⁴⁹ These restrictions spawned economic distress to already struggling communities.¹⁵⁰ Participants in the palm oil industry, a significant contributor to Indonesia's economy, see these restrictive land use policies as negatively impacting their ability to manufacture and produce.¹⁵¹ Categorically, the expansion of palm oil plantations is severely limited due to the strict regulations regarding land use.¹⁵² While the altruistic enterprises that the Indonesian government sought to take on should be lauded, it needs to be understood that farmers are bearing the burden of loss—losing not just their incomes, but their livelihoods as a result.¹⁵³

IV. ESG'S RELATIONSHIP TO SOVEREIGN CREDIT RATINGS

A country, just like an individual with a credit card or a corporation issuing a bond, receives a credit rating titled a “sovereign credit rating.”¹⁵⁴ Sovereign credit ratings evaluate the level of risk associated with lending to particular governments.¹⁵⁵ According to the World Bank, “sovereign credit ratings directly influence a country's cost of capital Lower-rated sovereigns generally pay a higher interest rate because of perceived higher credit risk. The higher cost of capital can also affect market access and therefore significantly limit sovereign financing options.”¹⁵⁶ Three credit rating agencies, Moody's, Fitch Ratings, and Standard & Poor's (S&P), control over ninety-two percent of the global market, including the sovereign market.¹⁵⁷ The credit rating agencies have deservedly poor reputations. They have failed to understand the impact their role plays in

¹⁴⁸ *See id.*

¹⁴⁹ *Indonesia to Use “Existing Laws” as Palm Oil Moratorium Expires*, REUTERS (Sept. 22, 2021, 4:01 AM), <https://www.reuters.com/business/environment/indonesia-use-existing-laws-palm-oil-moratorium-expires-2021-09-22/>.

¹⁵⁰ *See generally Indonesia Says Won't Approve New Palm Oil Permits After Moratorium Lapses*, REUTERS (Sept. 24, 2021), <https://news.trust.org/item/20210924090311-unm3b/>.

¹⁵¹ *See id.*

¹⁵² *See id.*

¹⁵³ *See generally id.*

¹⁵⁴ *Sovereign Credit Rating*, CORP. FIN. INST., <https://corporatefinanceinstitute.com/resources/finance/sovereign-credit-rating/> (last visited Oct. 11, 2022).

¹⁵⁵ *Id.*

¹⁵⁶ EKATERINA M. GRATCHEVA ET AL., WORLD BANK GRP., CREDIT WORTHY: ESG FACTORS AND SOVEREIGN CREDIT RATINGS 26 (Jan. 2022).

¹⁵⁷ Yuefen Li, *Debt Crisis: UN Expert Faults Credit Rating Agencies, Urges Reform*, UNITED NATIONS (Mar. 3, 2021), <https://www.ohchr.org/en/press-releases/2021/03/debt-crises-un-expert-faults-credit-rating-agencies-urges-reform>.

international debt architecture.¹⁵⁸ Specifically, the United Nations stated that “[i]nstead of warning of the coming debt crisis, and playing a role in preventing it, they end up exacerbating it . . . The impact of downgrades on developing countries can be enormous.”¹⁵⁹ Regardless of this poor track record, these credit rating agencies continue to set the baseline for lenders seeking to gauge the level of risk posed by government borrowers as they construct their portfolios.¹⁶⁰

Credit rating agencies consider various factors such as political stability, economic performance, and most relevant to the analysis, here, ESG standards.¹⁶¹ The reason for the inclusion of ESG is plain enough—the three topics are tied together. For example, a country with weak environmental policies and a poor track record of protecting its natural resources may be at a higher risk of experiencing economic disruption due to resource depletion. At the same time, scrutiny of such a country’s ESG standards may presently impair its ability to receive loans or take on debt.¹⁶² As a consequence, countries in emerging markets are forced to prioritize ESG-related policy changes in order to secure funding from external sources.¹⁶³

From the perimeter, it may seem that forcing nations to abide by stringent ESG standards would reap only positive impacts. The reality is different in emerging and frontier markets. Strong correlations between weak ESG ratings and sovereign credit ratings are illustrated by a country like Bangladesh, which as seen previously, is vulnerable to rising sea levels.

Lebanon, which experienced its first sovereign default in March 2020, is another example.¹⁶⁴ The nation is one where very high social risk combines with very weak governance. As a result, it suffered a credit rating downgrade in 2019.¹⁶⁵ At the time, the country’s public debt

¹⁵⁸ *Id.*

¹⁵⁹ *Id.*

¹⁶⁰ *See generally id.*

¹⁶¹ *See Sovereign Credit Rating, supra* note 154.

¹⁶² *See generally* Ed Parker, *ESG Is a Longstanding and Increasingly Important Sovereign Rating Factor*, FITCHRATINGS, (Feb. 10, 2022, 6:57 AM), <https://www.fitchratings.com/research/sovereigns/esg-is-longstanding-increasingly-important-sovereign-rating-factor-10-02-2022>.

¹⁶³ *See* Marc Jones, *Climate and ESG Risks Hurting 60% of Developing Countries’ Ratings – Moody’s*, REUTERS (Jan. 18, 2021, 8:49 AM), <https://www.reuters.com/article/ratings-sovereign-esg-moodys/climate-and-esg-risks-hurting-60-of-developing-countries-ratings-moodys-idUSL1N2JT0XW>; This issue rarely arises for advanced economies as their markets are robust with the ability to adapt and remain in strong financial health.

