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30485621

R2002-036 Other #: 22 Box #: 186472B  
President Wolfensohn - Briefings Books for Presidents Meetings - Meeting Materials  
Calendar - Corruption Meeting - December 15, 1995



**C-Word Meeting**

**Friday, December 15, 1995**

**3:00-4:00 pm**

**E 1227 (Conf. Room)**



# Archive Management for the President's Office

## Document Log

**Reference # : Archive-00761**

1243

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:** CORRUPTION MEETING ON DECEMBER 15, 1995 @ 3 P.M.

**DATE:** 09/07/96

### 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:** This is a brief which contains several memo's on Corruption from various parts of the bank  
-- From Shihata and Steer

#### File Location

- ☐ EXC
- ☐ IISC
- ☒ Archives

Cleared By

Date:

09/07/96



# OFFICE MEMORANDUM

DATE: February 28, 1996

TO: See Distribution Below

FROM: Andrew Steer, ENVDR *AS*

EXTENSION: 33299

SUBJECT: Financing Change: Schmidheiny-Zorraquin Book

1. Attached is a copy of the Schmidheiny-Zorraquin book as background to the event on Friday, March 8th. I understand that each of you has been invited to lunch at the Hay Adams following the Bank Group Program.
2. Also included is an updated program for the event. We will be sending briefing materials for the participants in the program (Messrs. Wolfensohn, Strong, Frank and Serageldin), by Friday this week.
3. Many thanks.

Distribution: Mr. Richard Frank, EXC  
Mr. Maurice Strong, EXC  
Mrs. Rachel Lomax, EXC  
Mrs. Jessica Einhorn, EXC  
Mr. Jemal-ud-din Kassum, CIOVP  
Mr. Ismail Serageldin, ESDVP  
Mr. Mark Malloch-Brown, EXTVP  
Mr. Andreas Raczynski, CTEDR

Attachment

cc: Ms./Mr. A.Gordon (EXT), D. Hanrahan (ENVPE)



## **FINANCING CHANGE**

### **The Financial Community, Eco-efficiency, and Sustainable Development**

#### **The World Bank Program**

March 8, 1996

11:00 to 12:30

The World Bank, Room JB1-080, 701 18th Street, N.W.

**11:00 Welcome**

Ismail Serageldin  
Vice President for Environmentally Sustainable Development  
The World Bank

**Introduction of The World Bank President, James D. Wolfensohn**

*Note; Mr. Wolfensohn will introduce Dr. Schmidheiny*

**11:05 Remarks**

Stephan Schmidheiny  
Co-Author, *Financing Change*  
Founder, World Business Council on Sustainable Development  
Chairman, Anova Holding AG

James D. Wolfensohn  
President, The World Bank

**11:35 Panel Discussion**

*Moderator:* Maurice F. Strong  
Advisor to the President, The World Bank

*Panelists:*

C. Fred Bergsten, Director, Institute for International Economics  
Richard H. Frank, Managing Director, Private Sector, World Bank  
Robert Grafton, Chairman of the Board of Partners, Andersen Worldwide  
Fernando Romero, Chairman, BHN Multibanco S.A.

*Question and Answer Period follows.*

**12:30 Closure**

Andrew Steer  
Director, Environment Department, The World Bank

## **FINANCING CHANGE**

### **The Financial Community, Eco-efficiency, and Sustainable Development**

#### **VIP Luncheon**

March 8, 1996

12:45 p.m. to 3:00 p.m.

The John Hay Room

The Hay Adams Hotel, 800 16th Street, N.W.

**12:45**      **Guests arrive and are greeted.**

**1:30**      **Guests are seated and lunch is served.**

**2:15**      **Welcome and Remarks**

Stephan Schmidheiny

Co-Author, *Financing Change*

Founder, World Business Council on Sustainable Development

Chairman, Anova Holding AG

**2:25**      **Remarks**

Eugenio Clariond Reyes

Chairman, Business Council for Sustainable Development Latin America

President, Grupo IMSA, S.A. de C.V.

*(Note talking points to include the importance of sustainable development policies to Latin America and the role of the Business Council for Sustainable Development-Latin America)*

*Dr. Schmidheiny will return to the podium to introduce Under Secretary Wirth.*

**2:35**      **Remarks**

Timothy Wirth

Under Secretary for Global Affairs

U.S. Department of State

*(Note: Talking points to include U.S. endorsement and support for furthering international sustainable development policies with specific emphasis on financing strategies)*

**3:00**      **Adjourn**

*Note: Each of the guests will be provided with a copy of Financing Change as they depart the lunch.*





# Record Removal Notice

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|--------------------------------------------------------------------------------------------------------------------------------|------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|------------------------------|
| <b>File Title</b><br>President Wolfensohn - Briefing Book for President's Meetings and Events - Corruption - December 15, 1995 |                                    | <b>Barcode No.</b><br><br>30485621                                                                                                                                                                                                                                                                          |                                        |                              |
| <b>Document Date</b><br>Feb. 8, 1996                                                                                           | <b>Document Type</b><br>Memorandum |                                                                                                                                                                                                                                                                                                             |                                        |                              |
| <b>Correspondents / Participants</b><br>From: Sven Sandstrom, EXC<br>To: Executive Directors distribution list                 |                                    |                                                                                                                                                                                                                                                                                                             |                                        |                              |
| <b>Subject / Title</b><br>Halifax Communique Follow-up                                                                         |                                    |                                                                                                                                                                                                                                                                                                             |                                        |                              |
| <b>Exception(s)</b>                                                                                                            |                                    |                                                                                                                                                                                                                                                                                                             |                                        |                              |
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| <b>Withdrawn by</b><br>K. Brenner-Delp                                                                                         | <b>Date</b><br>June 30, 2025       |                                                                                                                                                                                                                                                                                                             |                                        |                              |

A L L - I N - 1    N O T E

DATE: 23-Feb-1996 11:49am

TO: Stevan Jackson

( STEVAN JACKSON@A1@WBWASH )

FROM: Hilde Pieters, EXC

( HILDE PIETERS@A1@WBHQB )

EXT.: 80365

SUBJECT: RE: MEETING ON CORRUPTION WITH RACHEL LOMAX  
TUESDAY, FEBRUARY 27, 1996 @ 5:10 P.M.

Stevan,

Per our earlier conversation (also w/Deneen). Are there any specific papers which will be discussed at this meeting? Who will distribute them. Any particular memo from Mr. Shihata's office? Please keep me posted.

Txs.

Hilde

CC: Vorapaktra Yongpradit

( VORAPAKTRA YONGPRADIT@A1@WBWASH

CC: Denise Burgess

( DENISE BURGESS@A1@WBWASH )

CC: Deneen Johnson

( DENEEN JOHNSON@A1@WBHQB )

Rachel ? - There is  
one dated 1/31 ~~let~~ from  
Shihata. (See the attached)



THE  
CARTER CENTER

EXC 4938



FASCIMILE

To: Mr. James Wolfensohn  
President, The World Bank

Fr: Mr. James M. Brasher III  
Special Assistant to President Carter

Re: President Carter's Trip Report

Mr. Wolfensohn:

On behalf of President Carter I am forwarding to you this interesting account of what took place on his recent trip to Africa. It was good to see you in Washington.

*Jim Brasher* 12/4/95



GREAT LAKES TRIP REPORT - 11/16-11/30/95  
JIMMY CARTER

In September, Rosalynn and I made a tour of East Africa, primarily concerning health and agriculture, but we also discussed the crises in Rwanda and Burundi with leaders in the area, which is known as the Great Lakes region. It was apparent that the UN Security Council call for a comprehensive conference had little support among leaders of the five contiguous nations, and in October this effort was terminated, or postponed. At the suggestion of Presidents Mobutu of Zaire, Museveni of Uganda, and Mwinyi of Tanzania, we began plans for a narrowly focused meeting that would only involve the five nations of the immediate region: Rwanda, Burundi, Tanzania, Uganda, and Zaire. Leaders in the U.S. government and the UN were informed and approved, and we soon received extensive briefings from their experts.

In New York on October 22, Heads of State of the five nations announced their approval for the planned meeting, and suggested that Archbishop Desmond Tutu, former Tanzanian president Julius Nyerere, and I serve as facilitators. The Carter Center was asked to coordinate the meeting, which was later scheduled to begin on November 28 in Cairo, Egypt.

Prior to going to Cairo and accompanied by Rosalynn and ambassadors Marion Creekmore and Vince Farley, I visited Uganda, Zaire, Rwanda, and Burundi to consult closely with the presidents, other political and military officers, diplomats, church officials, and representatives of international organizations and NGOs. After some extremely difficult negotiations with skeptical leaders in Kigali and Bujumbura, they finally agreed to detailed agendas for our proposed conference.

We had an unforgettable visit to one of Rwanda's many genocide sites, not too far from Kigali. About 5,000 mostly women and children had crowded into a church and its surrounding buildings while their men went into the nearby swamps. The victims were killed with axes, spears or machetes - all but one survivor. She was a Tutsi woman who had been carrying her two smallest children. Stabbed and slashed, she was covered with blood and the bodies of other victims, and each time the assassins examined the pile, she was believed to be dead. I asked her if she knew who was in charge of the massacre, and she replied, "Oh, yes! They have been my neighbors for many years. She gave their names, and a representative of the International Tribunal standing nearby said he already had them on his list. We will always remember the hundreds of skulls, but particularly the stench of the still rotting clothing, human hair and bones that are knee deep in all the buildings.



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We then went to one of the major refugee camps near Goma, Zaire, where we were welcomed by more than 100,000 refugees, and met with four spokesmen from each of the five Zairian camps. I gave them a full report on our observations in their countries and urged them to cease any intimidation of the refugees who wished to return to their homes. It is quite likely that at least half of these Hutu leaders participated in the April 1994 genocide that cost the lives of more than 500,000 Rwandans, later resulting in an exodus of two million of their frightened neighbors. Many of these camp leaders never intend to return home where they will have to face their accusers, and do not wish the more timid masses to do so.

After this, we rested for three days in Uganda, where we had an arduous climb but an exciting visit with mountain gorillas near the borders of Zaire and Rwanda. There are now 630 of these remarkable creatures left, all of them in this small volcanic area. We spent an hour within 15 feet of a huge silverback and other members of his family, including a four year-old child. This region was heavily impacted by onchocerciasis, and the people were deeply grateful to the River Blindness Foundation for having alleviated their age-old affliction. We were proud of our association with this work.

One side comment is that we found the gorillas just outside the park boundary, on an almost impenetrable mountainside that is privately owned. It is too steep to cultivate, and the African Wildlife Foundation representatives want to purchase it, mostly about \$100 an acre. They need \$20,000 now, and a total of about \$100,000. Rosalynn and I will help, and others may wish to send a contribution. Indicate on the check that your contribution is being sent to save the mountain gorilla habitat. The mailing address is: African Wildlife Foundation, 1717 Massachusetts Avenue, N.W., Washington, D.C. 20036.

Our next stop was Gbadolite, in northern Zaire, where we met with President Mobutu to finalize our plans for the Cairo meeting. We then flew to Maastricht, Netherlands, to attend a conference of about 200 top African leaders and others who are interested in the continent. I spoke to the group, and met individually with key ministers from France, Belgium, Great Britain, and other countries that have a direct interest in the Great Lakes region.

We flew to Cairo that night, on 11/27, and the next morning convened our conference. At the insistence of some of the Great Lakes officials, it was closed to any outside participants or observers. To put it mildly, this was not a popular decision



Page Three

with some leaders from outside the region. In balance, the closed meeting turned out to be a good plan, because we had totally unrestrained discussions of the most sensitive issues, old wounds were opened and mostly healed, and we all decided that a follow-up conference will be necessary, perhaps early in 1996, to include those who were excluded this time.

A copy of our final communiqué is attached for those who want the details. To summarize some specific points, the key players in the region pledged to prevent cross-border raids; to remove intimidators from the refugee camps; to detect and destroy the illicit and inflammatory radio transmitters; to deliver persons indicted for genocide to the International Tribunal and urge others to do so; to give returning 1994 refugees priority in claiming their property; to encourage visits in and out of the camps by officials, successfully repatriated refugees, and representatives of NGOs; to welcome back a high number of refugees daily; to accept international assistance in restructuring the judicial systems of Rwanda and Burundi and in improving the security forces of Burundi; to return government property that the previous regime had taken into Zaire from Rwanda; and to authorize four eminent persons (Nyerere, Tutu, former president Toure of Mali, and me) to help assure implementation of our agreements and to make plans for the next conference. Most of these issues were hotly debated, but a final consensus was reached.

Another significant concession was made and announced by the Rwandan delegation; to extend the mandate for the United Nations armed force, UNAMIR, for another three months, provided its purpose is to assure the safe repatriation of the returning refugees. The modalities for this will have to be worked out between Rwanda and the UN. This is an urgent and important matter, since the departure of UNAMIR would send a negative signal to doubtful refugees. The present mandate expires on December 8. I sent this information to Secretary-General Boutros-Ghali before leaving Cairo on November 30.

Although the trip was long and somewhat arduous and a lot of work remains to be done, we feel that we accomplished all our objectives.

