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President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Materials

Corruption - July 19, 1996

Archive Management for the President's Office

Document Log

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Edit

Print

A. CLASSIFICATION

- ☒ Meeting Material
- ☐ Trips
- ☐ Speeches

- ☐ Annual Meetings
- ☐ Corporate Management
- ☐ Communications with Staff

- ☐ Phone Logs
- ☐ Calendar
- ☐ Press Clippings/Photos

- ☐ JDW Transcripts
- ☐ Social Events
- ☐ Other

B. SUBJECT: MEETING: CORRUPTION
VENUE: E1227 (CONF. ROOM)
IN ATTENDANCE: JDW, SANDSTROM, SHIHATA, ZHANG,
KOCH-WESER, MUIS, M. STEVENS, LOMAX, JOSIE
AGENDA: UPDATE ON CORRUPTION IN PREPARATION FOR JULY 23
INFORMAL MEETING WITH THE BOARD
EXC: JOSIE //LFG (7/16/96 2:40p)

DATE: 07/19/96

C. VPU

Corporate

- ☐ CTR
- ☐ EXT
- ☐ LEG
- ☐ MPS
- ☐ OED
- ☐ SEC/Board
- ☐ TRE

Regional

- ☐ AFR
- ☐ EAP
- ☐ ECA
- ☐ LAC
- ☐ MNA
- ☐ SAS

Central

- ☐ CFS
- ☐ DEC
- ☐ ESD
- ☐ FPD
- ☐ FPR
- ☐ HRO

Affiliates

- ☐ GEF
- ☐ ICSID
- ☐ IFC
- ☐ Inspection Panel
- ☐ Kennedy Center
- ☐ MIGA

D. EXTERNAL PARTNER

- ☐ IMF
- ☐ UN
- ☐ MDB/Other IO
- ☐ NGO
- ☐ Private Sector

- ☐ Part I
- ☐ Part II
- ☐ Other

E. COMMENTS:

ALL - IN - 1 NOTE

DATE: 16-Jul-1996 09:49pm

TO: Josie Bassinette (JOSIE BASSINETTE)

FROM: Steve Berkman, AFTCB → (STEVE BERKMAN)

EXT.: 34817

SUBJECT: Fraud on Bank Projects

~~Josie:~~

~~Per our discussion yesterday, I finally got around to putting some of my thoughts down for Mr. Wolfensohn. This is just a brief note on the concept of a Fraud Investigative Unit which would need further fleshing out if there is any interest in pursuing this idea. Thanks again for your encouragement.~~

~~Steve~~

To: Mr. James D. Wolfensohn

Subject: Fraud Investigation

1. A little over a year ago, I prepared a draft paper on the impact of corruption on the Bank's lending operations which I understand you have seen. This paper was the result of many years experience in the field and my frustration at the severe damage corruption has caused to the development process. The Bank's previous benign neglect in addressing this issue was equally frustrating to me and many others at the Bank. It is clear, that since your arrival, this condition is changing for the better.

2. Contrary to the opinions of some, corruption has a direct impact on the integrity of the lending program and I can say with certainty that Bank funds are being defrauded every day of every year. How serious is this, and to what extent are Bank funds being diverted for private gain? No one really knows for sure, and until recently, the Bank had very little incentive to find out. Is it 10% or 15% as some people say? Is it closer to 30% as others claim? Even if it were 10% (and none would dispute that figure), it would represent roughly \$2 billion of the Bank's annual disbursements. This is a conservative estimate, and based upon evidence I have seen personally, I would bet serious money that the actual figures are higher.

3. Although I retired some months ago, I have continued to be concerned about this issue. I am aware that the Bank, under

JDW

Steve Berkman is one of the original corruption crusaders. You'll remember that it was his paper on corruption in Africa that was discussed at your first meeting at the Bank on corruption.

He has now left as a staff member, but is still keenly interested. He wanted very much to share some news/ideas with you.

It is, by the way, thrilled that you have put corruption on the table.

Josie
7/17

your leadership, has made strides to deal with corruption and I am heartened by the progress that has been made in so short a time. I am concerned however, that the Bank, because of its size and oft times tendency to intellectualize problems rather than deal directly with them, will delay action in some areas where it has the potential to be highly effective in the immediate future. I am not in any way downplaying efforts that are presently underway (ie; policy reform, training, procurement guidelines, etc.). These efforts will produce measurable results in the long term, but I question whether they will stop specific acts of fraud today, or tomorrow. The fraud will continue unabated until such time as the Bank takes concrete action to deal with it at the operational level.