¹⁶⁴ *Id.*

¹⁶⁵ *Fitch Downgrades Lebanon to ‘CCC’*, FITCHRATINGS (Aug. 23, 2019, 4:04 PM), <https://www.fitchratings.com/research/sovereigns/fitch-downgrades-lebanon-to-ccc-23-08-2019>.

exceeded its GDP by 179 percent.¹⁶⁶ Corruption and mismanagement had been compounded by COVID-19 deficiencies.¹⁶⁷ Lebanon also had weak ESG ratings due to high levels of pollution and inadequate environmental regulations.¹⁶⁸ With the culmination of these factors, economic collapse followed in 2020, which devalued the country's currency.¹⁶⁹

The default generated a number of significant consequences for the country's economy and its people.¹⁷⁰ The value of the Lebanese pound plummeted, leading to hyperinflation and a shortage of basic goods.¹⁷¹ Unemployment rose and many businesses closed.¹⁷² The country has also lost access to international credit markets and, as a result, has had difficulty securing the funding needed to address the crisis.¹⁷³

V. SRI LANKA'S MOUNTING FAILURES

Over-leveraging on debt while also prematurely imposing vaunted ESG policies can lead to economic demise. This is well illustrated by the story of Sri Lanka. A small island nation located just off the southeastern coast of India, Sri Lanka has a population of roughly twenty-two million people.¹⁷⁴ Although small in land mass, the country offers or used to offer, a number of unique opportunities for businesses and investors alike.¹⁷⁵ As recently as 2019, Sri Lanka landed itself near the top of the list for destinations for foreign investment.¹⁷⁶ Unfortunately, the country's leaders then failed its businesses and investors miserably as a matter of governance.

¹⁶⁶ Hunter Williamson, *Lebanon's Worsening Collapse*, INKSTICK (Nov. 2, 2022), <https://inkstickmedia.com/lebanons-worsening-collapse/>.

¹⁶⁷ *See id.*

¹⁶⁸ *See id.*

¹⁶⁹ *See id.*

¹⁷⁰ Laura Gardner Cuesta & Elias Lambrianos, *Lebanon's Debt-Resolution Challenges Continue, One Year on From Default*, FORBES (Mar. 10, 2021, 11:12 AM), <https://www.forbes.com/sites/debtwire/2021/03/10/lebanons-debt-resolution-challenges-continue-one-year-on-from-default/?sh=6e71ef344eb9>.

¹⁷¹ *See id.*

¹⁷² *See generally id.*

¹⁷³ *See generally id.*

¹⁷⁴ Sinnappah Arasaratnam & Gerald Hubert Peiris, *Sri Lanka*, BRITANNICA, <https://www.britannica.com/place/Sri-Lanka> (Oct. 24, 2023).

¹⁷⁵ *Id.*

¹⁷⁶ *See generally* Rainer Michael Preiss, *Sri Lanka's Market: An Investment Gem Hidden In Too Much Pessimism*, FORBES (Aug. 7, 2019, 7:30 PM), <https://www.forbes.com/sites/rainermichaelpreiss/2019/08/07/sri-lankas-market-an-investment-gem-hidden-in-too-much-pessimism/?sh=5e1517585df6>.

On July 9, 2022, the people of Sri Lanka raided the presidential palace in the midst of economic collapse.¹⁷⁷ To understand why this happened, we must go back fourteen years to when the Sri Lankan civil war ended. The civil war arose from the ethnic tensions between the Buddhist Sinhalese Sri Lankan government and the Hindu Liberation Tigers of Tamil Eelam (“LTTE”), also known as the Tamil Tigers.¹⁷⁸ The war began in 1983 and ended in 2009 with the defeat of the LTTE by the Sri Lankan military.¹⁷⁹ The Rajapaksa siblings, Mahinda and Gotabaya played a significant role in ending the civil war.¹⁸⁰ Mahinda Rajapaksa, who served as President of Sri Lanka from 2005 to 2015, was the architect of the government’s military strategy that ultimately defeated the LTTE.¹⁸¹ His brother Gotabaya Rajapaksa played a key role in organizing and coordinating the military campaign against the LTTE, serving as the Secretary of Defense during his brother’s presidency and eventually becoming president himself from 2019 to 2022.¹⁸²

Subsequent to their victory over the LTTE, the Rajapaksa brothers attempted to improve the living and working conditions of the Tamils, providing them rights and opportunities which had not been available or taken away previously and during the war.¹⁸³ The Rajapaksa brothers found it to be extremely important to help improve the relationship between the Tamils and the Sinhalese, and so made leaps and efforts to integrate the Tamils into mainstream society.¹⁸⁴ In addition, the brothers concentrated their efforts on creating an environment that would be suitable for a reconciliation process. They pursued a number of economic development projects in the Tamil-majority areas in the North and East of

¹⁷⁷ Manuela Lopez Restrepo & Ari Shapiro, *Sri Lankan Protestors Party in the President’s Mansion as He Flees the Country*, NPR (July 13, 2022, 5:00 AM), <https://www.npr.org/2022/07/13/1111087981/sri-lankan-protesters-partied-in-the-presidents-mansion-what-comes-next-is-uncle>.

¹⁷⁸ Nithyani Anandakugan, *The Sri Lankan Civil War and Its History, Revisited in 2020*, HARV. INT’L. REV., (Aug. 31, 2020), <https://hir.harvard.edu/sri-lankan-civil-war/>.

¹⁷⁹ *Id.*

¹⁸⁰ See Jason Burke, *Mahinda Rajapaksa: Sri Lanka’s Saviour or War Criminal?*, THE GUARDIAN (Oct. 26, 2013, 7:03 PM), <https://www.theguardian.com/theobserver/2013/oct/27/mahinda-rajapaksa-profile>.

¹⁸¹ *Id.*

¹⁸² Meenakshi Ganguly, *Sri Lanka’s Former President Must Be Investigated for War Crimes*, WASH. POST (July 22, 2022, 12:00 PM), <https://www.washingtonpost.com/opinions/2022/07/22/gotabaya-rajapaksa-former-sri-lanka-president-must-face-war-crimes-investigation/>.

¹⁸³ See generally Burke, *supra* note 180.