A key to the success of this venture was a magic carpet, the Challenger airplane provided by our Trustee, John Moores. The Cairo meeting could not have been held without the support of the governments of The Netherlands, Denmark, Norway and the United States. We are deeply grateful to all who made it possible for The Carter Center to play this role.



**CAIRO DECLARATION ON THE GREAT LAKES REGION**  
**November 29, 1995**

Deeply concerned about the persistent tensions, hostilities, insecurities, and recent genocide in the Great Lakes region, and their adverse effects on democratic and economic development, the Presidents of Zaire, Uganda, Burundi, and Rwanda and a special Presidential envoy from Tanzania met in Cairo, Egypt on November 28-29, 1995. The meeting was co-convened by Presidents Mobutu and Museveni and former President Mwinyi, with the support of Presidents Ntubantunganya and Bizimungu. Former President Carter of the United States and Archbishop Tutu of South Africa served as facilitators. The Heads of State and Delegations at this summit meeting, which was an African initiative, pledged to take joint concrete actions to advance peace, justice, reconciliation, stability, and development in the region.

The Heads of State and Delegations were convinced that the problems of Rwanda and Burundi were basically a consequence of a confluence of negative interests of colonialism and local opportunists who have fostered the ideology of exclusion that generates fear, frustration, hatred and tendencies to extermination and genocide.

The Heads of States and Delegations call upon the international community to condemn vigorously the ethnic and political genocide ideology used in competition for conquest and monopoly of power.

Determined to prevent future genocide, ensure reconciliation with justice relating to the tragic genocide in Rwanda in 1994, and encourage the return of refugees to their home countries, the Heads of State and Delegations affirmed their mutual confidence and decided on the following specific actions:

a) They condemned the genocide in Rwanda in 1994, other incidents of mass killings in the past, and the ideology of genocide despicably used by some forces to pursue their own selfish ends. They also condemn the other similar acts and events which have occurred in the past and are recurring in Burundi.

b) The Heads of State and Delegations of the Great Lakes region solemnly pledge that their territories will never be used to serve as bases by armed groups to launch incursions or attacks against any other country represented at this conference.

They agree to cooperate by providing all information in advance on suspected persons or on anticipated incursions or armed attacks against another country.

c) The Heads of State and Delegations in whose countries refugees were currently located pledged to take action to curtail the activities of those in the camps who seek to intimidate the refugees wishing to return to their homes. President Mobutu

pledged soon to remove from the refugee camps the identified intimidators. The Tanzanian envoy affirmed his government's desire to isolate all criminals from the refugee camps, and will seek cooperation from the international community in acquiring the resources necessary to achieve this objective.

d) The Heads of State and Delegations agreed to prevent military training and delivery of weapons to militia groups or any other groups among the refugees.

e) The Heads of State and Delegations viewed with deep concern the use of radio broadcasts to spread hate and fear in the region. The participants pledged to take all possible action to terminate the illegal and inflammatory radio broadcasts from one country into another. They called upon the international community to assist by providing technology to identify the location of mobile transmitters.

f) The Heads of State and Delegations urged an acceleration of the work of the International Tribunal. They solemnly and unequivocally pledged to place at the disposal of the International Tribunal for trial all those indicted by the Tribunal, and urge leaders of all other nations to do the same.

They also expressed full support for the Commission of Inquiry's investigation of the assassination of President Ndadaye and the massacres that followed.

g) The Rwandan Head of State declared unequivocally that his government wanted the refugees to return to Rwanda at an early date, reclaim their property, live in safety and peace, help rebuild their country's economy, and participate in its political life under a broad-based government of national unity. This government will guarantee the safety of the returning refugees. It will work in collaboration with the United Nations, non-governmental organizations, and the international community. In cooperation with Zaire, it will work out arrangements by which refugees can return home to assess the situation for themselves and then go back to the camps to apprise the other refugees of the true conditions prevailing in Rwanda.

In addition, other visits to and from the camps by refugees, NGOs, and others will be encouraged.

h) The Heads of State and Delegations perceive no major restrictions to the return of refugees to Rwanda. They believe that when the refugees are convinced of the fact that conditions are safe to return, a large number will go home. A majority will move back to their country with minimum assistance. Working closely with UNHCR and other international agencies, the involved governments believe that the number of returning refugees who avail themselves of UNHCR assistance should rise progressively to 10,000 a day within a short time. There are no impediments within Rwanda or Burundi to an even higher rate of return.



i) The Heads of State and Delegations commend the UNHCR for its continuing efforts to assist the refugees and ameliorate their plight in the refugee camps. Its work and commitment are greatly appreciated. The participants would urge in the future that local representatives of UNHCR devote more of their attention and resources toward helping the refugees return and settle safely, even if this requires some modification of the organization's guidelines. The governments stand ready to work with UNHCR in this effort.

j) The horrendous genocide of 1994 massively strained the Rwandan judicial system. It is trying to cope with the unprecedented requirements, including training of many judges and magistrates. It will seek assistance from the international community as appropriate and consistent with its principles. Fully conscious of the conditions in its overcrowded prisons, it will separate prisoners according to the severity of charges against them, move as innovatively and expeditiously as possible to try or release those not guilty of serious crimes, and temporarily augment facilities for housing prisoners.

k) As requested and approved by the leaders of Burundi, the Heads of States and Delegations will provide assistance, and call upon the international community also to assist, in the implementation of the Convention of Government, including support for the National Debate. Security of persons is a fundamental problem in Burundi. As requested and approved by the leaders of Burundi, assistance will be sought to improve the system of justice. The Heads of State and the Delegations will support the efforts of the Burundian government to work out modalities for all the population to regain full confidence in the security forces.

l) The Heads of State and Delegations considered it imperative that the search for peace in the Great Lakes region should be accompanied by coordinated and concrete actions by the international community to mobilize financial resources so as to bring economic and social development to the region.

m) The Heads of State and Delegations agreed to seek solutions to related property and asset issues among governments in the region.

n) The Heads of State and Delegations requested that former presidents Nyerere of Tanzania, Toure of Mali, Carter of the United States, and Archbishop Tutu of South Africa analyze in depth the results of this meeting and the continuing problems of the region and prepare recommendations for consideration by the five governments at a second meeting, early in 1996. With prior approval from the five governments, other participants and observers will be invited.

The Heads of State and Delegations were pleased by the frank and constructive discussions that characterized their Cairo Summit. They commended The Carter Center for arranging the meeting.

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Mobutu Sese Seko

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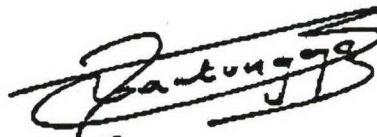
The Heads of State and Delegations expressed their profound appreciation to President Mubarak and the Egyptian people for their support and hospitality for this historic meeting.



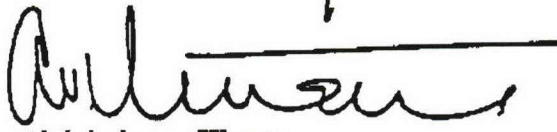
Yoweri Kaguta Museveni



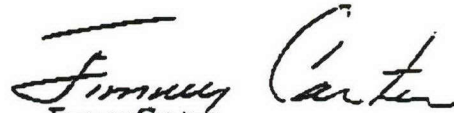
Pasteur Bizimungu



Sylvestre Ntibantunganya



Abdulrahman Kinana



Jimmy Carter  
(witness)

29 November 1995, Cairo, Egypt



New York Times 11/30/95

## Pact Reached On Return Of Rwandans

By DOUGLAS JEHL

CAIRO, Nov. 29 — A meeting of leaders from five African countries ended here today with agreement on a plan to provide for the safe and voluntary return of nearly two million refugees who fled Rwanda after a mass slaughter of minority Tutsi by majority Hutu last year.

The agreement, announced after a two-day meeting brokered by former President Jimmy Carter, does not provide a timetable for the refugees' return but envisions reaching an eventual rate of 10,000 a day "within a short time."

"I believe the refugees will return in large numbers when they believe that they will be safe," Mr. Carter said at a news conference.

The continued presence of 1.8 million Rwandan refugees in neighboring countries has strained relations across the region, and the meeting of leaders of Rwanda, Burundi, Zaire, Uganda and Tanzania was their first on the crisis.

But while the leaders said they were determined to encourage the refugees to return home, none would say at a news conference how their plan might succeed after four previous international efforts had failed.

Mr. Carter conceded that the plan to lift obstacles and provide reassurance to Hutu refugees who continued to fear for their safety would depend at first on finding a way to resume a flow that has dwindled to less than 100 a day.

"We feel that when the first ones go home and can testify that they are safe, there will be an increasing number each day who feel that they can return," he said.

The agreement appeared to forestall a threat by Prime Minister Kengo wa Dondo of Zaire to expel more than 800,000 of the Rwandan refugees there at year's end. Any return by refugees in large numbers has in large part been hindered through intimidation by Hutu leaders, and so President Mobutu Sese Seko of Zaire pledged to disarm and remove such people from refugee camps in his country.

Mr. Carter said Tanzania, which has several hundred thousand Rwandan refugees, had agreed to take similar steps against Hutu intimidators in camps there but would first need international assistance for Tanzanian forces.

The camps in Tanzania and in Zaire are housing many of the Hutu who took part in the massacres of an estimated 500,000 people in Rwanda last year, most of them Tutsi, and fear returning to a country that is now under a Tutsi-dominated Government.

President Mobutu, whose troops forced 14,000 Rwandans to return to their country in August, did not say explicitly today that he had lifted his Government's threat to oust the rest by the end of the month. But he said in a national broadcast last week that it would be "inhospitable" to force refugees back, and neither he nor the other leaders objected when Mr. Carter said all were committed to seeking their voluntary return.

"No one is contemplating forceful return of the refugees," the former President said.

At the same time, Mr. Carter said the Rwandan President, Pasteur Bizimungu, would request that the United Nations peacekeeping mission in the country be extended for three more months, a reversal that could postpone the withdrawal of about 1,800 troops, who are scheduled to leave by mid-December.

## OFFICE MEMORANDUM

DATE: June 13, 1995

TO: Josephine Bassinette, President's Office

FROM: Kevin Cleaver, Director, Africa Technical Department

EXTENSION: 34595

SUBJECT: **Africa Region: Draft Paper on Corruption,  
and a regional action plan in response**



Mr. Junaid Ahmad informed the Africa Region Management team that Mr. Wolfensohn wishes to see the draft paper entitled "Corruption and its impact on Project Management", and the Africa Region Action Plan to deal with these issues. The draft paper, and the draft action plan, are attached.

The Africa Region of the Bank has long been aware of corrupt practices in African governments, and in donor financed projects. This is a part of the problem of development. Project supervision missions find and report such practices, as do audits undertaken for Bank projects. We have a variety of remedies when problems are encountered. Most often we seek remedy with more senior Government officials. Sometimes the remedy is the replacement of individual managers who are responsible. Sometimes it is requesting Government to suspend or take action against Government staff or private individuals working with the project but outside project management. When these traditional remedies do not work, we suspend loan disbursements, or even cancel parts of loans. In the worst cases, as recently occurred in Tanzania, our entire lending program is affected. Specifically, we put on hold new loans until satisfactory action is taken by Government to deal with the problem.

One of the staff in my Department, Steve Berkman, has had a long standing interest in corruption in Africa. He has become a one man zealot in identifying corrupt practices, and in encouraging his colleagues to address the problem forcefully. He produced the draft paper attached entitled "Corruption and its Impact on Project Management" to record his observations about how corruption occurs. This paper is not part of the Region's work program, and was undertaken entirely on Mr. Berkman's own time. We have asked him not to disseminate the paper outside the Bank as it is modestly damaging, and in the opinion of Africa Region management, somewhat exaggerated as to the degree of the problem in World Bank financed projects and in the lack of follow-up by Bank staff. The paper is better in identifying corrupt practices generally than in assessing the extent of the problem in Bank projects. Although Bank staff follow-up when corruption is identified more than Mr. Berkman allows, we believe that we need to do more, and to act more systematically.



In order to plan for more effective staff response to corrupt practices, Mr. Jaycox created a task force to develop an action program for the Region. Mr. Jaycox's decision was taken after consultation with Messrs Richard Frank, J. Muis, and a representative of the External Relations Department. I have supervised this task force. Mr. Berkman has been an active participant. The second attachment is the draft Regional Action Plan developed by this task force.

The actions proposed relate primarily to ways in which supervision missions can more effectively identify corrupt practices and deal with them. It recommends more systematic Bank response to non-compliance with financial covenants and procurement requirements, encouragement of anti-corruption policy in country dialogue, and greater attention to the development of country financial management capacity and audit capacity. It recommends a more extensive training program for Bank staff in these matters.

Mr. Jaycox and Mr. Denning met with the task force in late May 1995 to review the action plan. A representative of the Comptroller's office attended. The plan was approved, and the team was given the task of putting meat on the recommendations by indicating how staff and management are to carry them out. This work is well underway. We hope to have implementation arrangements spelled out by September. The obvious follow-up actions are already being implemented by operations advisors and procurement advisors.

