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Global Financial Governance and Security Risks: IMF Programs in Terrorism-Linked Economies

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Abstract: *The International Monetary Fund (IMF) was established to provide global financial stability, yet its interventions in fragile economies have produced controversial outcomes. While IMF programs often provide short-term relief to nations with balance-of-payment crises, in the case of gray-listed countries—those identified by the Financial Action Task Force (FATF) for weak measures against terrorism financing—the assistance can have unintended geopolitical consequences. By sustaining the economies of states accused of supporting terrorism directly or indirectly, IMF bailouts allow such regimes to redirect domestic resources towards non-developmental priorities, including militarization and proxy warfare. For countries like India, which are directly impacted by cross-border terrorism and regional instability, this dynamic raises serious security concerns. This paper critically examines IMF's structural role, explores its interaction with gray-listed economies and argues for reforms that ensure international financial aid does not indirectly sustain terrorism or undermine regional peace.*

Keywords: IMF, Gray-Listed Economies, Terrorism Financing, FATF, Indian Security Interests

I. INTRODUCTION

The International Monetary Fund (IMF), founded in 1944, was created to promote global monetary cooperation, ensure exchange rate stability, and provide short-term financial assistance to members in balance of payments crises. Over time, it has become a key institution shaping the policies of developing and emerging economies. While its mandate is to safeguard financial stability, IMF interventions in fragile economies have often sparked debate over their broader political and security impacts.

Although presented as apolitical, IMF lending frequently intersects with geopolitics—particularly in economies flagged by the Financial Action Task Force (FATF) as gray-listed for deficiencies in countering money laundering and terrorism financing. By stabilizing such economies, IMF support can inadvertently allow governments with weak institutions and alleged links to terrorism to persist without reform. This raises a core dilemma: can international financial aid, without security oversight, truly foster stability or does it risk sustaining environments that fuel insecurity?

For India, a strong advocate of rules-based multilateralism and a direct victim of cross-border terrorism, this question is critical. IMF lifelines to gray-listed states may indirectly free domestic resources for militarization or non-state actors, creating a cycle where crises invite bailouts, bailouts restore temporary stability, and that stability prolongs security risks. This paper examines how IMF assistance to gray-listed and terrorism-linked economies affects regional stability, arguing that lack of coordination with security-focused bodies like FATF creates policy gaps that must be addressed to align global finance with global security.

II. IMF ENGAGEMENT WITH FRAGILE ECONOMIES

The International Monetary Fund (IMF) serves as the world's primary lender of last resort, aiming to prevent financial contagion and stabilize economies in crisis. Since the 1980s, its role has expanded through Structural Adjustment Programs (SAPs), which require borrowing states to adopt fiscal austerity, liberalization, and subsidy cuts in exchange for funding. These measures intend to restore stability but have often produced mixed outcomes in politically fragile states.

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Among them are gray-listed economies—identified by the Financial Action Task Force (FATF) for weaknesses in countering money laundering and terrorism financing. IMF support to such states is meant to avert collapse, yet it often cushions governments from the consequences of poor governance and limited security compliance. Many of these states return repeatedly to IMF programs, creating cycles of dependency rather than lasting reform.

The IMF's own evaluations note that programs in fragile environments achieve only brief stabilization before reforms stall. Because IMF funding focuses solely on macroeconomic targets and not on how freed domestic resources are used, it can indirectly allow continued spending on security or military sectors. This undermines FATF's pressure-based approach, which relies on financial constraints to push reforms.

For India, this poses a strategic concern: IMF lending can stabilize economies without addressing their security risks, weakening global counter-terrorism efforts and sustaining environments that threaten regional stability.

III. ECONOMIC IMPACTS OF IMF ASSISTANCE ON GRAY-LISTED COUNTRIES

IMF programs in gray-listed economies—identified by the Financial Action Task Force (FATF) for deficiencies in countering money laundering and terrorism financing—produce mixed outcomes. While they often deliver short-term stabilization, their long-term effects frequently include renewed debt crises, dependency, and weakened social sectors.