¹⁸⁴ See Charles Haviland, *Gotabhaya Rajapaksa: Sri Lanka North ‘Not Just For Tamils’*, BBC NEWS (May 28, 2012), <https://www.bbc.com/news/world-asia-18207198>.

the country which helped to improve the living conditions and economic opportunities for the Tamil population.¹⁸⁵

A. Perpetual Naval-Gazing: Sri Lanka's Economic Collapse

Even as the Sri Lankan government attempted to rebuild infrastructure and resettle citizenry after the war, high levels of corruption within the government hindered progress towards growing the economy.¹⁸⁶ One of the major issues with corruption in post-war Sri Lanka was the lack of transparency and accountability in government decision-making and spending,¹⁸⁷ as well as a culture of nepotism and cronyism.¹⁸⁸ The embezzlement of public funds by government officials also prevented successful implementation of development and reconstruction projects.¹⁸⁹ Additionally, mismanagement of funds caused delays and cost overruns in infrastructure projects, stalling economic growth.¹⁹⁰

Furthermore, corruption also led to a lack of foreign investment in the country. Deterred by the mounting levels of corruption and a lack of transparency, investors and businesses alike found it difficult to place their money into risky and unascertainable assets,¹⁹¹ hindering the country's economic growth.¹⁹² The Rajapaksa government contributed to this problem by prioritizing defense spending and public sector development over private sector growth.¹⁹³ The controversial Port City development project in Colombo provides a good example. The government awarded the project to a Chinese state-owned company without a transparent bidding process.¹⁹⁴ This project was also granted excessive tax concessions and other benefits, raising concerns of corruption and lack of fair competition.¹⁹⁵ A surplus of unscrupulous double-dealing by the Sri Lankan government, along with similar instances of corruption and a lack

¹⁸⁵ See generally *id.*

¹⁸⁶ See *Sri Lanka's Transition to Nowhere*, INT'L CRISIS GRP. (May 16, 2017), <https://www.crisisgroup.org/asia/south-asia/sri-lanka/286-sri-lanka-s-transition-nowhere>.

¹⁸⁷ See *id.*

¹⁸⁸ See generally *id.*

¹⁸⁹ *Id.*

¹⁹⁰ See *id.*

¹⁹¹ See generally Thamashi De Silva et al., *What Lies Behind Sri Lanka's Collapse?*, LSE BUS. REV. (July 19, 2022), <https://blogs.lse.ac.uk/businessreview/2022/07/19/what-lies-behind-sri-lankas-collapse/>.

¹⁹² *Id.*

¹⁹³ See Daniel Alphonsus, *Sri Lanka's Post War Defense Budget: Overspending and Underprotection*, S. ASIAN SCAN, Nov. 2021, at 4, 17-18.

¹⁹⁴ See Smruti S. Pattanaik, *Controversy over Chinese Investment in Sri Lanka*, E. ASIA F. (June 5, 2015), <https://www.eastasiaforum.org/2015/06/05/controversy-over-chinese-investment-in-sri-lanka/>.

¹⁹⁵ See generally *id.*

of transparency, deterred foreign investors and hindered the potential for economic growth.

The Rajapaksa brothers themselves were accused of various acts of corruption during their tenures in office.¹⁹⁶ First, and most notable, is the Sil Redi scandal, which refers to a corruption case involving the misappropriation of funds from a government-owned development bank by a group of private companies, including one owned by a close associate of the Rajapaksa family.¹⁹⁷ The scandal came to light in 2015 when an investigation by the Central Bank of Sri Lanka revealed that the companies obtained loans from the development bank using false documentation and used the funds for activities unrelated to the stated purpose of the loans.¹⁹⁸

The Rajapaksa brothers were also accused of generally mismanaging Sri Lanka's finances during their times in office.¹⁹⁹ They used public funds for large-scale infrastructure projects such as airports, ports, and highways, without proper planning and transparency.²⁰⁰ Such projects were often financed through loans from China, which led to a significant increase in Sri Lanka's debt.²⁰¹ There were also abuses at state-run businesses that led to significant losses.²⁰² Particularly notable is the state-run airline, Sri Lankan Airlines, which experienced heavy losses due to poor financial management, including the purchase of unnecessary aircraft and the failure to restructure management.²⁰³ The airline allegedly provided benefits to political cronies through the award of contracts and other financial favors.²⁰⁴ Stated simply, the Rajapaksas and other political leaders failed to maintain the "G" in ESG and therefore were in no position to meet the thresholds required to implement the "E" and "S." Similar to the responsibility that corporations have towards their shareholders, political leaders should govern based on their people's best interest.

To add insult to injury, the Rajapaksas increased defense spending after the civil war concluded.²⁰⁵ A move criticized viewed by some

¹⁹⁶ See generally Siri Gamage, *Sil Redi Case: A Crime, Bribe Or a Pious Act?*, COLOMBO TEL. (Oct. 2, 2017), <https://www.colombotelegraph.com/index.php/sil-redi-case-a-crime-bribe-or-a-pious-act/>.

¹⁹⁷ See *id.*

¹⁹⁸ See generally *id.*

¹⁹⁹ Amita Arudpragasam, *How the Rajapaksas Destroyed Sri Lanka's Economy*, FOREIGN POL'Y (Apr. 28, 2022), <https://foreignpolicy.com/2022/04/28/sri-lanka-rajapaksa-protests-economy-corruption/>.

²⁰⁰ See *id.*

²⁰¹ See *id.*; Gamage, *supra* note 196.

²⁰² See Gamage, *supra* note 196.

²⁰³ Greg Waldron, *SriLankan Airlines Files Legal Claim After Airbus Bribery Probe*, FLIGHTGLOBAL (Mar. 24, 2021), <https://www.flightglobal.com/airframers/srilankan-airlines-files-legal-claim-after-airbus-bribery-probe/143010.article>.

²⁰⁴ See *id.*

²⁰⁵ See Alphonsus, *supra* note 193, at 4.

observers.²⁰⁶ The stated purpose of the spending increase was the rebuilding and development of infrastructure and the maintenance of security and stability.²⁰⁷ The more realistic view sees a motivation and desire to maintain power and control as well as to reward loyalists with contracts and other resources.²⁰⁸ Failing to maintain proper governance again, the Rajapaksas were criticized for mismanaging the country's resources and the use of state funds for personal gain.²⁰⁹ Ultimately, the people of Sri Lanka were taken advantage of by their leaders and the potential of a country with incredible attributes saw their potential squandered.