In collaboration with the Managing Directors and Mr. Muis's office, we are thus taking steps to ensure that the energies of Mr. Berkman are channeled in constructive directions.

cc Messrs Jaycox, Denning, Ayub, Dia, J. Ahmad, J. Muis, Kaji, Frank

DRAFT  
AFRICA REGION ACTION PLAN

PUBLIC SECTOR FINANCIAL MANAGEMENT and PROCUREMENT:  
IMPROVING PERFORMANCE

Introduction

1. Increasing focus on governance issues in the Bank in general and in AFR specifically, has drawn greater attention to the importance of the proper management of public resources. Nowhere is this of greater concern than in the area of financial management and procurement whereby the flow of funds into, and out of, public sector institutions, is critical to the success of development lending operations and general assistance to borrowers.

2. Recognizing the need for further improvements in public sector financial management, AFR plans to increase our efforts in this area to ensure that public resources in general, and funds provided through the Bank's lending program in particular, are used as effectively as possible, with maximum transparency and accountability. To accomplish this in the coming months, we will seek to refine and improve the financial management tools and procedures that are already at the Bank's disposal as defined in the Financial Reporting and Auditing Task Force (FRAT) report and the Financial Accounting, Reporting and Auditing Handbook (FARAH). We will also seek to increase the use of these tools and procedures and most importantly, to make better use of the Bank's compliance regulations. It is proposed to accomplish these objectives through specific short term and long term actions as described below.

Short Term Actions

3. Immediate actions to be taken include the following:
- a. Project staff and borrowers to improve compliance with the current applicable financial management requirements including:
    - budget planning and execution
    - provision of counterpart funds
    - accounting, auditing and budget covenants
    - procurement policies/procedures
    - disbursement policies/procedures



- b. Increase Bank staff supervision and monitoring of the physical disposition of resources at the project level including:
  - supplier verification
  - delivery of contracted goods and services
  - use of goods and equipment as planned
  - execution of civil works
- c. Increase Bank staff supervision and monitoring of procurement including:
  - Statements of Expenditures
  - low value procurement
- d. Place more focus on project financial management (quality at entry) as emphasized in the FRAT and FARAH reports with special attention to the preparation and appraisal stages.
- e. Increase financial management training activities for borrower staff and TM's with emphasis on techniques for identifying fraud and appropriate corrective actions.
- f. Emphasize the Bank's response to non-compliance of financial covenants, procurement requirements, loan conditionalities and other fiscal requirements through stricter enforcement of remedial actions. Adherence to FARAH, procurement guidelines, and relevant OD's to be the guiding criteria.
- g. Establish procedures for a structured approach to desk reviews of audit reports and management letters by TM's and if necessary, by qualified auditing specialists.
- h. Establish formal reporting and information dissemination policies and procedures to permit timely and appropriate responses on the part of TM's and Bank management in cases of financial mismanagement and malfeasance.
- i. Emphasize and encourage anti-corruption policy formulation and enforcement in country dialogues.

### Long Term Actions

4. In addition to the continuation of the above short term actions, the following long term actions will be undertaken:

- a. Where relevant, provide greater coverage of in-country financial management capacity and performance issues in CAS', PER's, ESW, ARPP, CPPR and other non-lending outputs.
- b. Incorporate periodic regional internal reviews of compliance with applicable financial management policies and procedures.
- c. Conduct an analysis of staffing requirements and deployment in the area of financial management as defined in the FRAT report and implement its conclusions.
- d. Increase training activities for Bank TM's and borrower staff in financial management.
- e. Develop guidelines for an auditing framework for individual projects, including terms of reference for setting out specific scope and methodology for audits.
- f. Carry out country audit/accounting capacity assessments of audit firms and government audit agency suitability and performance as auditors for Bank assisted projects.
- g. Promote greater financial management accountability beyond the Bank's portfolio in Sub-Saharan African countries through the promotion of:
  - transparent and consistent accounting and auditing practices and financial reporting systems
  - independent auditing bodies as an essential part of public sector management efforts
  - projects to strengthen public and private sector accounting and auditing functions (e.g. Financial Sector Management projects, IDF grants, etc.)



h. Liaise and coordinate with other donors  
(especially with regard to broader sector  
investment operations) to implement a common  
approach for:

- Financial reporting requirements
- Assessment and selection of auditors
- Quality reviews of audit performance
- Establishing a common data base for  
financial information

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Jean-Jacques Raoul, AFRSA  
Jean-Claude Fayd'Herbe, AFTCB  
Steve Berkman, AFTCB  
5/4/95

# CORRUPTION and ITS IMPACT ON PROJECT MANAGEMENT

## INTRODUCTION

1. The diversion and misuse of public resources is a fact of life in all societies and at all stages of development. While this condition is often examined in light of its moral, economic and sociologic aspects, its impact on the management of public sector projects is often overlooked. This aspect of corruption is of great significance in the development process as it poses enormous constraints upon the performance of public institutions. Constraints which in many cases, prevent any success in building capacity, achieving institutional sustainability, or in the delivery of services to underdeveloped populations. Nowhere, is this condition worse, nor more damaging to progress, than on the African continent.

2. In examining this issue, it is evident that different groups tend to view it from different perspectives, thereby placing further constraints upon attempts to reduce its impact on economic development. In an effort to explore the various facets of this complex problem, the following paragraphs will attempt to define (i) the different forms of corruption, (ii) its affect upon public sector management, (iii) the ability of the Bank to respond to it, and (iv) options for dealing with it. For the most part, the observations, analyses, and conclusions that follow, are based upon the author's personal experience working on more than one hundred projects in sub-Saharan Africa over the past ten years, while additional viewpoints have been obtained from internal and external documents and articles on the subject.

## THE DIFFERENT FORMS OF CORRUPTION

3. What follows, is a sampling of corrupt practices that will not surprise any informed person. What is important however, is to understand the impact these activities have on the day to day management of public institutions. This sampling will then form the basis for further discussion of the diversion of public resources for private gain and how it affects the development process. The following examples are not in any order of priority, but are a composite selection of actual cases encountered in the Bank's lending operations in sub-Saharan Africa.

4. Contract Management. In many countries, it is a given condition, that no agreement between a private contractor and a public institution will be signed unless



some payment (in money, goods or services) is made by the contractor to the civil servants directly involved. Despite safeguards provided both in Government, and in Bank procurement regulations (ie; competitive bidding, review panels, inspection and audits), this practice diverts resources in the following ways:

- a. Outright Cash Payments. These can range from 10% to 30% of the cost of the contract, and may be arranged through (i) third parties (often to nationals based overseas posing as international firms)<sup>1/</sup>, (ii) local companies that are "supposed" to provide subcontracted goods or services, and sometimes by (iii) direct payments into foreign bank accounts. Typically, in order to cover the extra cost of these kick-backs, the contractor is forced to cut back on the quality and/or quantity of goods and services delivered. This is done with the tacit, and if need be, official approval of the civil servants involved, and the contractor usually has little trouble getting the necessary invoices and disbursement documents signed and processed by them.
- b. Overpricing. A variation on the above practice, involves contract overpricing. This is more common with local contracts which, when they are financed by project counterpart funds, are seldom supervised in detail by the Government or the Bank. In these cases, it is not unusual to find contract prices anywhere from two, to four or five times actual costs, and is usually accomplished by arranging for competing bids that are even higher than the chosen contract award. These higher competing bids may be submitted by (i) other contractors on the promise of future contract awards on the same basis, or (ii) non-performing companies (owned by the civil servants, their friends, or their relatives) that submit phony bids to create the impression of fair and competitive bidding.<sup>2/</sup>

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<sup>1/</sup> In one case, a winning international bidder on a \$25.0m contract was asked to employ a UK based national to ensure receipt of the award. The services to be provided by the national were of no use to the bidder, but his fee was to be \$3.75m (15% of the contract). There was ample evidence in this matter to show the complicity of the key civil servants involved in the award and management of the contract.

<sup>2/</sup> A typical scam involves contracts for maintenance or repair services which are poorly specified, time consuming to verify, and often very costly. In one case, over 30% of project counterpart funds were disbursed for various minor building repairs and maintenance which could not be verified, nor were they relevant to the project.



- c. Foreign Travel. In preparing contract specifications and/or terms of reference, civil servants often include foreign travel in the services to be provided by the contractor. This takes the form of (i) meetings at international locations, (ii) overseas training and study tours,<sup>3/</sup> and (iii) visits to equipment suppliers. While these activities can be legitimate in certain instances, there are numerous cases where large sums have been disbursed from contract accounts without proper justification or accounting.<sup>4/</sup>
- d. High Mobilization Fees. It is not uncommon for excessively high mobilization fees to be written into contract agreements. These fees (often between 40% to 80% of the contract price) are frequently found in local contracts, and wherever Bank oversight is marginal. Typically, the mobilization fee is paid immediately after the contract is signed, whereupon the civil servants are paid their kick-backs. Thereafter, the contractor has little incentive to proceed with the execution of the contract. As a result, some work is started but soon dwindles, and then often comes to a halt as the contractor disappears. After lengthy delays and feeble attempts to have the contractor (who is seldom, if ever, held accountable) return to work, the process is repeated, as the staff of the public institution seek additional funding to employ another contractor.

The overall impact of the above practices is to totally sabotage the effective management of contracted services in such a way that while scarce funds are diverted, unfinished civil works and other projects are left to rot. This is most evident in the many thousands of partially completed and/or otherwise unusable structures that can be found in various states of degradation throughout the continent. Thus, in addition to the contract funds siphoned off by the civil servants, the entire investment itself becomes victim to corrupt and ineffectual management with the result that

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<sup>3/</sup> In one case, a project director arranged for an individual (one-on-one) six week training course in "oral expression" in Paris for which \$40,000 was charged against the contract.

<sup>4/</sup> Over a three year period, one project director spent 80 days overseas on the pretext of verifying procurement activities which were managed by an international procurement agent. Records indicate that he seldom visited the vendors concerned, while the expenses for these trips came to over \$100,000 as charged against the project.



the goods and services contracted for, are seldom made fully or even partially available for use by the public.

5. Procurement. There are numerous ways in which public employees divert funds through fraudulent procurement practices. These practices are often interrelated with those in contract management as described above, and especially when the procurement of high cost items is involved. As with contracts, it is a given, that any purchases made by a public sector institution, will involve one form of kick-back or another as the following examples will show:

- a. Fraudulent Procurement. This is a common practice whereby purchase orders are generated to procure goods and services from complicit suppliers and/or from shell companies owned by civil servants, their friends, and/or their relatives.<sup>5/</sup> Invoices are submitted, approved and paid with little or no verification that the goods and/or services have been provided. In many cases, a few token items are delivered, while in others, nothing is delivered.<sup>6/</sup> In most cases, the prices for these goods and services are anywhere from two to five times competitive prices in the marketplace and in some cases, have even been beyond 1000% of market prices.
- b. Product Substitution. Whether through contract or general procurement, cases abound where higher quality/higher cost items are specified in purchase orders, invoiced, and paid for, while inferior goods are provided. This can involve changes in model numbers, changes in size and/or capacity, and even the provision of used equipment in the guise of new.<sup>7/</sup> This practice permits manipulation of competitive prices to provide greater margins for kick-backs and can be more prevalent where greater monitoring of the

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<sup>5/</sup> On one project, more than 50% of the local suppliers used to provide goods and services were not located at the addresses shown on the purchase orders and invoices, yet the project management and the tenders review committee had approved these suppliers as reputable and established firms.

<sup>6/</sup> In one case, sixty telephones were ordered, invoiced, and paid from counterpart funds, but only eight telephones were delivered for the eight person Project Implementation Unit office.

<sup>7/</sup> In one case, a purchase order for several pieces of new heavy construction equipment worth over \$250,000 was processed, yet used machines worth roughly \$60,000 to \$75,000 were accepted for delivery and paid for.

procurement process is carried out, but inventory verification is not.

- c. Excessive Quantities. Ordering excessive quantities of goods and materials is another way of diverting public funds. If the kick-back on one item is good, then ten items are that much better, and whether they are delivered or not is another matter. This practice also tends to be more common where quantities are consumed and difficult to verify (ie; office supplies, fuel, building materials, etc.). 8/
- d. Petty Cash and Miscellaneous Expenses. While individual cases of petty cash and minor procurement seldom amount to significant sums, in aggregate they can be a steady drain on the scarce financial resources of any African institution. They can range from the simple purchase of fuel for an institution vehicle whereby part of the purchase is put into jerry cans for private consumption, to inflated expense accounts submitted by senior civil servants.9/

The interesting thing about the abuses noted above, is that they occur within a variety of safeguards and control systems (ie; technical review committees, tender boards, inventory control, accountants and auditors) that should, but do not, prevent them. In fact, there is sufficient evidence to conclude that the more safeguards there are, the more abuse will occur. This is because more people are involved in the process, and thus have a stake in its success. Thus, everyone involved in initiating purchase orders, reviewing bids and prices, clearing invoices, issuing stores receipts, making payments, and managing the accounts, has a vested interest in maintaining the semblance of transparent procurement. Following from this, the amount of funds diverted through procurement becomes larger, as more and more individuals seek to collect their share of the pie.

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8/ In one particular case, a Water Board purchased a ten year supply of water treatment chemicals that had a shelf life of six months. By purchasing twenty times the amount needed, the management maximized their opportunity for personal profit, while purchasing materials that would soon be useless.