3.1 Short-Term Stabilization

IMF disbursements boost reserves, slow currency depreciation, and improve market sentiment. As shown in Table 1: IMF Program Frequency and FATF Status (2010–2023), gray-listed economies enter IMF programs far more frequently than other developing states, yet show limited FATF compliance progress during program periods.

Table 1: IMF Program Frequency and FATF Status (2010–2023)

Category	Gray-Listed Economies (avg.)	Non–Gray-Listed Developing Economies (avg.)
Number of IMF programs (2010–2023)	4.2	1.7
Median interval between programs	2.7 years	6.8 years
Completion rate of IMF programs	48%	79%
FATF compliance improvement	Limited (2–3 recommendations)	Moderate (6–8 recommendations)

Source: IMF IEO Review 2022; FATF Mutual Evaluation Reports

3.2 Long-Term Structural Weakness

Despite temporary gains, post-program indicators show relapse. Table 2: Macroeconomic Indicators Before, During, and After IMF Programs highlights that debt burdens rise while growth and reserves decline after program completion, showing shallow reform and dependency.

Table 2: Macroeconomic Indicators Before, During, and After IMF Programs

Indicator	Pre-Program	During Program	Post-Program
Reserves (months of imports)	1.8	3.4	1.6
Annual inflation (%)	15.3	9.2	13.8
Real GDP growth (%)	0.8	2.4	0.5
Public debt-to-GDP (%)	65	71	83
Defense share of budget (%)	19	21	22

Source: IMF Country Reports; World Bank WDI; SIPRI Database

3.3 Security Implications of Economic Effects

These patterns indirectly affect security. IMF funds stabilize macroeconomic indicators but also free domestic revenues that can be diverted to security or military spending, while social sectors absorb austerity cuts. In gray-listed states, this dynamic blunts FATF's pressure mechanism and prolongs financial networks linked to terrorism.

For India, this linkage between financial relief and security risk is central: IMF aid meant to prevent economic collapse may inadvertently enable regimes to sustain the very networks that fuel regional instability.

IV. GEOPOLITICAL AND SECURITY IMPLICATIONS

IMF programs in gray-listed economies have consequences that go beyond economics. By stabilizing fragile states without addressing their security deficiencies, they can indirectly weaken global counter-terrorism frameworks and create risks for regional stability, especially from India's standpoint.

4.1 Stabilizing Economies Without Security Oversight

IMF lending targets macroeconomic stability—currency support, fiscal consolidation, and external balance—but ignores security compliance. This creates tension with the Financial Action Task Force (FATF), which relies on financial pressure to push gray-listed states toward reforms. IMF support eases this pressure, allowing such governments to avoid addressing terrorism-financing deficiencies while still receiving global liquidity.

4.2 Fiscal Space for Militarization

Because IMF funds are not tracked for end-use, they indirectly free domestic resources that governments can redirect. In many gray-listed states, this means sustained or rising defense spending even during austerity, while social sectors face cuts. Such patterns shield military and security apparatuses that may enable support—direct or indirect—for non-state violent actors.

4.3 Undermining Global Security Architecture

This dynamic creates a contradiction between two major global regimes: the IMF promoting financial stability and FATF pushing counter-terrorism compliance. When these operate in isolation, IMF lending can dilute FATF's deterrent effect, eroding the credibility of international efforts to cut terror financing networks.

4.4 Strategic Concerns for India

For India, which has consistently faced cross-border terrorism, this contradiction is deeply concerning. IMF support helps gray-listed states withstand the economic costs of FATF scrutiny, indirectly enabling them to maintain hostile capabilities. It also signals that geopolitical interests can override security norms, undermining trust in multilateral systems where India is a responsible contributor but has limited voting influence.

V. INDIAN PERSPECTIVE

India's stance on IMF support to gray-listed economies is shaped by its dual role as a major emerging economy and a state directly affected by cross-border terrorism. While India supports global financial stability, it views unconditional IMF assistance to terrorism-linked states as a security risk.