B. *Floating or Flat: Sri Lanka's Exchange Rate Crisis*

At the heart of Sri Lanka's economic collapse are the technicalities regarding the country's exchange rate.²¹⁰ There are a variety exchange rates, namely a freely floating, managed float, pegged, or fixed exchange rate.²¹¹ Since 2001, Sri Lanka has maintained a freely floating exchange rate, which meant that its monetary authorities refused to intervene in the market and that the rate was determined by market forces and could fluctuate by any amount in response to market forces and government policies.²¹² The government maintained the flexible exchange rate even

²⁰⁶ See Rathindra Kuruwita, *In Defense of Sri Lanka's Defense Budget*, THE DIPLOMAT (Dec. 14, 2022), <https://thediplomat.com/2022/12/in-defense-of-sri-lankas-defense-budget/>.

²⁰⁷ See Tamanna Salikuddin, *Five Things to Know about Sri Lanka's Crisis*, U.S. INST. OF PEACE (July 15, 2022), <https://www.usip.org/publications/2022/07/five-things-know-about-sri-lankas-crisis>.

²⁰⁸ See Jeff M. Smith, *The Reign of the Rajapaksas Ends, Again*, THE HERITAGE FOUND. (Aug. 29, 2022), <https://www.heritage.org/asia/commentary/the-reign-the-rajapaksas-ends-again>.

²⁰⁹ See *id.*

²¹⁰ Ondaatjie & Karunungan, *Sri Lanka's Debt Crisis Lingers as Foreign-Currency Reserves Slip*, BLOOMBERG (last updated Mar. 7, 2022, 11:17 PM), <https://www.bloomberg.com/news/articles/2022-03-07/sri-lanka-s-debt-crisis-lingers-as-fx-reserves-slip-in-february#xj4y7vzkg>; Adopting a flexible exchange rate can lead to imbalances in the economy and during the civil war, the government maintained a flexible exchange rate system, and the value of the rupee has fluctuated in response to market forces and government policies.

²¹¹ See *Exchange Rates*, ENCYCLOPEDIA, <https://www.encyclopedia.com/social-sciences/applied-and-social-sciences-magazines/exchange-rates> (last visited Nov. 28, 2023).

²¹² *Id.*; see Andy Mukherjee, *Insolvent Sri Lanka Should Cancel Its Central Bank*, WASH. POST (May 1, 2022, 9:38 PM), https://www.washingtonpost.com/business/insolvent-sri-lanka-should-cancel-its-central-bank/2022/04/28/1fc60d5c-c750-11ec-8cff-33b059f4c1b7_story.html; see also *Domestic Foreign Exchange Market*, CENT. BANK OF SRI LANKA, <https://www.cbsl.gov.lk/en/financial-system/financial-markets/domestic-foreign-exchange-market> (last visited Oct. 21, 2023) ("Sri Lanka has a floating exchange rate

during a number of economic challenges after the civil war ended in 2009.²¹³ The global financial crisis and the resulting drop in tourism and remittances, as well as a sharp increase in oil prices, placed immense pressure on the country's balance of payments.²¹⁴ In addition, there was a large increase in government spending, which led to a significant increase in the budget deficit.²¹⁵

In 2021, the government eventually resorted to a fixed exchange rate, unofficially pegging the Sri Lankan rupee to the U.S. dollar.²¹⁶ However, this change did not last. The Central Bank of Sri Lanka (CBSL) began printing money to finance the government's deficit, which led to an increase in inflation and a depreciation of the rupee.²¹⁷ These circumstances forced the CBSL to deplete its foreign exchange reserves in an effort to maintain the fixed exchange rate, which made the country more vulnerable to external shocks.²¹⁸ Dwindling foreign currency reserves eventually forced the central bank to drop the peg.²¹⁹ The Sri Lankan rupee then collapsed.²²⁰

Mahinda Rajapaksa was voted out of power as a result of a worsening economic situation.²²¹ The new government, led by Maithripala Sirisena was forced to take measures to stabilize the economy, even seeking a loan from the IMF and once again allowing the rupee to float.²²² Although Sri Lanka saw a period of attempted stabilization, when Gotabaya Rajapaksa came to power as President in 2019, governmental naval-gazing and infighting came back to the fore.²²³

system since 2001 which allowed the independent adjustment of the exchange rate according to the market forces of demand and supply.”)

²¹³ *See id.*

²¹⁴ *See* Mukherjee, *supra* note 212.

²¹⁵ *See id.*

²¹⁶ *Id.*

²¹⁷ *See* P. Nandalal Weerasinghe, *Evolution of Monetary and Exchange Rate Policy in Sri Lanka and the Way Forward*, BANK OF INT'L SETTLEMENTS, <https://www.bis.org/revue/r180123d.pdf> (last visited Oct. 21, 2023).

²¹⁸ *See id.*

²¹⁹ *See id.*

²²⁰ *Id.*

²²¹ Jason Burke, *Sri Lanka Election: Shock as President Mahinda Rajapaksa Concedes Defeat*, THE GUARDIAN (Jan. 8, 2015, 08:35 PM), <https://www.theguardian.com/world/2015/jan/09/sri-lanka-election-shock-as-president-mahinda-rajapaksa-concedes-defeat>.

²²² *See* Shihar Aneez, *Exclusive: IMF Agrees to Extend Sri Lanka Loan Program, Disburse Delayed Tranche - Sources*, REUTERS (Feb. 28, 2019, 9:54 PM), <https://www.reuters.com/article/us-sri-lanka-imf-exclusive-idINKCN1QI3D3>.

²²³ *See* Pallavi Pundir, *Why This Rich and Powerful Family Is Blamed for All of Sri Lanka's Money Problems*, VICE (June 8, 2022, 1:12 AM), <https://www.vice.com/en/article/93a9ke/rajapaksa-wealth-politics-sri-lanka-economic-crisis>.