9/ In one case, a catering invoice was approved and paid for eighteen cups of tea and snacks in the amount of \$2700 (equivalent in local currency). In another case, a traveling project manager withdrew \$15,000 for "incidental expenses" (in addition to his per diem allowance) while on a one week mission to Washington.



6. Private Use of Public Resources. In addition to the various methods of diverting funds noted above, civil servants also divert both physical and human resources for their own personal gain in numerous ways. As noted in the following examples, the diversion of these resources poses additional strains on the ability of public institutions to perform their mandated functions:

- a. Use of Vehicles and Heavy Equipment. The private use and misappropriation of vehicles is one of the more widespread abuses by senior and mid-level civil servants. Vehicles desperately needed by field personnel to carry out their duties are routinely kept for the personal use of senior staff and their families <sup>10/</sup>, while construction equipment (ie; bulldozers, dump trucks, etc.) and its operators are often diverted for use on farms and other properties owned by themselves, friends or relatives. The cost of these actions is further increased by fuel and maintenance expenses which are borne by the institutions owning the equipment, not to mention the wear and deterioration while being used for personal gain.
- b. Repair of Privately Owned Vehicles and Equipment. Certain types of public institutions maintain workshop and repair facilities (ie; Ministries of Works, Transportation, Water Boards, Power Utilities, etc.) that are frequently used to repair privately owned vehicles and other equipment.<sup>11/</sup> These activities consume and/or occupy (i) worker time, (ii) spare parts, (iii) workshop supplies, and (iv) workshop space and equipment, that are all paid for by the institution. In many cases, parts are taken from government owned vehicles and equipment, for use on private repair jobs. Thus, in addition to the overt diversion of resources for these activities, the institutional vehicles and equipment are further rendered useless from the lack of usable parts and components.

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<sup>10/</sup> It is not unusual to find Bank funded vehicles, driven by civil service drivers, taking the children of senior staff to and from school each day, effectively taking the vehicles and the drivers out of service for roughly 25% of the working day for this one personal use alone.

<sup>11/</sup> In some cases, workshops can be entirely occupied with private repair work ranging from bicycles and motorcycles, to cars, taxis, trucks and buses, while desperately needed institutional vehicles remain sidelined and out of commission.

- c. The Use of Government Owned Housing. While African governments typically provide housing for senior civil servants, it is not unusual to find that they do not vacate after leaving the post for which the housing was provided. In other cases, housing owned by the government is overlooked in accounting and auditing exercises while they are rented out by senior officials. While the effect of these actions is more subtle, it nevertheless places further constraints on the government's ability to maximize its resources for the public good.
- d. The Diversion of Supplies and Materials. Generic supplies and materials (ie; construction materials, fuel, spare parts, etc.) procured by public institutions are often diverted for private use. This can range from a few sheets of corrugated roofing, to whole tanker truck loads of fuel.<sup>12/</sup> Spare parts, tires, batteries and other vehicle components are also popular targets for institutional theft. Given the difficulties of obtaining these supplies and materials in the first place, and the value of their foreign exchange component, the loss of these items seriously undermines an institution's ability to function.

While many of the above abuses are not as blatant as fraudulent contracts and procurement, they become a constant drain upon the institution, further preventing it from carrying out its mandate. As a result, vehicles and equipment in operating condition are not available, while those that are inoperable, cannot be put back in service due to missing spare parts. In other areas, power plants, water treatment plants and other public utilities, operate at less than full capacity (in part) because fuel, lubricating oil, and minor spares have been stolen.

7. Revenue Collection. Government institutions that collect monies from the public (ie; Customs, power utilities, water boards, etc.) are also prime targets for the diversion of funds by those who collect these monies. In this, each public employee at each stage of the collection process will attempt to divert some portion of the monies by:

- a. Preparing a bill of lesser amount and sharing the difference with the customer.

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<sup>12/</sup> In one case, a power utility recorded average monthly losses of 250,000 litres of diesel fuel from its power generating plant, yet did nothing to curtail the daily thefts openly conducted by its employees.



- b. Not billing and/or eliminating invoices and sharing the amount with the customer.
- c. Not entering paid amounts (either in their entirety or incorrectly) in accounts receivable ledgers.
- d. Improper transfer of funds, sidetracking funds while they earn interest, and foreign exchange manipulations prior to bank deposit.

These diversions of revenue can encompass large sums 13/ and are seldom, if ever, picked up by auditors.

8. Payroll Abuses. Another way in which resources are diverted from public institutions is through fraudulent payroll accounting. Typically, personnel rosters are inflated with the names of ghost workers, with paychecks going to friends, relatives, or fictitious names. Hidden behind poor personnel management practices, these abuses are widespread throughout the public sector.14/

9. The Interrelationship Between Corrupt Practices. As can be seen by the above examples, any public institution is quite liable to be plagued by many different forms of corruption at the same time. As each level of management and employee groups seeks to take their "share of the pie", outside political interests also seek to manipulate monies flowing to, and from, the institution for their own personal gain.15/ Thus, while senior civil servants are seeking personal gain through contract and major procurement fraud, mid-level staff are arranging vehicle and building repair scams, while low level workers are stealing vehicle parts, tires, and fuel. The result of these actions in their totality is, in almost all cases, to completely negate any effective use or management of the institution's financial,

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13/ In one case, out of revenue collections of \$64.4m, a customs agency deposited only \$40.2m and retained the \$24.2m for extra budgetary expenditures and distribution among its senior staff.

14/ In the case of one parastatal, the Director of Personnel was unable to show exactly how many persons were employed, but estimated the number to be somewhere around 16,000. A confirmation of payroll records showed that roughly 20,000 persons were being paid each month. Yet despite these discrepancies, paychecks continued to be paid directly into unverified bank accounts on a monthly basis.

15/ In one case, a Minister of Health arbitrarily ordered the Central Bank to transfer the accounts of a public hospital to his personal control without consulting and/or advising the hospital's Board or its chief administrator. The Central Bank illegally complied without the approval of the hospital's legally constituted Board, and the hospital was left without any further control of its finances.



physical, or human resources, which are usually already below minimum operating levels.<sup>16/</sup>

The enormity and extent of these practices within the public sector can best be demonstrated by the following summary of findings by an Auditor-General during an annual audit of a single Ministry of Finance. Of fifty five accounts reviewed by the Auditor-General;

- \* one account showed irregular procurement
- \* six accounts showed irregular payments
- \* fifteen accounts could not be verified due to missing, or unprovided documentation
- \* one account showed excessive overpricing
- \* four accounts showed improper contract awards
- \* six accounts showed that goods procured could not be verified through inventory records
- \* nine accounts could not verify revenue collected
- \* ten accounts could not verify revenue deposits

From this, one finds that only three of the 55 accounts were audited without incident, while the amounts involved in these irregularities came to more than US\$60 million. This, just in one year, in one Ministry. Even more interesting, is the fact that this information is published within the country each year, is available to the public, government officials, politicians, and the donor community, yet little, if anything is done with this information to address the corruption issue.

#### THE IMPACT OF CORRUPTION ON PUBLIC SECTOR MANAGEMENT

10. The problem with discussing corruption, is that it encompasses so many moral, legal, cultural, and political perspectives, that people tend to lose sight of the extremely damaging impact it has on the management and operation of public sector institutions. Whether corruption is just another way of redistributing wealth (as some would claim), an efficient way of "greasing the wheels" (a justification subscribed by some), or a way of compensating underpaid civil servants (as still others will say), it is a hard and inescapable fact that resources stolen from an institution reduce its ability to function. The more resources are stolen, the less the institution can deliver

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<sup>16/</sup> On one \$23.0m Bank project in which the Government was only able to provide roughly 30% of the required counterpart funds, the project manager and project accountant were found to be responsible for the diversion of almost all the counterpart funds provided (over \$1.0m) through various fraudulent practices. Despite concrete evidence of fraud provided by the Bank, the Government never accepted the Bank's findings, the monies were never returned, while the individuals were eventually transferred to other posts within the Ministry.



the services it is mandated to deliver.<sup>17/</sup> If this concept is accepted, then one must also accept that attempts to build institutional capacity will not succeed unless the corruption is dealt with in the same manner and intensity as other issues (ie; policies, planning, systems, etc.).

11. In order to address the corruption issue as it relates to public sector management, one must put aside the myriad excuses that concerned parties use to avoid taking concrete action. As far as the redistribution of wealth theory goes, it is only those few at the highest levels of power who really become wealthy. As far as "greasing the wheels", this certainly does not occur in Africa, for if it did, given the rampant corruption that exists on the continent, one would expect to see far more institutional success stories than we now have. And as far as compensating underpaid civil servants, one finds that those who steal the most, are those who do the least. So how can these actions continue to be excused in light of the overall degradation and failure of the African public sector?

12. Thus, if we dispose of the excuses, we must accept that corruption drains the very life blood of any institution, which is embodied in its financial, physical and human resources. Financial, in the diversion and manipulation of already meager budget allocations. Physical, in the theft and personal use of equipment, supplies, materials, and facilities. Human, in the lost productivity as public employees spend time corrupting the system, or are unable to work due to the corruption of others. Under these conditions, how can even the most honest and committed civil servants perform their duties when their management and co-workers are busy stripping the institution of its resources? Under these conditions, how can any investments in institutional development or capacity building achieve meaningful success or sustainability?

13. Finally, in looking at the corruption issue from a purely management perspective, one sees an endless stream of constraints that prevents even the most committed manager from managing effectively. The signing and effectiveness of contracts is delayed endlessly as various parties seek to obtain kick-backs. Contractors disappear after receiving high mobilization fees, or cheat on the quality of goods and services to make up for kick-back costs. Meager operating budgets are dissipated in the purchase of overpriced goods and services that are not essential to the institution's highest priorities. Salaries are paid to staff who are not present, or if they are, are underemployed due to lack of

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<sup>17/</sup> This impact can even have exponential proportions, as when a stolen carburetor (worth \$200) places a \$25,000 vehicle out of service, which in turn keeps a crew of six employees from working in the field, which in turn, further delays a large project operation.



supplies and materials. Equipment is rendered useless from having parts and supplies stolen. Revenue earned, is diverted from accounts receivable. And so on.

14. When these conditions permeate the institutional environment (as they frequently do), effective management becomes totally impossible. How then, can one expect to build institutional capacity, or strengthen management, by providing additional financial resources, technical assistance, policy advice, training, and all the other approaches that have been tried over the years, unless one also deals with the corruption factor? <sup>18/</sup> If the management of the African public sector is ever to become sustainable, it is imperative that corruption be dealt with on the same level as other development issues. This will require much greater accountability, transparency, and oversight by both governments and the donor community, than exists at present.

#### THE BANK'S ABILITY TO RESPOND TO CORRUPTION

15. The enormity of international donor aid to Africa<sup>19/</sup> is a critical factor in the corruption issue, for this aid either becomes a direct source of funding for corrupt practices, or frees up local funds for similar purposes. With billions of aid dollars flowing into the public sector, and with the existing propensity for corruption, it is to be expected that any and all activities connected with these flows, will be subject to abuse at all levels. How donors respond to the challenge of corruption, and its impact upon public sector management, thus becomes a key factor in the development process, for as noted earlier, it is not only the resources stolen that one must consider, but more importantly, the impact that the loss of these resources has on the utilization of remaining resources.

16. Because of the multitude of divergent interests in the development business, it is extremely difficult for a single donor, such as the Bank, to deal effectively with corruption as it relates to lending operations. While

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<sup>18/</sup> An interesting example of how this subject is avoided is found in a recent Bank study conducted on macroeconomic risk management in a country whose major source of income is from oil revenue. While expounding at length on exchange rate appreciation, market volatility, external shocks, risk transfer, and how the Government should manage its oil revenues, not one word is mentioned about missing revenue which, according to a recent international report, amounted to more than US\$12.2 billion between 1988 and 1994. This same report also indicates that roughly 10% of oil earnings continue to be paid into dedicated offshore accounts which are chiefly controlled by the Presidency.

<sup>19/</sup> As an example; Bank lending for FY92 and FY93 totaled \$6.8bn, while figures for 1991 show total donor aid at more than \$13.0bn.



governments appear to be intent on obtaining Bank financing for development, individuals within government are intent on using this financing for political and personal reasons that are often not in the best long term interests of the nation.<sup>20/</sup> Thus, while the Bank is intent on providing funds for development, these funds do not always translate into viable and/or successful projects.<sup>21/</sup> At the same time, other donors may seek to get on board with Bank lending by co-financing, or providing grant funds, for specific project components that may serve other agendas than those of the borrowers.<sup>22/</sup>

17. Thus, while the enormous extent and cost of corruption is tacitly acknowledged, and while numerous systemic, but often ineffective, safeguards are put in place to prevent it, it continues to seriously undermine the development of the public sector. This is due in part, to the fact that the Bank and the rest of the donor community have only recently begun to face the corruption issue head on and in the open.<sup>23/</sup> In order to expand upon this newly evolving recognition, one must fully accept that it is people, much more than systems, that cause corruption to exist. And unless people (on both the donors side, and the recipients side) are committed to dealing with corruption, systemic manipulation (ie; stricter accounting systems, audits, procurement regulations, etc.) can be helpful, but can never bring the present public sector chaos under control by itself. In this regard, an interesting and hopeful development is occurring in Uganda, where committed leadership at the highest levels is strengthening the Office

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<sup>20/</sup> This is evident in the numerous "white elephant" projects that are found throughout the region, and in the insistent requests by borrower staff for vehicles, overseas training, and other perks that are of much more benefit to the individual, than they are to the institution.