5.1 Security Concerns

Gray-listed states are flagged by the Financial Action Task Force (FATF) for deficiencies in countering money laundering and terror financing. When such states receive IMF aid, they can prevent financial collapse while continuing to divert domestic resources to security or military uses. This undermines FATF's pressure-based approach and indirectly sustains networks that threaten India's security.

5.2 Diplomatic and Governance Imbalance

India has only about 2.6% voting share in the IMF, limiting its influence on lending decisions, while advanced economies hold over 50% collectively. This imbalance allows strategic considerations of major shareholders to outweigh security concerns of directly affected nations like India. Such decisions weaken trust in multilateralism and create perceptions of bias.

5.3 Economic Spillovers

IMF-backed stabilization in gray-listed states can briefly boost regional sentiment but often ends in renewed crises. These cycles create financial volatility, illicit flows, and instability that spill over into India's regional trade and

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investment environment. They also slow poverty reduction and development in neighboring economies, raising indirect risks.

5.4 India's Strategic Approach

India advocates linking IMF support with FATF compliance. It supports tying disbursements to measurable progress on the FATF's 40 Recommendations and strengthening financial intelligence systems. India also backs broader IMF governance reforms to give emerging economies greater say, ensuring security-sensitive perspectives shape lending to high-risk states.

VI. CRITICISM OF IMF IN DEVELOPING AND HIGH-RISK STATES

The IMF has played a crucial role in averting financial crises in developing countries, yet its interventions have faced significant criticism from scholars, policymakers, and civil society. In politically fragile and high-risk states, IMF lending is often accused of causing economic distortions, fostering dependency, and exacerbating social and political instability—concerns that are particularly acute for gray-listed economies, where financial stability and security are closely linked.

6.1 Structural Adjustment and Social Costs

A major critique centers on the IMF's conditionalities, especially the Structural Adjustment Programs (SAPs) of the 1980s. SAPs required austerity, currency devaluation, trade liberalization, and privatization. While designed to restore macroeconomic balance, they often reduced spending on health, education, and welfare, triggering inflation, unemployment, and social unrest. Research by Stiglitz (2002), Easterly (2005), and the IMF's IEO (2019) shows that SAPs often deepened short-term poverty and rarely produced sustained growth. In gray-listed states, such shocks can worsen insecurity by enabling extremism and illicit financial activity.

6.2 The Dependency Trap

Critics also highlight the IMF's role in creating long-term dependency. Over 70% of programs in low-income countries are followed by another within five years (IMF IEO, 2022), reflecting weak domestic institutions and a focus on short-term stabilization over structural reform. In gray-listed economies, repeated borrowing can weaken incentives to strengthen anti-money laundering and counter-terrorism measures, undermining the purpose of FATF gray-listing and perpetuating financial and security vulnerabilities.

6.3 Political Bias and Geopolitical Selectivity

The IMF is often accused of political bias, favoring countries aligned with major shareholders (Dreher & Jensen, 2007; Stone, 2011). This can lead to lenient conditionalities for strategic partners, raising concerns that geopolitical interests override economic and security considerations. For India, this can mean that assistance to gray-listed states dilutes the pressure to curb terror financing, eroding trust in multilateral financial governance.

6.4 Governance Deficits and Lack of Security Coordination

Finally, the IMF operates largely in isolation from security-focused institutions. Its mandate prioritizes economic assessment, leaving no formal mechanism to factor in FATF compliance or security risks. Consequently, IMF lending can counteract FATF restrictions, stabilizing economies without addressing underlying insecurity. Scholars like Griffith-Jones (2020) and Moyo (2018) argue for integrated frameworks linking financial assistance to security conditions to prevent such systemic gaps.