C. *The “E” in ESG: Influence and Impact of Environmental Altruism*

In 2019, Gotabaya Rajapaksa promised to wean Sri Lanka off chemical fertilizers with what he explained would be a ten-year transitional period.²²⁴ This campaign promise of gradual transition did not last long. In April 2021, Rajapaksa expedited his plan with a sudden ban on synthetic fertilizers and pesticides.²²⁵ By incorporating ESG policies into its frameworks, his government has made immense progress in reaching sustainability goals, showing its commitment towards sustainable development by reducing the country’s reliance on imported chemical fertilizers in furtherance of promoting the use of organic fertilizers.²²⁶ However, this policy had sweeping negative impacts on the country’s agricultural sector.²²⁷ Unfortunately, the rapid and uninhibited ban on chemical fertilizers also became a key contributing factor in the country’s later economic collapse.²²⁸

At the heart of Sri Lanka’s ban on chemical fertilizers, a reduction in crop yields has been shown to be one of the major impacts of the fertilizer ban.²²⁹ Sri Lankan farmers rely heavily on chemical fertilizers that are precisely balanced to ensure that plants retain specific nutrients that are required for optimal growth. Without access to the fertilizers, the farmers see a decline in crop yields.²³⁰

Over 90 percent of Sri Lanka’s farmers had used chemical fertilizers before they were banned. After they were banned, an astonishing 85 percent experienced crop losses. Rice production fell 20 percent and prices skyrocketed 50 percent in just six months. Sri Lanka had to import \$450 million worth of rice despite having been

²²⁴ Chelsea Follett & Malcolm Cochran, *Sri Lanka is a Wake-Up Call for Eco-Utopians*, HUM. PROGRESS (Jul. 15, 2022), <https://www.humanprogress.org/sri-lanka-is-a-wake-up-call-for-eco-utopians/>.

²²⁵ *Id.* (“[Rajapaksa] was so confident in his policies that he declared in a[n] . . . article for the World Economic Forum in 2018, ‘This is how I will make my country rich by 2025.’”) (quoting Ranil Wickremesinghe, *Sri Lanka PM: This is How I Will Make My Country Rich By 2025*, WORLD ECON. F., (Aug. 29, 2018)), [<https://web.archive.org/web/20190122012624/https://www.weforum.org/agenda/2018/08/this-is-how-we-will-make-sri-lanka-rich-by-2025/>].

²²⁶ *Id.*

²²⁷ *See id.*

²²⁸ Aanya Wipulasena & Mujib Mashal, *Sri Lanka’s Plunge Into Organic Farming Brings Disaster*, N.Y. TIMES (Dec. 7, 2021), <https://www.nytimes.com/2021/12/07/world/asia/sri-lanka-organic-farming-fertilizer.html>.

²²⁹ *Id.*

²³⁰ *Id.*

self-sufficient just months earlier. The price of carrots and tomatoes rose fivefold . . . [Tea exports crashed] 18 percent between November 2021 and February 2022—reaching their lowest level in more than two decades.²³¹

Consequently, Sri Lankan farmers were forced to rely on more expensive organic fertilizers that led to an increase in production costs.²³² Furthermore, the fertilizer ban made it difficult for many farmers to compete with larger and more industrialized farms. Heavy losses of income for smaller farmers were a result.²³³

Another impact of the ban includes a steady increase in food prices. As crop yields have decreased, the supply of certain food items has become limited, leading to higher prices for consumers.²³⁴ The shortage in food supply has made it more difficult for low-income families to afford basic food items and now contributes to rising levels of food insecurity.²³⁵ The ban also caused an increase in the use of hazardous pesticides and herbicides by farmers attempting to compensate for the loss of crop yields.²³⁶

Although the whole sequence of events began with the implementation of sustainable food systems, the knock-on effects show an increase in the use of these chemicals, which can be harmful to human health and the environment.²³⁷ While the intentions of the ban were admirable, the lack of proper planning and implementation has led to unintended negative consequences. The ban has made it more difficult for farmers to earn a living and for consumers to afford basic food items.²³⁸

The ban also contributed, along with corruption and financial mismanagement, to an economic collapse.²³⁹ The economic collapse came directly as a result of the government's default on its \$51 billion foreign debt in 2022.²⁴⁰ The crisis led to severe inflation, daily blackouts, and a

²³¹ Follett & Cochran, *supra* note 224.

²³² Uditha Jayasinghe & Devjyot Ghoshal, *Fertiliser Ban Decimates Sri Lankan Crops as Government Popularity Ebbs*, REUTERS (Mar. 3, 2022, 4:01 AM), <https://www.reuters.com/markets/commodities/fertiliser-ban-decimates-sri-lankan-crops-government-popularity-ebbs-2022-03-03/>.

²³³ *See id.*

²³⁴ *See id.*

²³⁵ Wipulasena & Mashal, *supra* note 228.

²³⁶ *See id.*

²³⁷ *See id.*; *see also* Jayasinghe & Ghoshal, *supra* note 232.

²³⁸ *See id.*

²³⁹ *See* Arudpragasam, *supra* note 199.

²⁴⁰ Lillian Karnungan & Amelia Pollard, *Sri Lanka Falls Into Default For The First Time Ever*, BLOOMBERG, <https://www.bloomberg.com/news/articles/2022-05-19/sri-lanka-enters-default-and-warns-inflation-may-surge-to-40#xj4y7vzkg> (May 19, 2022, 4:39 PM).

shortage of fuel and domestic gas.²⁴¹ As a result, the citizenry flocked to the presidential palace of Gotabaya Rajapaksa demanding that he step down from office.²⁴² To the surprise of tens of thousands of protesters, the president had already escaped to the Maldives.²⁴³

As it turns out, Sri Lanka would have been wiser to take a step back from initiating ESG standards. The country was already facing significant economic difficulties as a result of a number of factors, particularly a lack of foreign direct investment and political unrest,²⁴⁴ and well intentioned ESG policies turned toxic when rapid transition was introduced into this mix.