<sup>21/</sup> This is evident in the determination of lending operations that are more attuned to the availability of Bank funds, then they are to the borrowers ability to absorb them. Thus, Bank lending continues to outpace disbursements while also having an effect upon the overall negative transfer of funds to the region. While it is noteworthy that this condition has been recognized, and that some positive trends are emerging, the overall level of lending to the region is still well above the absorptive capacity of the borrowers.

<sup>22/</sup> Typical examples include the conditional co-financing of technical assistance, the provision of equipment, overseas training fellowships, etcetera, that may only be carried out by donor country firms and/or individuals. This can result in the the excessive use of costly expatriates, research that is seldom applied, the acquisition of overly sophisticated systems and equipment, irrelevant training, and other activities that bring little or no sustainable results to the development process.

<sup>23/</sup> This however, is still at an early stage, and has not yet reached a level of intensity or focus that the subject requires.



of the Inspector General to investigate, pursue, and prosecute cases of corruption.<sup>24/</sup>

18. How these various factors play out in the development and implementation of the Bank's lending operations may best be described through the following observations;

- a. The Political Excuse. Because corruption is so interrelated with national politics, and because the key borrower contacts are almost always politically appointed persons, it is difficult for Bank staff to raise the issue of corruption forcefully while attempting to process lending operations. Thus, any talk of corruption, if it should occur, is quickly dismissed by the recipients as interference in their local politics, while Bank staff are understandably hesitant to risk any confrontation that would delay lending operations. All this occurs under the general rule that the Bank can provide advice and assistance, as long as it does not get involved in politics.<sup>25/</sup>
- b. The Institutional Assessment. In all lending operations, the Bank conducts assessments of the recipient institutions to determine their management capacity and ability to achieve lending objectives. Typically, these assessments primarily focus on the resources needed to achieve project success and sustainability, but contain very little detailed evaluation of the institution's management culture and how managers and employees carry out their responsibilities and functions. In fact, if these assessments were more comprehensive and realistic, it is reasonable to conclude that a more selective lending program could have produced better institutional results over the past two decades.
- c. Counterpart Funds. As important as Bank funds are to project success, counterpart funds are equally important. For although they are of much smaller amounts, counterpart funds are critical to the day

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<sup>24/</sup> An interesting paper on this endeavor was presented by the Inspector General (Mr. Augustine Ruzindana) at a workshop in Kampala in November 1994.

<sup>25/</sup> This of course, is a selective issue, as the Bank frequently structures lending operations and places conditionalities in loan agreements that may at times, be contrary to the political interests or desires of the borrowers, but which they accept in order to qualify for the loans.



to day management of project operations. When however, these funds are not provided in their entirety, and when they are misused and diverted as noted above, project operations can be seriously affected. Despite recognition of this problem, the use (or rather misuse) of these funds is perceived as an internal borrower issue, and not something in which the Bank can, or should, intervene.<sup>26/</sup> As a result, little, if anything is done, and the abuse of counterpart funds on Bank funded projects continues to have a serious impact on the Region's portfolio.

- d. Getting the Project Approved. It is incredible to note that with occasional exceptions, lending operations are seldom rejected once they have been entered into the Bank's lending program. <sup>27/</sup> From the first instance when development funds are allocated, all tasks and actions that follow, are primarily geared to support continuation of the lending process. Project benefits are highlighted, while project risks are downplayed. Project objectives and outcomes are shown to meet critical needs of society and the economy, while past institutional history is poorly assessed and/or ignored. Vague statements are made about "management weaknesses", and most certainly, no assessments are made as to the impact of corruption upon the institution's health. Once the lending operation has gained its initial momentum, no appraisal report <sup>28/</sup> or review committee will reject it as being untenable. And it is in this way, that Bank funds flow to poorly managed and corrupted institutions.
- e. Financial Management Skills. While the Bank's main operational focus is on the provision and use

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<sup>26/</sup> A typical response by Bank staff, when confronted with evidence of stolen or misused counterpart funds, is "What can we do? After all, it's their money."

<sup>27/</sup> This is a critical issue, for in reality, it is very seldom that a borrower will approach the Bank with a reasonably coherent and developed project proposal. And although steps are being taken by the Bank to address this issue (ie; through developing greater client participation and ownership) the pressure to meet Bank lending quotas is still very dominant at the operational level. This is most evident in the nearly 100% success rate of appraisal missions, which almost always return with an approved project, no matter how badly the sector or the institution is being managed, and whether in fact there is any serious chance for success or not.

<sup>28/</sup> In reviewing hundreds of appraisal reports, the author has yet to see one report that recommended rejection of a specific project, or even a project component.



of its funds, its staffing composition tends to be very weak in terms of in-house accounting, financial management, and auditing expertise. 29/ Thus, while economists abound and smaller numbers of financial analysts exist, there tends to be very little true accounting and auditing expertise within its Africa Region ranks. As a result, and in addition to the disincentives noted above, Bank staff have very little professional interest in pursuing the time consuming and contentious issues connected with good financial management.

As can be seen from the above observations, despite the enormous impact that corruption has upon the health and management of public institutions, there are many reasons why staff avoid taking any effective action to deal with it. While privately recognizing the seriousness of the issue, they continue to be extremely hesitant to factor corruption into their assessments of institutional capacity and/or project feasibility. And, while criticisms of corruption are coming more into the open within the Bank, there does not yet appear to be a comprehensive plan to deal with it at any time in the near future. As a result, the wrong message is being sent to the politicians and civil servants, often acting out of personal interest in the name of their governments, that corruption is either tacitly accepted by the Bank, or at least is something the Bank does not wish to involve itself with. Under these circumstances, there is little evidence to show that the damaging impact of corruption upon public sector management, at least as a function of Bank intervention, will diminish over the coming years.

#### OPTIONS FOR DEALING WITH CORRUPTION.

19. Recognizing that corruption can never be eliminated entirely, but also recognizing that it is a critical constraint upon the effective management of the public sector, the Bank, if it is truly serious about governance, capacity building, and sustainability, should seek to address this issue when and where it can, and at whatever levels it can. Most importantly, a change must occur in the Bank's culture that will impact positively upon the borrowers cultures. That change must focus upon the proper management of institutional resources, with all the necessary commitment, safeguards and accountability that are

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29/ At the end of 1993 there were eight accounting specialists employed in the Bank's Africa Region with a (FY93) portfolio of 656 projects and an undisbursed balance of \$13.1bn.



required.<sup>30/</sup> Borrowers must come to understand that the Bank is serious about financial management and that the flagrant abuse of public funds will no longer be ignored. For if this message is not fully understood by the borrowers, then one can only predict further deterioration of the public sector in Africa and with it, further deterioration of the Bank's portfolio.

20. Thus, the most effective actions that can be taken by the Bank to counteract corruption, involve greater focus on the assessments of management capacity and commitment, more realistic project design, and the day to day implementation of project operations, for this is where projects either succeed or fail. And while the Bank has begun to take steps in this direction, there is still a long way to go before real changes can occur. The following examples are not listed in any order of priority, but will serve as suggested actions in this regard:

- a. Financial Management Supervision. Although the Bank insists upon the establishment of accepted accounting systems and practices, oversight of these activities usually tends to be weak and inadequate. In order to improve this situation, financial supervision criteria should be established that would provide task managers with step by step guidelines on what to look for in project accounts,<sup>31/</sup> how to verify accounting entries, and how to address accounting problems. Supervision can also be enhanced through related actions as noted below.
- b. Computerized Accounting. Because handwritten ledger entries and general bookkeeping tends to be extremely poor <sup>32/</sup> in the public sector, all accounting on Bank funded projects (ie; special, project, and interest accounts) should be entered on pre-programmed computer diskettes that can be submitted for Bank supervision on a quarterly, or semi-annual basis. In this way, borrower staff will develop better financial management skills as entries will, of necessity, have to be made at the

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<sup>30/</sup> This is not presently the case, where project accounts are poorly kept, physical inventories are not verified, and audits are submitted so late as to render them useless.

<sup>31/</sup> This would primarily entail more intensive and more frequent spot checking of account entries and related documentation, in addition to periodic physical verification of goods and services procured.

<sup>32/</sup> It is not uncommon for ledger entries to be entered in pencil, frequently erased and re-entered, kept on separate pieces of paper and not entered, entered under different dates, and written in other ways not compatible with good bookkeeping practices.



time of transaction and with greater attention to accuracy. Borrower staff will also be aware that the accounts may be subject to a more complete review by Bank staff, who will have the time and the option to review them more thoroughly at headquarters, rather than conducting superficial reviews during supervision missions. This procedure would help to impose greater transparency in project accounting, and should not be confused with the present trend of financing more complex Management Information Systems (MIS) in institutional development components of lending operations.

- c. Institutional Thresholds. One of the major problems in assessing institutional implementation capacity, is how to determine management integrity and the point at which the institution will, or will not, be able to effectively manage donor inputs. This requires the establishment of minimum criteria and/or thresholds that must be met if an institution is to qualify for assistance.<sup>33/</sup> In this way, borrowers will be obliged to achieve at least minimum standards of institutional integrity if they wish to receive assistance, while the Bank will be able to assess more accurately, the chances for project success and sustainability.
- d. Audits. In addition to frequently being of poor quality and/or incomplete, annual audits are often submitted so late as to be useless as a management tool.<sup>34/</sup> Thus, by the time audits are received, evaluated, and responses are transmitted back to the borrowers, it is too late to take any effective action to correct financial management problems. In addition, management letters are frequently not submitted, or if they are, are frequently ignored. As a result of these auditing

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<sup>33/</sup> For example; an institution would have to account for at least 90% of its resources in order to qualify for assistance. Thus, if more than 10% of its employees could not be identified, or located, it would be below the threshold. If more than 10% of its revenue was unaccounted for, it would be below the threshold. As another example; if more than 20% of its procurement was found to be above competitive market prices, it would be below the threshold. These kinds of assessments can be done in an equitable manner so as not to exclude any reasonably viable institutions, and are relatively easy to conduct, when carried out by experienced staff.

<sup>34/</sup> A review of audit submissions on Bank funded projects for FY93 indicates that only 24% had complied with audit submission dates, with some being two or three years late.



failures, the auditing process is almost totally ineffective on most lending operations. In this regard, corrective action by the Bank should be integrated with stricter financial management supervision and computerized accounting as noted above. In this way, project accounting ledgers can be closed on time at the end of each fiscal year, and submitted on diskette to the auditors and the Bank simultaneously. The audit reports would then be submitted simultaneously to the borrower and the Bank for further action.

- e. Supplier Verification. As noted in paragraph (5) above, there are numerous instances (especially with regard to local procurement and where unknown international firms are involved) where shell companies are established primarily for the purpose of defrauding public institutions. By conducting periodic follow-up and spot checks of vendors and suppliers, the Bank would be in a better position to verify the integrity of project procurement. This requires more than a casual review of procurement documents and involves actual field visits to supplier locations when and where circumstances warrant. <sup>35/</sup> This subject might also be used as institutional threshold criteria as noted in paragraph (20.c) above whereby a certain percentage of dealings with such suppliers would be a threshold factor.
- f. Contract Management. As noted in paragraph (4) above, contract management requires more stringent guidelines in order to preclude abuse. While contracts are more strictly monitored under international competitive bidding (ICB) procedures, local contracts (and especially those financed by counterpart funds) tend to be poorly supervised. Standardized guidelines for mobilization fees would be effective in this regard, and as noted in paragraph (20.e) above, periodic follow-up and spot checks should be made of contractor facilities, equipment, staffing, and contract outputs when and where circumstances warrant. This subject might also be used as institutional threshold criteria.

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<sup>35/</sup> As an example; if twenty purchase orders, invoices and payments were made between supervision missions, or between accounting periods, then several suppliers would be selected for site visits, review of goods delivered, pricing, and inventory control. As these inspections confirm the integrity of procurement, the number of visits can be reduced accordingly, although spot checks should still be made from time to time.



- g. Financial Management and Procurement Skills. While supervision of financial management, accounting and procurement is reasonably straightforward, the skills, focus, and interest that most Bank staff bring to the task, is considerably less than that required to do the job effectively.<sup>36/</sup> In this regard, if the Bank is serious about building institutional capacity, strengthening management of the public sector, achieving transparency, improving disbursements, and otherwise making more effective use of its funds, then it must drastically increase the number of operationally deployed staff with accounting, auditing and procurement skills. The present ratio of Bank staff with these skills in the Africa region is totally untenable, and needs to be increased perhaps as much as five fold <sup>37/</sup> if there are to be any genuine improvements (as opposed to improvements in ratings) in the Bank's present portfolio.

21. While there may also be policy options that the Bank might wish borrowers to pursue in dealing with corruption, it is fairly evident that most governments have more or less adequate systems in place to deal with the problem, but lack sufficient commitment to adhere to them. If there is any policy option to be pursued, it should be a policy of the Bank to place greater emphasis upon more accurate and transparent institutional assessments, BEFORE approving specific lending operations. When institutions fall below certain established thresholds of viability, and where corruption precludes even minimum levels of management effectiveness, then lending should not proceed. In the meantime, the above options, in most cases, can be implemented within the framework of existing institutional regulations and safeguards, provided that staff time and skills are properly deployed to deal with this issue.