4. In this regard, permit me to present a proposal that I know has been discussed previously, but has not as yet been implemented. This is the establishment of a Fraud Investigative Unit which I feel is well justified for the following reasons:

a. While all agree that corruption exists, and while the Bank is making intensive efforts to improve its audit and compliance functions, there is still no concerted effort to specifically investigate fraud here and now. With a \$140 billion portfolio and \$20 billion in annual disbursements (forgive me if these figures are not precise) which are processed through tens of thousands of civil servants and private individuals around the globe, this alone should be sufficient justification to establish such a unit. Even under the most generous circumstances, can we assume that none of these individuals will attempt to defraud Bank funds? In the light of human experience, this is an extremely difficult assumption to make.

b. Up to now, the Bank has seldom been taken seriously in its efforts to maintain probity in its lending operations. Borrowers are able to get around and/or pervert Bank guidelines, while Bank staff experience difficulty in preventing it. Borrowers know the Bank is anxious to disburse, and Bank staff know their lending programs depend on it. When fraud is investigated (and this is rare), the time lapse between discovery and corrective action is so long as to nullify any chances of changing the culture of corruption.

c. The ability and willingness to police oneself is not a readily found quality. This is as true for the borrowers as it is for Bank staff. When one mentions fraud on Bank projects, everyone 'circles the wagons' and focuses primarily on damage control. This in part, is one reason why many are hesitant to seriously and decisively address the issue. If this were not the case, one could ask why the Bank had to wait for your arrival before bringing it out in the open. After all, fraud on Bank projects did not just start two years ago.

d. While the exact cost of fraud will never be known, those with experience in the field put the range from 10% to 40% of

Bank lending depending upon the country in question. At the high end, is the case of Nigeria, where several years ago the Bank's Nigeria country team estimated that 40% of procurement was being defrauded from Bank projects. This, in a country that has borrowed over \$7 billion from the Bank since the 1960's. One must also consider that the economic cost of such fraud may be considerably higher than the actual dollar amount stolen from project accounts. A dollar stolen may have \$10 of negative economic impact.

e. Although talk of corruption and fraud is now accepted openly at the Bank (something that was severely frowned upon until recently), and some borrowers are exhibiting more concern about this issue, it is a subject that is still mostly addressed in the abstract. The time is right to move from talk to concrete action in the field, and nothing the Bank does in the immediate future would send a stronger signal than to establish a Fraud Unit with sufficient autonomy to investigate lending operations and specify follow-up actions where necessary. In my opinion, this would even be more effective than threats of suspension (which first require investigation anyway), because the suspension process does not move swiftly enough, and only winds up punishing project beneficiaries instead of the culprits.

In sum, we have an institution that is managing a huge portfolio where thousands of transactions occur each day and where, despite numerous systemic safeguards, there is very little substantive oversight of them. The paperwork is frequently in order, but beyond that, very little verification of the use of funds takes place. In practice, if and when fraud is ever uncovered, it is more due to accident than by design. This is where fraud thrives.

5. Although the Bank has several groups responsible for ensuring the integrity of its portfolio (ie; CTR, IAD, Regional supervision, etc.) there is no one specifically assigned and/or budgeted to investigate fraud (as opposed to audits) in the operational environment of the Bank. I know from long experience that this rarely occurs through the project supervision process. Following from the above, I cannot think of any legitimate reason why the Bank can not, or should not, have a dedicated group of persons to conduct fraud investigations according to their own agenda. The group does not have to be large (5-10 persons), nor does it have to be established on a permanent basis. It could be administered through CTR or IAD on a pilot basis for 2-3 years to conduct a sampling of lending operations to:

- a. Determine the extent of fraud.
- b. Identify patterns of fraud.
- c. Make recommendations on corrective actions to be taken.

The establishment of this group would not in any way supercede

other Bank efforts to deal with corruption, but should be seen as a concrete step to support these efforts while taking immediate action to stem the illegal diversion of funds from the Bank's lending program. If successful, and the need is further justified, the Fraud Unit could become a more permanent part of Bank operations.