VI. STRIKING A BALANCE: ESG AND A HEALTHY ECONOMY

A country like Sri Lanka needs to balance the implementation of ESG policies with the need to maintain a healthy economy. The feasible adoption of ESG standards can be achieved by taking a phased approach to implementing ESG policies, starting with the most pressing and critical issues and gradually building up to more comprehensive policies.²⁴⁵ More specifically, the policies must integrate the promotion of economic growth with the improvement of the environment. While carrying out ESG policies is important for promoting sustainable development and producing long-term economic prosperity, some countries need to exercise restraint and caution when applying ESG measures until their economic infrastructures are able to handle the added challenges.²⁴⁶ Sri Lanka, with its economic issues, political unrest, high levels of debt and lack of foreign direct investment became a particularly inappropriate candidate for rapid implementation.²⁴⁷

Vietnam, another frontier market uses a phased approach to the introduction of ESG policies.²⁴⁸ The state has been working to improve its

²⁴¹ Ayeshea Perera, *Sri Lanka: Why is the Country in an Economic Crisis?*, BBC NEWS (Mar. 29, 2023), <https://www.bbc.com/news/world-61028138>.

²⁴² *Id.*

²⁴³ Uditha Jayasinghe et al., *Sri Lankan President Flees to Maldives, Protestors Storm Prime Minister's Office*, REUTERS (July 13, 2022, 6:31 PM), <https://www.reuters.com/world/asia-pacific/sri-lanka-president-gotabaya-rajapaksa-flees-country-ap-2022-07-12/>.

²⁴⁴ *Id.*

²⁴⁵ See generally Ngoc Anh Tran et al., *A Snapshot of ESG in Vietnam*, ALLENS (Aug. 16, 2022), <https://www.allens.com.au/insights-news/insights/2022/08/a-snapshot-of-esg-in-vietnam/>.

²⁴⁶ See Marc Jones, *Climate and ESG Risks Hurting 60% of Developing Countries' Ratings*, REUTERS, <https://www.reuters.com/article/idUSL1N2JT0XW/> (Jan. 18, 2021, 8:46 AM).

²⁴⁷ See Perera, *supra* note 241.

²⁴⁸ See Tran et al., *supra* note 245.

environmental policies and reduce its carbon emissions.²⁴⁹ To accomplish these goals, the country started with pilot projects, testing different technologies and strategies for reducing carbon emissions.²⁵⁰ For example, Vietnam's newest Power Development Plan increased its targets for renewable energy generation to twenty-six percent of the total electricity generated within the country.²⁵¹

Seeking to limit the consequences on their economy, the Vietnamese government attempts to lessen their carbon footprint through high-impact, low-cost initiatives.²⁵² For instance, leaning on fundamental changes, Vietnam has implemented policies and programs to promote the use of energy-efficient lighting in homes and businesses.²⁵³ These initiatives include providing subsidies and incentives for households and businesses to purchase energy-efficient lighting, as well as setting standards for energy-efficient lighting products.²⁵⁴ Implementing eco-friendly policies in this way allows for choice and provides an affordable route to consumers and producers. On a larger scale, Vietnam has been pushing the use of bio-fuels and biogas as a way to reduce its dependence on fossil fuels and promote sustainable development.²⁵⁵ Specifically, biogases, which are generated from the fermentation of organic matter such as agricultural waste and livestock manure, are used for cooking and heating and can provide a source of income for farmers.²⁵⁶ To go even further, Vietnam has also put in place feed-in tariffs as a policy mechanism that guarantees a fixed price for electricity generated from the use of bio-fuels and other renewable energy sources.²⁵⁷ The fixed price brought on by feed-in tariffs, although higher than the market price, incentivizes developers to limit their initial overhead costs.²⁵⁸ Once again, the ability for

²⁴⁹ *See id.*

²⁵⁰ *See id.*

²⁵¹ Thang Nam Do et al., *Vietnam's Solar and Wind Power Success: Policy Implications for the Other ASEAN Countries*, 65 ENERGY FOR SUSTAINABLE DEV. 1, 5 (2021).

²⁵² *See From Ambition to Impact: Vietnam ESG Readiness Report 2022*, PWC (2022), <https://www.pwc.com/vn/en/publications/2022/pwc-vietnam-esg-readiness-2022-en.pdf>.

²⁵³ *Vietnam - National Energy Efficiency Program 2019 – 2030*, WORLD BANK, <https://documents1.worldbank.org/curated/en/598851561961183317/pdf/Vietnam-National-Energy-Efficiency-Program-2019-2030.pdf>.

²⁵⁴ *See id.*

²⁵⁵ *Transforming Waste into Biogas in Vietnam*, MYCLIMATE, <https://www.myclimate.org/information/carbon-offset-projects/detail-carbon-offset-projects/vietnam-biogas-7229/>.

²⁵⁶ *Id.*

²⁵⁷ *See Vietnam to Cut Rooftop Solar Feed-in Tariff in Bid to Ease Grid Pressure*, REUTERS (Mar. 17, 2021, 4:21 PM), <https://www.reuters.com/article/vietnam-energy-solar-idAFL4N2LF1ZL>.

²⁵⁸ *See generally* Alexander Morse, *Can a Feed-In Tariff Help Increase Renewable Energy Capacity?*, ROCKEFELLER INST. OF GOV'T (Feb. 24, 2021), <https://rockinst.org/bl og/can-a-feed-in-tariff-help-increase-renewable-energy-capacity/>.

consumers to choose allows for development when it can be afforded rather than forced.

Even as Vietnam has implemented these high-impact, low-cost projects through a phased approach, it has experienced strong economic growth in recent years.²⁵⁹ With a GDP growth rate averaging five to seven percent per year, the country finds itself amongst the flourishing frontier market countries.²⁶⁰ Vietnam has a young and rapidly growing population, and a relatively low cost of labor which makes it an attractive destination for foreign investment.²⁶¹ The comparison with Sri Lanka is telling. According to the Corruption Perceptions Index (“CPI”), Vietnam finds itself trending upwards towards a less corrupt government whereas Sri Lanka finds itself trending downwards on the index.²⁶² Such data points indicate that Vietnam gave itself a better chance of succeeding at implementing sustainability developments because their governments maintained healthy habits before enacting environmental initiatives. By prioritizing healthy economic habits, Vietnam has been able to protect the wallet of consumers and producers while also establishing a route towards sustainability.