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<sup>36/</sup> This is also confirmed in the Financial Reporting and Auditing Task Force Report by ACTCO dated August 8, 1994.

<sup>37/</sup> This would bring the level to around 50 to 60 persons which, when translated to project operations, would allow one person to cover roughly 10 to 15 projects. Stated another way, this would translate to one accounting, auditing, or procurement specialist for each \$250.0m of the Bank's undisbursed funds in the region. While it is recognized that various professional groups within the Bank's workforce all clamor for additional staff (ie; sociologists, anthropologists, technical specialists, etc.) none can be more critical to the financial integrity of the Bank's lending operations than those in the financial management cluster. Thus, the above is not an unreasonable assessment when coupled with the workload of future lending operations, and is not recommended as an addition to present staffing levels, but rather as a true shifting of the skills mix in the region.



## CONCLUSIONS

22. While it is acknowledged that the issue of corruption is complex, contentious, and extremely difficult to resolve, there are nevertheless numerous ways in which it can be minimized, provided there is sufficient commitment to do so. While corruption is not merely an African phenomenon, it is clear that the people of Africa suffer more than any other region from the loss of national resources as a result of this cancer in the public sector. It is also clear, that there are two facets of the African management culture which contradict each other. The public sector culture is rapacious in its efforts to divert public resources for private gain, yet the private sector culture shows another side of the African manager that is efficient and effective in an extremely difficult environment.<sup>38/</sup>

23. In this regard, it is evident that the African manager is capable of effective management, provided that the institutional culture will permit such behavior. In order to change this culture, it is necessary for the borrowers and the donor community both, to make a much more concerted effort to address this issue. For it is only through local commitment combined with, and supported by, better control and supervision from the funding sources, that attitudes about corruption can begin to change. And it is only through more open discussion, that the truly damaging impact corruption has on the continent will be appreciated by all parties. If all the resources that have been diverted from the public sector over the past two decades had been used for economic development, instead of personal gain, it is clear that the decline of Africa would have been much less, and perhaps could have even resulted in some degree of positive growth. This did not happen however, and it is safe to conclude that if the issue of corruption in the public sector is not addressed with greater intensity, Africa's economic decline will continue, with or without improvements in other economic indicators.

Steve Berkman, AFTCB  
April 3, 1995

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<sup>38/</sup> In this, it is clear that in business dealings within the private sector (that is, between two private parties), African managers will not pay kick-backs on contracts, will not pay above market prices for goods and services, will not hire "ghost" workers, and will not do any of the other corrupt practices that are so common in the public sector. This supports the conclusion that African managers can conduct business with probity, when the environment is conducive to such behavior.



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| <b>Withdrawn by</b><br>Diego Hernández                                                                                                                    | <b>Date</b><br>March 13, 2025      |                                                                                                                                                                                                                                                                                                              |                                        |                               |



JULES W. MUIS  
Vice President and Controller

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WBG ARCHIVES

Mr. James D. Wolfensohn

CONFIDENTIAL

November 8, 1995

Re: The C..... Word

Enclosed please find a CTR paper on the Bank's historic position, action and inaction vis à vis corruption, followed by concrete recommendations. I commissioned the paper with the aim of putting teeth into the Bank's response to what can properly albeit "cliché-ly" be called a cancer that eats into our operating and development effectiveness: the ongoing mortgaging of present and, in particular, future generations we aim to serve in developing countries.

But this paper was also inspired by CTR's plan to introduce COSO this year, as the guiding internal control principle and framework throughout the Bank. COSO is predicated on open communication (top down and bottom up) -- on areas of potential risk, including controversial ones; on substance over form in all we do; on the "proper" tonal setting from the top; and on the complementarity of individual, unit and corporate accountability -- one of your main themes in upgrading the Bank's operating culture.

The historic landscape of the Bank's record on addressing one of its main nemeses is a mixed one: from occasional denial or legalistic escapism (i.e., the view that the Bank's Articles of Association prohibit the Bank from taking an active stance on corruption, since to do so would take the Bank into the political arena), via resignation by exhaustion, to predominantly reactive, piecemeal, mainly process driven solutions; some with teeth, some without, some put into practice, some ignored. That does not mean, however, that no one cares: one sees some courageous pockets of proactive stances taken. The fact of the matter is, however, that with some exceptions, senior management has hardly ever led the debate and when it has done so, it has led from behind, with what initiative there is by lower level staff. Moreover, there is no organizational focal point on the subject. It is fair to say that based on our interviews, there is a hunger for leadership from the top on the too often taboo subject of "the C.... word." The purpose of this paper, in the wake of your statements at the Annual Meetings in October 1995 on corruption, is to stimulate Bank leadership and commitment to a concerted, visible, and coordinated set of actions to address corruption as it affects the Bank -- both as a lender and as an employer -- and its clients.

The proposed action, warped as it may be by "Controllers myopia," takes a systemic approach -- one that launches an unequivocal, non-condoning posture by looking at corruption as a three-way phenomenon -- between two conspirators and one or many victims -- and by



equally emphasizing the responsibility of donor countries and their suppliers, rather than painting it as a problem caused solely by developing countries. (Apart from the U.S. with its Foreign Corrupt Practices Act, most donor countries do not prohibit the payment of bribes overseas, and many allow foreign bribes as tax deductible business transactions.) The paper stresses the leverage effect of bribes, in that they disproportionately inflate not only project costs but also the resulting debt burden of countries with large populations living in poverty, ultimately responsible for debt repayment in the years to come. And it invites further economic analyses on the distorting effects of corruption on poverty reduction and economic development -- the Bank's mandate -- as well as (controversial as they may be) its income distribution effects, some of which may be positive. Proposed actions are also process driven, boring as that sounds, but they do put teeth into extant procedures and introduce some new ones.

Most importantly, this menu for a possible action plan would put the Bank on the map, as an institution that cares *ex ante* about corruption, rather than copes *ex post* when it cannot get around the issue. It adds a building block to your own theme of individual accountability, and extends the concept to the institution as a whole vis à vis the world it serves.

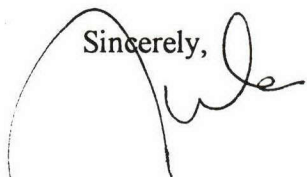
The paper was written by Myla Williams, following her interviews with managers and staff from across the Bank, and has been discussed extensively by managers within Controllers. It is not intended to reflect a Bankwide or even CTR consensus position, since widespread agreement on such a controversial issue -- apart from "corruption is bad" -- is not only virtually impossible but too often leads to paralysis by analysis.

ho I am first seeking your endorsement in principle to pursue the topic along the lines proposed, after which I would share and discuss it with the Vice Presidents -- regional, central, financial, and in particular, legal -- and translate the outcome into an action and business plan, for your final approval. This procedure was recommended by Mark Malloch Brown, in view of the sensitivity of the subject. My best guess is that once we have costed out the proposed actions, we will find that this more robust, bold but practical approach to corruption will pay itself back more than once, as a win-win development proposition.

Finally, your commitment would allow the Bank to make a quality leap, building on the goodwill already generated since June, towards an institution that will not allow itself to be compromised by defeatism, legalistics or other barriers in its search for professional and managerial excellence.

I look forward to your response.

Sincerely,

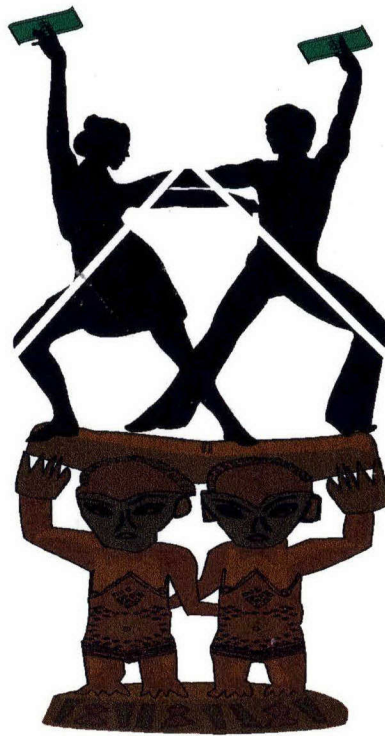


cc: Messrs./Mme. Lomax, Frank, Kaji, Sandstrom, Shihata



# THE C----- WORD\*

THE WORLD BANK'S EXPOSURE  
AND HOW TO ADDRESS IT



\*Corruption - from the Latin *com rumpus*,  
meaning "jointly broken," or alternatively,  
"it takes two to tango"  
(song title by Hoffman & Manning, 1952)

CTRPV  
November 8, 1995

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## FOREWORD

This paper expresses the views of CTRVP -- rather than a Bankwide consensus -- on the issue of corruption and its implications for the World Bank. CTRVP gratefully acknowledges the input and suggestions of staff from across the Bank, in particular: Nimrod Raphaeli, Raghavan Srinivasan (OPR); Michael Stevens (PSP); Graham Joscelyne, Robert Saunders (IAD); Robert Picciotto (OED); Louis Forget, Hans Gruss, Christian Walser (LEG); Katrina Sharkey (EDI); Randolph Andersen, Fayezul Choudhury, Michael Ruddy, George Russell (ACT); Babu John, V.S. Raghavan, Senga Sengamalay (LOA); Richard Lynn, Kabir Ahmed, Miguel Schloss (PBD); Karl Krueger, George West (CTRCS); Ladipo Adamolekun, Stephen Berkman, Colin Lyle, Katherine Marshall (AFR); Francis Colaco, Marianne Haug (EAP); Allan Legg (ECA); and James Wesberry (LAC).



## I. PURPOSE AND SCOPE OF PAPER

1. The purpose of this paper is to stress the exposure of the World Bank (IBRD and IDA) to corruption, to take stock of how far the Bank has gone toward heeding its own rallying cry to establish accountability as a means of addressing it, to take stock of what other organizations have done or are undertaking, and to recommend further actions for the Bank to take to minimize its exposure, and in so doing, further optimize its development effectiveness. This paper will not attempt to shed new intellectual or ethical light on the issue of corruption, about which much has been written and more could be learned. Nor will it attempt to quantify the extent to which corruption has directly affected the Bank (i.e., has involved Bank loan funds and/or the Bank's budgetary resources), as this was beyond the terms of reference for this paper. While its recommendations focus mainly on the Bank (IBRD and IDA), they are equally relevant to the Bank Group as a whole (i.e., including IFC and MIGA).

2. For purposes of this paper, corruption is defined as the misuse of position for private gain; more specifically, the use of influence (whether by a politician, supplier or civil servant, or staff member or manager of the World Bank) on account of his or her position, to reap illicit, personal or corporate benefit -- either monetary or in-kind, and whether for himself or herself, or for an entity or person close to him or her. Corruption can take many forms, including bribery, fraud, extortion, embezzlement, falsification, and kickbacks. It typically involves two beneficiaries profiting at the expense of one or more third parties.

## II. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

3. Corruption compromises the ability of the Bank to carry out its fundamental mission of poverty alleviation and economic development. Corruption also puts the Bank's financial integrity at risk -- in terms of its own assets, those for which it has a fiduciary responsibility, and IBRD loans and IDA credits. And the real victims are the poor, for whom corruption inflates the future debt burden, by an amount far greater than bribes themselves. Hence, corruption jeopardizes the Bank's ability to carry out its mission of poverty alleviation and economic development. With its mission and effectiveness at stake, the Bank must confront the issue in a clear and consistent manner.

4. The Bank has already taken a number of actions to strengthen financial accountability -- in the Regions' project work; in policy setting units within the Bank (CTR, OPR, and MPS); and via EDI training seminars and grant allocations from the Bank's Special Programs in support of capacity building. But more remains to be done. To take the recommended actions, the Bank will need to overcome several major internal attitudinal barriers. These include: (a) the Bank's own inhibitions to discuss corruption, long a taboo subject; (b) a perceived incentive structure that, despite some improvements following the Portfolio Management Task Force Report, to some extent continues to emphasize lending volume (output) at the expense of quality and effectiveness (outcome); (c) a tendency to recognize corruption as merely an ethical or political issue, and not a serious economic development or financial control issue, for the Bank to address accordingly; (d) the legalistic position that to address corruption, unless specifically related to the use of Bank loan funds or at the request of the borrower, constitutes political activity -- prohibited by the Bank's Articles of Agreement; and (e) not giving resource priority to this strategy (including staff with necessary specialized expertise) in the face of declining or stagnant budgets. Unless management is prepared to confront and overcome these barriers, the Bank will remain *corruptus*, i.e., "jointly broken," and jeopardize its development effectiveness as well as its reputation for financial strength and integrity.



5. Corruption is increasingly a key issue in public debate. The time is ripe for the Bank to take a more coherent and proactive role in this debate. This paper recommends that the Bank take certain steps to address systemic accountability, accountability of suppliers -- and their governments -- under Bank projects, accountability of the Bank's borrowers, and accountability of Bank management and staff. These proposed actions (summarized in Table 1) are aimed at (i) galvanizing a concerted, visible, and coordinated effort at the highest levels of management and across the Bank, to address corruption issues affecting the Bank both as a lender and as an employer; (ii) going beyond past exhortations to specific actions; and (iii) linking the Bank's anti-corruption strategy to the Bankwide COSO initiative's emphasis on effectiveness and accountability for financial controls. Over the medium to long term, the cost of taking the proposed actions will be more than offset by more efficient project implementation and real, albeit not easily quantifiable, improvements in the Bank's effectiveness and development impact.