6. I am well aware that there are some within the Bank who feel that fraud is not a serious impediment to the Bank's development objectives. In this, I strongly disagree and I can support my position with facts. Some will also feel that present actions being taken to address the corruption issue (ie; the SGS operation) are sufficient. In this, I am convinced that these present actions can be enhanced further by the creation of a Fraud Unit, and that this could be a decisive turning point in the Bank's quest to bring a greater degree of probity to the development process. Without wishing to take up more of your valuable time, I would be happy to provide you with more detailed inputs on this matter if you so desire.

Sincerely,
Steve Berkman



Record Removal Notice



File Title President Wolfensohn - Briefing Book for President's Meetings - Meeting Material - Corruption - July 19, 1996		Barcode No. 30485539
Document Date July 17, 1996	Document Type Memorandum	
Correspondents / Participants To: Mr. James D. Wolfensohn From: Ibrahim F. I. Shihata		
Subject / Title Continuation of our Discussion on Corruption		
Exception(s) Attorney-Client Privilege		
Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.
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File Title President Wolfensohn - Briefing Book for President's Meetings - Meeting Material - Corruption - July 19, 1996		Barcode No. 30485539		
Document Date April 23, 1996	Document Type Memorandum			
Correspondents / Participants To: Mr. James D. Wolfensohn From: Ibrahim F. I. Shihata				
Subject / Title Overview of International Instruments on Corruption				
Exception(s) Attorney-Client Privilege				
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The World Bank

SVEN SANDSTRÖM
Managing Director

7-9-96

Jim,

Corruption

This is the background note for the informal Board session on the 23rd (which you will chair...).

It is a rather low key note, intended to kick off a discussion. We will then prepare a full paper which will be more aggressive.

You only need to read the last two pages, on "Next Steps".

Could we send this to the EDs Wednesday evening? That way they also have it before Friday's retreat! / Sven

INFORMAL BOARD MEETING

July 23, 1996

Background Note: World Bank and Corruption

Introduction

1. On June 20th the paper "Fraud and Corruption," prepared by the Legal Department, was presented to the Board. It proposed changes to the Bank's loan documentation to strengthen the control of corruption in Bank projects. In reviewing this paper, Executive Directors postponed approval and it was agreed that an informal Board meeting would be held as soon as possible, on the broader issue of corruption and development, and the implications for the Bank.

2. This background note has been written to facilitate the Board's discussion of corruption. It lists, first, reasons for the heightened interest inside and outside the Bank in corruption as an issue of development effectiveness. Next, it sets forth the Bank's present approach to assisting countries control corruption. Thirdly, it suggests, in general terms, how the Bank's approach might evolve in the future. Taking account of Executive Directors' comments, management intends to develop a comprehensive paper for presentation to the Board in the Fall. Meanwhile, management will submit a revised paper on changes to the Bank's procurement documentation for Board consideration on July 25.

Corruption as an Issue of Development Effectiveness

3. Corruption is not a new issue for the Bank. For many decades the Bank has sought to ensure that the funds it lends to countries are used for their intended purposes, and that contracts for goods and services are awarded in a transparent and cost-effective way. However, in recent years heightened attention has been given in many quarters to corruption and its impact on social and economic development.

- Corruption has become an issue of aid effectiveness in donor countries, in turn affecting IDA replenishment. The IDA 10 report records deputies calling for greater transparency to improve "effectiveness of resource use and to reduce corruption and waste." The IDA 11 report, building on the policy framework for IDA 10, stresses good governance.

- Corruption is no longer being referred to obliquely in Consultative Group meetings (CGs). In 16 out of 72 CGs chaired by the Bank between January 1993 and April 1996 the theme of corruption was explicitly raised by participants.
- The Bank's External Affairs Department's surveys revealed how attitudes to aid in rich countries have been adversely affected by perceptions of corruption in poor countries and the misuse of taxpayers' aid funds.
- Corruption has become an electoral issue in many developing and transition countries. New governments have come to power with a mandate for cleaner government. In others, it remains a sensitive issue.
- A range of initiatives to address corruption at the international level are being taken, such as disallowing in OECD countries tax deduction of bribes to foreign officials.
- In the past five years, there has been an explosion of media coverage of corruption in both industrialized, developing and transition countries.
- The recent G7 summit flagged combating corruption as a major task for multilateral development banks to tackle.

Against this background, management has begun reviewing the Bank's actions in this area and its capacity to respond to country requests. In addition, there is a continuing need to ensure the effectiveness of measures to curb misuse of Bank resources.