Other frontier markets, alongside phased approaches to implementing ESG policies, have put in place mechanisms to monitor and evaluate progress of these sustainability initiatives. For example, Ethiopia carefully monitors and analyzes its ESG projects through government agencies such as the Ministry of Environment, Forest, and Climate Change and the Ministry of Energy.²⁶³ These agencies are responsible for making adjustments as needed to provide the greatest chance of success.²⁶⁴ Ethiopia also conducts Environmental and Social Impact Assessments of its major development projects.²⁶⁵ These assessments help to identify

²⁵⁹ See *Vietnam World Economic Outlook (April 2024)*, INT’L MONETARY FUND, <https://www.imf.org/external/datamapper/profile/VNM>.

²⁶⁰ See *id.*; see also *MSCI Frontier Markets Index (USD)*, MSCI, <https://www.msci.com/documents/10199/f9354b32-04ac-4c7e-b76e-460848afe026>.

²⁶¹ See Phyllis Schwartz, *The Vietnam Manufacturing Advantage*, CONSUMER TECHNOLOGY ASS’N (Apr. 05, 2021), <https://www.cta.tech/Resources/i3-Magazine/i3-Issues/2021/March-April/The-Vietnam-Manufacturing-Advantage>.

²⁶² See *Corruption Perceptions Index*, TRANSPARENCY INT’L (last visited 2022), <https://www.transparency.org/en/cpi/2022>; Vietnam scores a 42 out of 100, while Sri Lanka scores 36/100.

²⁶³ Kaleab Girma, *Coal Mining Threatens Ethiopia’s Ancient Coffee Forest*, MONGABAY (June 14, 2022), <https://news.mongabay.com/2022/06/coal-mining-threatens-ethiopia-ancient-coffee-forest/>.

²⁶⁴ See *id.*

²⁶⁵ Melisha Charles et al., *A Roadmap for ESIA Policy Change in Ethiopia Should Address Wide-Ranging Governance Reforms*, 40, INT’L ASS’N FOR IMPACT ASSESSMENT, 243, 243-244, (2022).

mitigation measures to minimize negative impacts to a specific project.²⁶⁶ Ethiopia has proven that sustainability projects can be undertaken while also pursuing a burgeoning economy.²⁶⁷ Even as the country implemented measures such as a National Climate Resilience Strategy and a National Forest Policy, Ethiopia has seen a GDP growth rate averaging around 6.2 percent per year.²⁶⁸

The private sector has emerged as a significant source of funding for sustainability initiatives in emerging and frontier markets,²⁶⁹ assisting governments that often have limited resources and face competing priorities.²⁷⁰ Impact investing is just one of the many ways that the private sector helps provide the necessary funding for sustainability developments. Impact investing allows for companies or corporations to invest in the types of projects that have constructive societal or environmental impacts.²⁷¹ This type of investment can take many forms, from venture capital funding for early-stage companies to debt financing for sustainable infrastructure projects.²⁷²

The private sector can also partner with governments and international organizations to implement sustainable projects. Public-private partnerships are a commonly used method for implementing infrastructure projects around the world—renewable energy projects, water treatment plants, and waste management facilities among other possibilities.²⁷³ The private company provides the necessary capital for the project and operates it, while the government provides land or other resources and purchases the energy produced.²⁷⁴ It is important to note, however, that these agreements must be structured in a way that is fair to both the public

²⁶⁶ *Id.* at 243.

²⁶⁷ *See generally id.* at 243, 245, 250.

²⁶⁸ *See generally Ethiopia's Climate Resilient Green Economy National Adaptation Plan*, FED. DEMOCRATIC REPUBLIC OF ETH. (May 2019), <https://www4.unfccc.int/sites/NAPC/Documents/Parties/Final%20Ethiopia-national-adaptation-plan%20%281%29.pdf>; *see also Ethiopia World Economic Outlook*, INT'L MONETARY FUND (Apr. 2024), <https://www.imf.org/external/datamapper/profile/ETH>.

²⁶⁹ *See generally* Ananthakrishnan Prasad et al., *Mobilizing Private Climate Financing in Emerging Market and Developing Economies*, 2022 STAFF CLIMATE NOTES 1 (2022).

²⁷⁰ *See id.* at 19.

²⁷¹ *See generally id.* at 9.

²⁷² *See id.* at 9, 11.

²⁷³ *See generally* Kotsopoulos & DeCandido, *Why PPPs Are the Intersection between ESG and Infrastructure*, PREQIN (Sept. 6, 2021), <https://www.preqin.com/insights/research/blogs/why-ppps-are-the-intersection-between-esg-and-infrastructure>.

²⁷⁴ *See generally Public-Private Partnership Handbook*, ASIAN DEV. BANK, <https://www.adb.org/sites/default/files/institutional-document/31484/public-private-partnership.pdf> (last visited Mary 13, 2024).

and private sectors and that the government maintains control over key aspects of the project.²⁷⁵

VII. FACING THE MIRROR: CREDIT EVALUATION UPHEAVAL

Even as frontier and emerging market countries attempt to balance the implementation of ESG policies and the development of a healthy economy, credit evaluating institutions need to acknowledge that they could help alleviate the burdens that weigh on governments. At an institutional level, sovereign credit evaluations are an important tool for investors to assess the creditworthiness of a country and determine the risk of lending money to that country.²⁷⁶ However, as more and more investors are becoming aware of the importance of ESG factors impacting their portfolios, there is growing concern that these evaluations are placing too much weight on ESG considerations and not enough on traditional economic factors.²⁷⁷

It is also important to ensure that ESG considerations do not unduly influence sovereign credit evaluations and make it more difficult for frontier and emerging markets to attract foreign investment. Foreign direct investment into countries is vital to maintaining these countries' long-term economic health as foreign investment confers many benefits onto a growing economy.²⁷⁸ Meanwhile, creditors should take a more flexible approach to their ESG evaluations. For instance, rather than evaluating a country's compliance with a specific set of ESG regulations, credit rating agencies could focus on whether a country is making progress to reduce its greenhouse gas emissions or improving its governance structure.²⁷⁹ These fundamental changes would allow agencies to more accurately assess a country's long-term sustainability while also still taking into account traditional economic factors. For instance, if Gotabaya Rajapaksa had retained his original plan for a ten year transition towards complete use of organic fertilizer, credit ratings agencies could still have provided a

²⁷⁵ *See id.*

²⁷⁶ *See* Brian Tayan, *ESG Ratings: A Compass without Direction*, HARV. L. SCH. F. ON CORP. GOVERNANCE (Aug. 24, 2022), <https://corpgov.law.harvard.edu/2022/08/24/esg-ratings-a-compass-without-direction/>.