### III. THE BANK'S EXPOSURE

#### A. The Risks

6. The Bank's financial integrity and its associated reputation as a sound financial institution are *sine qua non* to its effectiveness as a lender, and particularly as a lender to developing countries. The potential for corruption puts the Bank's financial integrity at risk on two fronts: (i) the Bank's own assets and those for which it has a fiduciary responsibility (i.e., trust funds); and (ii) IBRD loan and IDA credit funds. The statistical chance is always there that a major scandal could break and damage the Bank's reputation and therefore its effectiveness, at a time when it has come under close scrutiny by its members and severe criticism by some NGOs (albeit often for varying and sometimes self-serving reasons). The inevitable price the Bank and its ultimate clients -- the poor -- would pay in that case is paralysis of the Bank's resource mobilization potential.

#### B. The Victims

7. Corruption is of deeper concern to the Bank than in the context of its own financial integrity and capacity to raise funds in capital markets and in donor country capitals. Corruption is an impediment to economic development. It therefore goes to the heart of the Bank's *raison d'être*. The victims are very often the poor -- viz., diversion of increasingly scarce donor funds and the higher debt burden that results from procurement contracts inflated by an amount highly leveraged relative to the amount of associated bribes. Hence it mortgages future generations with the bills to pay for their forbears' ill-gotten, expensive lifestyle. Corruption damages a country's credibility, is an obstacle to transparency -- a prerequisite for competition -- and deters private investment critical to economic growth, even in high-growth developing countries. High transaction costs (financial and/or otherwise, e.g., delays) are often associated with corruption. Social costs can far outweigh the personal benefits, as in the case of violated environmental, public health, and safety standards. And corruption is exacerbating donor fatigue. Corruption therefore compromises the ability of the Bank to carry out its fundamental mission of poverty alleviation and economic development.



**Table 1**  
**RECOMMENDED NEXT STEPS**

| <b>A. Systemic Accountability</b>                                                                                                                                                                                                                                                                                                                                                                                          | <b>B. Accountability of Suppliers And Their Governments</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>C. Accountability of the Bank's Borrowers</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>D. Accountability of Bank Staff</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
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| <b>(i) Multi-Country Initiatives</b>                                                                                                                                                                                                                                                                                                                                                                                       | <b>(i) Donor Governments</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>(i) Immediate Actions</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           | <b>(i) Financial Management and Covenant Compliance</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                           |
| <p>(a) Link a multilateral debt initiative (should one materialize) to a coherent and visible anti-corruption strategy of the Bank.</p> <p>(b) Increase Special Programs grant support for international NGOs and professional associations, to develop international standards and best practice guidance for accounting and auditing, and for establishing legal and regulatory frameworks and enforcement capacity.</p> | <p>(a) Together with the IMF and other multilateral development banks, work with the OECD and the European Community to pressure their member countries' repeal of tax deductibility of foreign bribes, and toward universal adoption by member governments of domestic anti-corruption laws.</p> <p>(b) Work with the WTO toward an international convention, making transnational corruption (including bribery) a crime and establishing an international grievance mechanism; limit bid eligibility to firms based in signatory countries.</p> | <p>(a) Require regional sign-off on the adequacy of the project accounting system in place, as a condition for effectiveness for every loan and credit; offset costs by relaxing requirements for project audits (e.g., require more limited reviews rather than full audits), which are of limited value in project management.</p> <p>(b) Include a mandatory review of financial accountability issues relevant to a given project at the key review stages (Initial Executive Project Summary, Final Executive Project Summary and Loan Committee), highlighting outstanding issues flagged in reports of the borrower's Auditor General; have IAD periodically audit these reviews for compliance and effectiveness.</p> <p>(c) Include in all Public Expenditure Reviews (PERs) not only an assessment of (i) the allocation of resources, but (ii) the government's institutional capacity to manage budgets and public expenditures, and (iii) the accounting framework within which government funds are accounted for and controlled; and recommendations on how to address weaknesses.</p> <p>(d) Make Board consideration of new Bank loans to a given borrower contingent on financial covenant compliance under all Bank loans under implementation in that country.</p> | <p>(a) Assemble Regional teams to do in-depth review (including some physical verification) of SOEs for a sample of problem projects, to assess nature and extent of misprocurement.</p> <p>(b) Establish a structured position of Regional Accounting and Auditing Adviser, in the front office of each Regional Vice President and with a dotted line reporting relationship with ACTCO, to serve as a focal point for addressing borrower accountability issues in the Region.</p> <p>(c) Establish a small team of financial, accounting, and procurement specialists in each Regional Technical Department to serve as consultants to task managers; the team would monitor project financial management at entry and thereafter, compliance with financial covenants and procurement guidelines; the team would have a dotted line reporting relationship to the proposed Regional Accounting and Auditing Adviser.</p> <p>(d) Institute more systematic independent <i>ex post</i> field SOE reviews (including some physical verification) on a sample basis, under the Bank's direction, whether at the Bank's expense or funded by the borrower; the Bank should contract for this work within a global framework vis-a-vis international accounting firms' worldwide headquarters.</p> |

**Table 1**  
**RECOMMENDED NEXT STEPS**

| <b>A. Systemic Accountability</b>                                                                                                                                                                                                                                                                                                                                                                                                                    | <b>D. Accountability of Suppliers And Their Governments</b>                                                                                                      | <b>C. Accountability of the Bank's Borrowers</b>                                                                                                                                                                                                                                                                                                                                                                       | <b>B. Accountability of Bank Staff</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>(i) Multi-Country Initiatives (Cont'd)</b>                                                                                                                                                                                                                                                                                                                                                                                                        | <b>(ii) Suppliers</b>                                                                                                                                            | <b>(i) Immediate Actions (Cont'd)</b>                                                                                                                                                                                                                                                                                                                                                                                  | <b>(i) Financial Management and Covenant Compliance (Cont'd)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                             |
| <p>(c) With international NGOs and professional associations, cosponsor conferences, workshops, and EDI seminars for government officials on accounting, auditing, and legal framework and enforcement issues relevant to developing countries.</p> <p>(d) Undertake a major research initiative on corruption (e.g., a WDR) to improve understanding of its dynamics, the implications for economic development, and options for addressing it.</p> | <p>(a) Revise the Bank's procurement guidelines and bidding documents to include a no-bribery pledge, to be signed by a senior official of the bidding firm.</p> | <p>(e) Make it official Bank policy to suspend disbursements if an audit is overdue by more than 90 days.</p> <p>(f) Require that written terms of reference for all audit engagements in connection with Bank-financed projects be submitted to the Bank for no-objection review, prior to the audit engagement.</p> <p>(g) Revise Standard Bidding Documents to remove ambiguity regarding tolerance of bribery.</p> | <p>(e) Establish a cycle of internal audits of supervision reports to check for systematic independent SOE reviews as well as for project audit compliance.</p> <p>(f) Building on the work of the Portfolio Management Task Force, reorient the incentive system to reward outcome rather than output -- e.g., the flagging of accountability issues and enforcement of financial covenants, even if at the expense of commitments and/or disbursements; reflect this shift in Performance Management Process and management contracts.</p> |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                        | <b>(ii) Procurement</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|                                                                                                                                                                                                                                                                                                                                                                                                                                                      |                                                                                                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                        | <p>(a) Make random post reviews of procurement contracts the responsibility of field offices (overseen by proposed team in the Regional Technical Departments), and include review of this procedure in IAD field office audits.</p> <p>(b) Address clearly in the Staff Rules the obligations of Bank staff to report known or suspected violations of the Bank's procurement guidelines, and put in place a mechanism for handling these leads.</p>                                                                                        |



**Table 1**  
**RECOMMENDED NEXT STEPS**

| A. Systemic Accountability                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              | D. Accountability of Suppliers And Their Governments | C. Accountability of the Bank's Borrowers                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                    | B. Accountability of Bank Staff                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
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| (ii) Country-Level Initiatives                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          | (ii) Suppliers (Cont'd)                              | (ii) Longer Term Actions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | (iii) Bank Financial Resources                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| <p>(a) Collaborate with the IMF, other MDBs, and borrowers to include anti-corruption policies in economic and regulatory reform programs.</p> <p>(b) Finance initiatives at the country level -- through the Bank's lending program as well as its Institutional Development Fund -- for building capacity in accounting, auditing, and legal frameworks, based in part on Country Financial Accountability Assessments.</p> <p>(c) Through high level country visits by both the Bank's General Counsel and its Controller, work to raise borrowers' awareness of the importance of institutional development and accounting, auditing, and legal professionalism, to effective governance, poverty alleviation, and economic development.</p> <p>(d) In country dialogue, stress the importance of eliminating incentives that spawn corruption, and of promoting a transparent, competitive investment climate.</p> |                                                      | <p>(a) Make proper financial management a development objective in its own right and as such, a priority for Bank financing; implement a more aggressive schedule of Country Financial Accountability Assessments (an assessment for each borrower country by the year 2000, and an update every five years), and feed results into CASSs, discussions at Consultative Group meetings, and Lending Allocations Reviews.</p> <p>(b) Revise the grievance procedures for allegations of procurement malfeasance under Bank projects, to facilitate recourse to the Bank (e.g., via a hot line or continued use of the Inspection Panel), and clarify these procedures in the Bank's procurement guidelines and Instructions to Bidders.</p> <p>(c) Give prominence to corruption and its impact on economic performance, in the context of policy dialogue and private sector development and financial sector work; encourage borrowers to adopt anti-corruption legislation, put in place enforcement capacity, and promote a transparent, competitive investment climate.</p> <p>(d) Strengthen sanctions for borrowers that have willingly engaged in misprocurement, and/or have not enacted anti-corruption legislation; limit IBRD/IDA lending to countries that have enacted anti-corruption legislation or signed an international convention, on grounds of country performance.</p> | <p>(a) Consider adopting commercial bank practice of having staff members sign an annual "integrity letter" on a retrospective basis, in addition to the prospective statement signed upon appointment to the Bank.</p> <p>(b) Take steps to clarify in the Staff Rules and the Bank's Code of Professional Ethics, that Bank staff are obliged to report, <i>inter alia</i>, suspected or known fraud or corruption committed either by Bank staff related to the use of Bank or fiduciary resources, or by borrowers in connection with Bank loans or other services; and establish a mechanism for their doing so.</p> <p>(c) Establish a formal mechanism by which the Ethics Officer makes regular reports to IAD on lessons learned from breaches of Staff Rules and/or the Bank's Code of Professional Ethics, to assess whether preventative measures are needed.</p> |

### C. The Cynics

8. That being said, why should the Bank bother to confront corruption? After all, some would argue, it is a fact of life, a concomitant of human nature which the Bank cannot purge. In some situations, it may even enhance efficiency and redistribute wealth more equitably. It is subject to different cultural interpretations (although, according to a scholarly treatment of the history of bribes, a form of it -- bribery -- is officially condemned in the laws of every country<sup>1</sup>). As Robert E. Klitgaard writes,

“ ‘But who’s to say that a given act is really “corrupt”? Maybe it is corrupt in your culture but not in theirs. And might not corruption play a useful role in developing societies? Doesn’t it grease the wheels of commerce, build political coalitions, and help organizations overcome red tape? Besides, what can you or anyone else do about corruption? Like sin, it’s everywhere. So isn’t your topic fatally fraught with arbitrary value judgments, naivete, and futility?’

“Each of these rhetorical questions has a point. Together, they have spawned the definitional debates, functionalist apologies, and moralist and antimoralist polemic that have dominated the literature on corruption. And yet if you are interested in what to do about corruption, the questions may strike you as tangential, even supercilious. It is as if you expressed an interest in reducing poverty and were told that ‘poverty’ is a relative term, that poverty has its social functions and perhaps its social utility, and that the poor shall always be with you.

“Like illness, corruption will always be with us. But as this sad fact does not keep us from attempting to reduce disease, neither should it paralyze efforts to reduce corruption. Corruption involves questions of degree. Countries and agencies have more and less corruption, and various kinds of illicit behavior are more and less harmful. We can do better in controlling corruption.”<sup>2</sup>

### D. The Stakes

9. In short, because corruption compromises its ability to carry out its basic mission, the Bank cannot afford to take the passive position that it is a necessary evil. With poverty reduction, economic development, and the donor community’s confidence in aid effectiveness at stake, the Bank will be best served if it confronts the issue in a clear and consistent manner and takes advantage of its ability to lead by example and promote best practices, by setting and enforcing rigorous standards for its borrowers and their suppliers under Bank loans, and by taking a balanced view of the root causes of corruption -- including the complicity of developed countries that allow (even encourage) their firms to pay foreign bribes. In confronting the issue of corruption, the Bank should also set and enforce rigorous standards for its own management and staff, since minimizing risk to the Bank from corruption is ultimately their responsibility; in line

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<sup>1</sup>John T. Noonan, Jr. Bribes (New York: Macmillan, 1984), pg. 702.