World Bank's Approach to Controlling Corruption

4. While the Bank has always sought to minimize the misuse of funds within the projects it finances, it has never had an explicit "strategy" to control corruption. But the Bank has recognized for many years that corruption is an integral issue of governance, and has sought to help governments control it, both directly and indirectly. This has occurred in the context of Bank actions in three broad areas: economic policy reform, institutional reform, and the control of corruption within Bank financed projects. In addition, surveys and research directed primarily at other problems are yielding insights into corruption, as a by-product. Combined, these areas of action constitute the Bank's present "strategy" to control corruption.

Economic Policy Reforms

5. The first "leg" of the Bank's approach comprises, in effect, the Bank's structural adjustment agenda, though the latter is aimed, in the first instance not at governance but at improved economic performance.

- *Liberalization of trade and investment and financial sector reforms:* Structural adjustment programs, which the Bank has supported for nearly two decades, reduce the scope for “rent-seeking” by replacing administrative mechanisms (e.g., import licenses, foreign exchange and bank credit allocations) with market mechanisms.
- *Tax reform:* Both by helping countries simplify their tax structures (reducing scope for administrative discretion, increasing transparency) and by strengthening tax administration (reducing evasion and improving financial controls), the Bank helps tackle corruption in customs and tax administration. In countries where civil service capacity has collapsed, the Bank has supported the “enclaving” of revenue departments as a short term measure.
- *Regulatory reform:* Eliminating price controls, simplifying government regulations through sector policy reforms and strengthening the regulation of private and state-owned enterprises operating in non-competitive markets further limits the scope for rents.
- *Privatization:* Likewise, the shifting of activities from the public to the private sector, operating in a competitive environment, eliminates rent sharing between government departments and their captive enterprises. More broadly, the scale of the public sector at risk is diminished.

Institutional Reforms

6. The second leg of a Bank “anti-corruption strategy” comprises institutional reform. Although slower in achieving results, institutional reform is about building capacity inside and outside the public sector to combat corruption.

- *Government Financial Management reform:* In recent years, there has been a rapid increase in the number of countries where the Bank is assisting in the modernization of government budgeting, financial management, accounting, and auditing systems. Examples are the integrated financial management projects in LAC, and accounting and auditing reform in Africa and Asia. Mostly, these projects have been financed by TA or sector loans and credits. There has also been creative use of Institutional Development Fund (IDF) grants.
- *Civil Service Reform:* In the past decade, the Bank has supported civil service reform (CSR) in more than 40 countries. The emphasis has been on reforming pay and employment conditions, training, and personnel management. These have long been recognized as preconditions for controlling corruption in the public service. Most recently, professional standards, ethics and values have been stressed, to reduce corruption in the bureaucracy – further elements which need to be in place to create or restore an “enabling environment” within the public sector.

- *Public Procurement:* How government departments and agencies procure goods and services is, ultimately, an aspect of public sector management. Through CPARs – Country Procurement Assessment Reviews – and through IDF grants for the preparation of new procurement legislation and associated training, the Bank seeks to strengthen institutional capacity within countries to procure goods and services in a transparent and competitive manner.
- *Governance:* Finally, on a broader governance front, the Bank assists countries control corruption through actions such as :
 - Legal and regulatory framework reform;
 - Judicial reform;
 - Encouraging greater transparency in government budgets and financial statements;
 - “Integrity workshops” conducted by EDI;
 - EDI’s training workshops for economic journalists;
 - Support for professional bodies in the accounting field;
 - More participatory approaches to the design and implementation of policies, programs and projects.

Fiduciary

7. The third leg in what might be seen as the Bank’s strategy to control corruption is the efforts made to guard against corruption in Bank loans and credits, and among Bank staff.

- *Controlling Corruption in Bank Projects:* Periodically updated, the Bank has long established procedures for procurement, disbursement, reporting, and auditing in Bank projects. These procedures are based on the principles of economy, efficiency, and transparency in public procurement. A set of amendments to loan documentation designed to facilitate action against any manifestation of corruption was discussed informally by the Board on June 20th and is being submitted for Board consideration on July 25th.

Financial reporting under Bank loans is being strengthened by the revision of Operational Policies on Financial Management. OP10.02 (draft) tightens the time

frame for borrower completion of audits of project expenditures, and for suspension of disbursements in the event of non-compliance.

Regular auditing of procurement on a country basis has been introduced; and clearer procedures for dealing with allegations of corrupt conduct by external suppliers, contractors or consulting firms with respect to procurement under Bank-financed contracts are being proposed.