²⁷⁷ *See id.*

²⁷⁸ Prakash Loungani & Assaf Razin, *How Beneficial Is Foreign Direct Investment for Developing Countries?*, INT'L MONETARY FUND (Jun. 2001), <https://www.imf.org/external/pubs/ft/fandd/2001/06/loungani.htm> (explaining that "FDI is seen as 'good cholesterol' because it can confer benefits.").

²⁷⁹ *See generally* Torsten Ehlers et al., *Green Bonds and Carbon Emissions: Exploring the Case for a Rating System at the Firm Level*, BIS Q. REV. (Sept 14, 2020), https://www.bis.org/publ/qtrpdf/r_qt2009c.htm.

score determined by the effort put forth by Sri Lanka.²⁸⁰ Furthermore, to avoid hindering the ability of countries in frontier and emerging markets to attract foreign investment, sovereign credit evaluations should take into account external factors that may impair a country's ability to implement ESG policies.²⁸¹ For example, evaluations could consider the impact of global commodity prices or changes in trade policies on a country's ability to implement policies to reduce emissions or improve governance. The reluctance by credit rating agencies to tailor their evaluations is coming at a cost to sovereigns and the goal of balancing sustainability initiatives with a healthy economy.

In short, the evaluation of a country's creditworthiness should take a nuanced approach looking towards a variety of factors, including a country's progress towards improving governance structures, its reduction of fossil fuel output, and its implementation of sustainable development initiatives.²⁸² Such an approach would consider a country's unique circumstances and challenges and would recognize that progress in these areas is often gradual.²⁸³ For instance, countries with readily available renewable energy resources are able to reduce their carbon emissions where countries that rely far more heavily on the use of fossil fuels are not.²⁸⁴ Similarly, a nation that has a history of political unrest (e.g. Sri Lanka, Lebanon) may face greater challenges when attempting to improve its governance structures than a country with a more stable political environment.²⁸⁵

Further, by adopting a more nuanced approach, credit rating agencies would assess a country's progress in these areas over time, rather than simply assigning a fixed rating based on a snapshot in time.²⁸⁶ Nuanced standards should also take into account a country's efforts to address ESG issues, such as the development of a comprehensive climate action plan, the implementation of anti-corruption measures, or the establishment of an independent regulatory body to oversee environmental and social concerns. Nuanced standards should also allow credit rating agencies to consider the private sector's engagement and efforts in applying sustainability goals. Specifically, a microscope could be placed on the

²⁸⁰ See Follett & Cochran, *supra* note 224; President Gotabaya Rajapaksa grew concerned about soil degradation and therefore implemented the sudden shift in 2021.

²⁸¹ See Ehlers et al., *supra* note 279.

²⁸² GRATCHEVA ET AL., *supra* note 156, at 8.

²⁸³ See *id.* at 7.

²⁸⁴ See generally *id.* at 43.

²⁸⁵ Zeina Karam & David Rising, *A World Apart, Lebanon and Sri Lanka Share Economic Collapse*, THE ASSOCIATED PRESS (June 24, 2022, 12:03 AM), <https://apnews.com/article/covid-health-lebanon-asia-55efa30436d38e5885d74d204d7f572b>.

²⁸⁶ See *id.*, at 8.

extent to which companies are transparent in their financial reporting and have strong internal controls in place to prevent fraud. Looking to such metrics would help to balance the weight of ESG implementation and create a more collaborative approach to addressing these issues.

CONCLUSION

Overall, ESG strategies back frontier and emerging market countries into a corner and if possible should be cautious when taking on foreign debt when ESG conditions are attached.²⁸⁷ These conditions can have significant economic impacts on vulnerable markets, which are often fragile and in need of development.²⁸⁸ As seen in the example of Sri Lanka, a chemical fertilizer ban that was implemented with the goal of promoting sustainable agriculture²⁸⁹ caused a sudden shift to organic fertilizers that in turn led to a decrease in crop yields and increased food prices, which negatively impacted the country's economy.²⁹⁰

In order to balance a healthy economy while implementing ESG policies, it is important for actors in these markets to consider the potential economic consequences and plan accordingly. This may include investing in research and development to find sustainable alternatives, providing support to affected industries, and engaging in comprehensive stakeholder consultations.

In tandem, rating agencies should take a more nuanced approach when evaluating ESG policies in frontier and emerging markets. Rather than solely focusing on a country's adherence to ESG standards, they should also consider the economic context and the potential impacts of their rating on a country's economy. These tailored considerations will ensure that ESG policies are implemented in a way that is both responsible and sustainable. Furthermore, sovereign borrowers in frontier and emerging markets should also be aware of the impact of ESG policies on their credit ratings, as these ratings have significant impacts on their ability to access foreign debt. They should be aware of the requirements of ESG rating agencies and take measures to improve their ratings accordingly, without compromising on the economic growth and development of their countries.

Although holding off on applying ESG standards may seem like a hard pill to swallow and as much as countries may want to help tackle climate change as soon as possible, there must be an awareness that certain parts

²⁸⁷ See Yukhananov, *supra* note 64.

²⁸⁸ See *id.*

²⁸⁹ See Wipulasena & Mashal, *supra* note 228.

²⁹⁰ *Id.*

of the world are not ready to completely stray away from traditional practices. Without the same level of resources and regulations as developed markets, a more cautious approach needs to be undertaken so as not to disturb economic flows. Worth noting is that these countries often have a larger need to rely on natural resources and traditional industries, such as agriculture and mining, which at present by necessity require fossil fuels. Therefore, implementing ESG policies has and will most likely harm economies of emerging and frontier markets for the foreseeable future.