VII. POLICY RECOMMENDATIONS

IMF support to fragile and gray-listed economies often stabilizes finances but can weaken global security by reducing pressure on governments linked to terrorism financing. For India, a major emerging economy and frequent target of

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cross-border terrorism, this poses real risks. Addressing these challenges requires reforms to align IMF assistance with security objectives while supporting development in vulnerable states.

7.1 Integrating FATF Compliance into IMF Lending

IMF lending currently ignores a country's FATF status, allowing gray-listed states access to funds without addressing terror financing deficiencies.
Policy proposals:
Make FATF compliance a precondition for IMF disbursements in high-risk states.
Integrate FATF mutual evaluation reports into IMF staff assessments.
Link fund release to progress on FATF's 40 Recommendations, focusing on terror financing, beneficial ownership transparency, and financial intelligence units.
This ensures financial stabilization does not undermine global security norms.

7.2 Establishing a Joint Oversight Mechanism

India can advocate for a coordinated IMF–FATF platform to monitor fund usage in gray-listed states.
Policy proposals:
Create a security-compliance unit within the IMF to review lending proposals.
Collaborate with FATF's International Cooperation Review Group (ICRG) to prevent indirect support of terrorism-linked networks.
Close the gap between economic and security governance.

7.3 Reforming IMF Governance

Greater inclusion of emerging economies can bring security-sensitive perspectives into decision-making.
Policy proposals:
Adjust IMF quota shares to increase representation for major emerging economies, including India.
Require supermajority approval for lending to gray-listed/high-risk states.
Establish advisory roles for regional stakeholders affected by IMF programs.
These changes make IMF governance more inclusive and accountable.

7.4 Conditional Developmental Assistance

Support should link stabilization with institutional and governance reforms.
Policy proposals:
Structure programs so initial disbursements address crises, while later tranches require measurable progress in financial governance, rule of law, and anti-terror financing.
Promote IMF and World Bank technical assistance to strengthen domestic regulatory, tax, and judicial capacity.
This approach balances stabilization with long-term institutional development, reducing dependency.

7.5 Alternative Regional Financing Mechanisms

India should enhance regional and multilateral financing options to reduce sole reliance on the IMF.
Policy proposals:
Expand the BRICS New Development Bank and AIIB to provide emergency funds with security-compliance clauses.
Promote a South Asian financial stability forum to coordinate regional crisis responses while enforcing counter-terrorism financing norms.
These measures diversify financial governance and limit gray-listed states' ability to bypass reforms through IMF bailouts.

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VIII. CONCLUSION

The IMF has long acted as a guardian of global financial stability, stepping in to prevent economic collapse in states facing severe balance-of-payments crises. However, as this paper has shown, its interventions in fragile and gray-listed economies—those flagged by FATF for deficiencies in countering money laundering and terrorism financing—often generate unintended security consequences. While IMF programs provide short-term stabilization, they can also allow governments to delay structural reforms and divert resources toward militarization or non-developmental spending, indirectly sustaining financial networks that facilitate terrorism.

For India, this paradox carries particular significance. As both a major IMF contributor and a country directly impacted by cross-border terrorism, India faces the dual challenge of supporting global economic stability while safeguarding regional security. IMF assistance to gray-listed states weakens the financial pressure intended by FATF mechanisms, allowing high-risk states to benefit from liquidity without meaningful reform. Meanwhile, responsible states bear the burden of compliance, creating structural imbalances and eroding confidence in rules-based multilateralism.

Resolving this contradiction requires more than rhetoric—it demands institutional reform. IMF lending frameworks should integrate FATF compliance criteria, and formal coordination mechanisms must ensure that financial support does not inadvertently enable terrorism financing. India, with its growing economic clout and commitment to multilateralism, is well positioned to lead this agenda. By advocating IMF governance reforms, supporting joint oversight with FATF, and promoting alternative regional financing platforms, India can help align global financial assistance with security imperatives.

Ultimately, the goal is not to withhold aid from fragile economies but to ensure that such support strengthens, rather than undermines, stability. Aligning global finance with global security is essential for lasting peace, sustainable development, and a resilient international order.

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