- *Changes in Bank internal procedures:* Greater emphasis is being given to portfolio management and supervision, and performance measurement. Public availability of Bank project documents, the creation of the independent Inspection Panel, and more participatory approaches to project design indirectly improve the accountability of government agencies implementing Bank-financed projects through NGOs and other civil society action;
- *Guarding against corruption by Bank staff:* Long standing staff rules on outside interests and disciplinary measures (e.g., Staff Rule 3.01 and 8.01) have been strengthened by the issue of a “Code of Professional Ethics” in September 1994 and annually thereafter. The Bank’s Ethics Officer has been charged with investigating cases of corruption involving Bank staff should they arise, and to report regularly. In addition, staff rule 8.01 is being amended to make termination mandatory where there is misuse of Bank funds.

Bank Research

8. Corruption has not been researched systematically as a free-standing topic by the Bank. However, in a number of areas, Economic and Sector Work (ESW) and research are providing useful insights.

- The Bank’s two governance reports have both addressed corruption as a key issue of governance.
- Public expenditure reviews and other forms of ESW for many years have drawn attention to the lack of transparency in government accounts. A few are now beginning to address combating corruption directly.
- Private Sector Assessments (PSA) which survey the policy and institutional environment confronting firms, now routinely ask questions about bribery.
- Service Delivery Surveys (SDS), financed mostly by IDF grants, are opinion surveys of beneficiaries of government services, holding, in effect, a mirror up to government performance. These are yielding information on petty corruption – whether beneficiaries have to bribe officials to obtain services the latter are mandated to deliver.

- Surveys of manufacturing enterprises in transition economies, which identify crime and corruption as costs imposed on firms.
- The issue of corruption has started to be included in Country Assistance Strategy (CAS) papers.
- The World Development Report 1997 on “The State in a Changing World” will include a discussion of corruption and its implications for the effectiveness of the state.

Next Steps

9. For the reasons listed at the beginning of this Note, management believes that the Bank needs to review the existing approach, building on it where necessary. As noted, proposals to strengthen anti-corruption provisions in Bank loan documents have already been presented to the Board, and other steps have been taken on the fiduciary front to ensure misuse of Bank loan funds is minimized, and that Bank staff adhere to the highest ethical and professional standards.

10. It is management’s intention to submit to the Board a more substantive paper on corruption as an issue of development and the role of the Bank, which may include detailed proposals, for approval in the Fall.

11. The specifics still need to be worked out, but they are likely to be developed along the following lines:

- (i) The Bank’s view is that corruption is a phenomenon that all countries, rich and poor, and public organizations (including international ones) have to confront. Ultimately, it is up to countries to find ways of controlling corruption, while the Bank’s role is a facilitating one.
- (ii) The Bank acknowledges that corruption is a complex phenomenon, not obviously related to form of regime or stage of development. It may adversely affect economic growth, public finances, private sector development, the poor and the environment in varying degrees, according to country circumstances and the strength of formal and informal institutions to keep it in check.
- (iii) In borrower countries, the Bank will raise with governments’ corruption as an issue of development effectiveness when the Bank perceives it having negative effects on development objectives, both in the sectors we support and generally.

- (iv) Consistent with its fiduciary responsibilities, the Bank will take all necessary measures to ensure misuse of loan funds is minimized. However, it recognizes that the best safeguard in the long run is increased borrower accountability.
- (v) In raising corruption with borrower governments, the Bank's stance will be cooperative rather than confrontational, indicating how public policy is affected and offering assistance in controlling its costs, through policy reform, and improved public management systems.
- (vi) Where corruption appears to be systemic, undermines both the government's development objectives and Bank projects, and governments are reluctant to act, the Bank will reconsider the level of lending.
- (vii) The Bank will use international fora, to speak out on corruption as an issue of aid and development effectiveness. The Bank will lend its weight to international efforts to control it, through actions by both industrialized and developing countries, as appropriate. In doing so, it will work closely with the IMF and other international financial institutions.

12. The views of Executive Directors in the informal session on July 23 will be a timely contribution to this process.

Public Sector Management Unit
Poverty and Social Policy Department
Human Capital Development



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Additional Comments		The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group. <table border="1"><tr><td>Withdrawn by Diego Hernández</td><td>Date March 13, 2025</td></tr></table>	Withdrawn by Diego Hernández	Date March 13, 2025
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