<sup>2</sup>Robert E. Klitgaard, Controlling Corruption (Berkeley: University of California Press, 1988).



with the principles underlying the COSO initiative being started across the Bank in FY96,<sup>3</sup> it is not limited to the purview of the Bank's Controller.

#### IV. THE BANK'S ACTIONS AND INACTIONS

##### A. Exhortation

10. Six years ago the World Bank exhorted the donor community -- itself included -- to address the issue of corruption:

"The widespread perception in many countries is that the appropriation of the machinery of government by the elite to serve their own interests is at the root of this crisis of governance. The willingness of the donor community to tolerate impropriety - by failing to insist on scrupulous conduct by their own suppliers, by not ensuring that funds are properly used, by overlooking inadequate accounting and auditing, and by tolerating generally lax procurement procedures - aggravates the malaise. Everyone avowedly deplores the situation and wishes it were otherwise. But it will not be so until accountability is instituted."<sup>4</sup>

##### B. Actions

11. The Bank has subsequently taken some actions to strengthen financial accountability on the part of borrowers and Bank staff, many of which are summarized below.

##### (i) Regions

12. The Regions have introduced operations specifically aimed at strengthening the borrower's national accounting and auditing capacity.<sup>5</sup> The Regions are also introducing Country Financial Accountability Assessments in selected countries<sup>6</sup> as recommended in the Financial Reporting and Auditing Task Force (FRAT) Report; they are including the issue of financial

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<sup>3</sup> "COSO" stands for the "Committee of Sponsoring Organizations of the Treadway Commission." This Committee developed criteria for assessing the adequacy of internal controls for assuring the integrity of financial reporting, efficiency, and effectiveness. The term "COSO" refers to these criteria.

<sup>4</sup>Sub-Saharan Africa: from Crisis to Sustainable Growth (Washington, DC: The World Bank, 1989), pg. 192.

<sup>5</sup>Such operations are under way in Tanzania, Zambia, Uganda, Madagascar, China, Indonesia, Pakistan, Mongolia, Nepal, Bolivia, El Salvador, Venezuela, Mexico and Egypt. Others are planned for Laos PDR, the Philippines, India, and a second operation in Indonesia.

<sup>6</sup>Country Financial Accountability Assessments have been completed for Moldova, Kenya, Malawi, Senegal, Zimbabwe, South Africa, Morocco, Tunisia, and Iran; and are planned for *inter alia* Estonia, Latvia, Lithuania, Ukraine, and Peru.

accountability in Country Portfolio Performance Reviews (CPPRs) and at Consultative Group (CG) meetings; they are creating working groups to resolve auditing problems; and they are engaging local professional accountants at resident missions.

13. With the 1987 reorganization, the number of accounting and auditing specialists and financial analysts in the Regions dropped significantly. And those who remained have typically become task managers, no longer working in their specific area of expertise. To address this problem, the Regions together with the Accounting Department (ACT) are assessing the Regions' skills needs in accounting and auditing as against their current skills inventory, and will develop a remedial action plan, in collaboration with the Accounting, Auditing and Budgeting Staffing Group.

#### **(ii) Africa Region**

14. In response to a paper voluntarily written by one of its staff members,<sup>7</sup> which describes various types of corruption associated with past Bank projects, the Africa Region has formed a task force to develop an action program for the Region, in the course of its supervision work, to identify and deal with corrupt practices. The action plan begins with a "SWAT Team" effort during October - December 1995, to review Statements of Expenditure (SOEs)<sup>8</sup> for a sample of 50 problem projects. Depending on the outcome of this initiative, the task force will then consider specific remedial steps to improve borrower compliance with accounting and auditing covenants as well as with procurement guidelines. Further actions will include greater coverage of in-country financial management capacity in Country Assistance Strategies (CASs) and in other nonlending outputs, more emphasis on "quality at entry" in terms of project financial management, and more extensive training of staff as well as an assessment of the Region's staffing requirements in the area of financial management.

#### **(iii) Controllers**

15. Within CTR, ACT in 1993 established an advisory service to the Regions and their field offices on issues of borrower accountability; in the spring of 1995, issued to all task managers and many borrowers the Financial Accounting Reporting and Auditing Handbook (FARAH), which stresses the importance of quality of project accounts and internal controls at entry; is drafting an Operational Policy and Bank Procedure to replace Operational Directive 10.60 on Accounting, Financial Reporting and Auditing; is offering training to task managers on the Bank's requirements for project accounts, SOEs, Special Accounts, and audits; is revising the Guidelines for Bank Project Financial Reporting and Auditing; and is making the Bank's financial reporting of trust funds more transparent.

16. CTR's Loan Department (LOA) is rigorously exercising its fiduciary role in portfolio management, by closely monitoring the status of audit compliance in each country in collaboration with task managers, so as to avoid overdue situations; and is training local field staff as well as

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<sup>7</sup>Stephen A. Berkman, "Corruption and Its Impact on Project Management," April 1995.

<sup>8</sup>When Bank-financed expenditure amounts are small and the associated documentation is voluminous, the Bank reimburses the borrower with loan funds, against a withdrawal application supported by an SOE prepared and certified by the implementing agency and acceptable to the Bank in form and content. Supporting documentation is retained by the borrower or project entity, and made available for inspection and verification by independent auditors and Bank supervision missions. Once the Bank and the borrower agree to the use of SOEs for specified categories or items of expenditure within defined dollar-equivalent limits, all withdrawal applications for such expenditures are to be submitted with SOEs.



staff of borrowers' project implementation units on procedures for withdrawal applications and SOEs, including documentation requirements. LOA is also -- in collaboration with the Internal Audit Department (IAD) and the Borrower Accountability Unit in ACT -- proactively following up on all reports of fraud in connection with Bank loan disbursements. In each known case of misuse of Bank loan funds disbursed in the past two to three years, the Bank has enforced its policy of full repayment of these misused funds. In several instances, these cases were detected and brought to the attention of the Bank by vigilant accountants in project implementation units.

(iv) COSO

17. More broadly, CTR is about to embark on a major effort to strengthen the Bank's internal controls, with the aim of independent attestation using a COSO framework<sup>9</sup> in FY96; and has asked each Vice President and each Chief Administrative Officer or Program Coordinator to sign a letter of representation with respect to (i) the adequacy of internal controls in their VPU, and (ii) their knowledge (either actual or contingent) of fraud or corruption, whether committed by Bank staff or by borrowers in connection with Bank operations.

(v) Legal

18. At the request of the Board, the Senior Vice President and General Counsel of the Bank has issued legal opinions, statements, and memoranda<sup>10</sup> to clarify the meaning of the prohibition of political activities in the Bank's work, as stated in the Bank's Articles of Agreement.<sup>11</sup> The most recent of these papers states:

“Upon the request of a borrowing member, the Bank may finance projects for purposes of ensuring predictability and stability of the business environment and efficiency of public administration, such as civil service reform, legal and regulatory reform and judicial reform. Through such reforms, the Bank should be able to assist its borrowing countries in their efforts to fight corruption and increase transparency and accountability in public functions [emphasis added]. These aspects of institutional development are directly relevant to the Bank's objective of facilitating investment for productive purposes. Experience has proven their great importance, especially for

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<sup>9</sup>Attestation by the Bank's external auditor that the Bank's financial reporting meets the criteria set by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

<sup>10</sup>Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995; Issues of "Governance" in Borrowing Members - The Extent of Their Relevance Under the Bank's Articles of Agreement (SecM91-431), April 12, 1991 and (SecM91-131), February 5, 1991; and Prohibition of Political Activities Under the IBRD Articles of Agreement and Its Relevance to the Work of the Executive Directors (SecM87-1409), December 23, 1987.

<sup>11</sup> Per Article IV, Section 10 of the IBRD Articles of Agreement: “The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.” The same language is in Article V, Section 6 of the IDA Articles of Agreement.



countries in transition from command to market economies and for private sector development generally.”<sup>12</sup>

#### (vi) Operations Policy

19. The Operations Policy Department (OPR) issued a discussion paper in 1991 entitled Managing Development: The Governance Dimension (SecM91-820), which examined the meaning of governance and its relevance to development, and another report in 1993, Governance: The World Bank's Experience (R93-203), which gave an overview of the Bank's activity in the area of governance. More recently, in January 1995 OPR revised the Bank's procurement guidelines to include language relating to corruption. As in the past, procurement contracts financed under Bank projects are to be reviewed by the Bank either prior to or following signature, depending on the dollar value. Contracts above a given threshold dollar amount (based on, *inter alia*, country performance, and specified in the loan or credit documents) are subject to prior review by the Bank, and if approval is given it is done on a “no objection” basis. Contracts below that threshold are subject to post review by the Bank. The new language regarding corruption in the Bank's procurement guidelines is as follows:

“[I]f a borrower has awarded a contract after obtaining the Bank's ‘no objection,’ the Bank will declare misprocurement only if the ‘no objection’ was issued on the basis of incomplete, inaccurate or misleading information furnished by the borrower, or if it is established, by a decision of a court of law, that the contract was awarded on the basis of corrupt practices.”<sup>13</sup>

20. In addition, OPR has introduced a provision in the Bank's “Instructions to Bidders” issued in those countries which have instituted a legal requirement that bidders sign a “no bribery pledge.” This new provision calls for bidders, as a condition for eligibility to bid for Bank-financed procurement, to disclose commissions and gratuities paid to local persons or risk disqualification. At OPR's instigation, Country Procurement Assessment Reviews (CPARs) were introduced in 1992 and are to be conducted for every country every four years. As part of these CPARs, the Regions are working with borrowers to align local bidding procedures with the international competitive bidding procedures set out in the Bank's procurement guidelines, in terms of efficiency and transparency.

#### (vii) Development Training

21. The Economic Development Institute (EDI) conducted a workshop in November 1994 on “Enhancing Transparency and Accountability: Issues and Options,” which focused on the economic and social costs of corruption, strategies for combating it, case studies for pursuing anti-corruption programs in Uganda and the Ukraine, and the potential role of EDI and the Bank as a whole in promoting transparency and accountability. Bank and IMF staff accounted for 28 of the 43 participants, six participants were from the two case study countries, and the remaining nine were academics, consultants, or NGO representatives. EDI has also offered a workshop to train developing country journalists, with the goal of promoting transparency and information flow, both of which contribute to an enabling environment for private sector development.

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<sup>12</sup>Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995, pg. 25.

<sup>13</sup>Appendix 4, para. 3 of the Bank's procurement guidelines. Standard Bidding Documents (SDBs), mandatory and issued by the Bank, already include provisions regarding undue influence, bribes, etc. See Instruction 28.2 of SDB for Goods; and Instructions 26 and Conditions of Contract 74.1 of SDB for Works.



**(viii) Bank Grants**

22. The Bank has supported the strengthening of borrowers' accountability through two of its grant programs -- the Institutional Development Fund (IDF) and the Special Grants Program (SGP). Since its inception in FY93, the IDF has been used to fund 24 initiatives, for a total Bank contribution of \$6.6 million, spanning 20 countries, to strengthen the accounting and auditing standards, Auditor General function, procurement procedures, and/or judiciary system of the recipient governments. The SGP is funding the development of an international accounting standard for agriculture by the International Accounting Standards Committee (IASC), and is supporting an initiative by the International Organization of Supreme Audit Institutions (INTOSAI) to strengthen SAIs in developing countries through training and information exchange on a regional basis. SGP funding for these two initiatives is expected to total about \$1.4 million.

**(ix) Human Resource Policies**

23. In terms of managers' and staff accountability for abiding by the Bank's own procedures (including the handling of budgetary and trust fund resources), MPS ensures that as a condition of appointment, every new staff member and consultant sign a letter stating that he or she has reviewed and understands the Staff Rule pertaining to "Outside Activities and Interests" as well as the paragraph dealing with the "General Obligations of Staff Members" in the "Principles of Staff Employment." In addition, the Bank's President distributed to all staff on September 20, 1994 a copy of the Bank's Code of Professional Ethics, and beginning in FY93 ACT has required task managers to sign an annual letter of representation regarding use and financial reporting of Bank-executed trust fund resources.

**C. Inactions**

24. While the above initiatives are worthwhile, they are not sufficient. There continues to be a shortage of operational staff skilled in accounting and auditing, and management does not adequately stress their importance in conveying incentives and motivating staff. The consequences are many, and serious: (i) 37% and 7% of audit reports due in FY95 and FY94, respectively, are currently overdue; (ii) of the FY94 audit reports received, more than 500 (or about 15%) were qualified and in connection with nearly 300, Bank staff reported the possibility of serious accountability issues; (iii) Bank projects are designed without due prior consideration of borrowers' financial management capacity; (iv) the Bank does not adequately consider reports of the Auditors General in its borrower countries when planning a given country's lending program; (v) there is inadequate independent *ex post* review of SOEs; and (vi) there is inadequate attention to performing post reviews of bidding documents for procurement.

25. In addition, the Bank has been reluctant to discuss the issue of corruption openly. Consequently the Bank has not exerted pressure on donor countries to eliminate the tax deductibility of foreign bribes, enjoyed by their corporations doing business abroad. And there is ambiguity surrounding Bank staff's responsibilities for reporting fraud and corruption. Hence the Bank cannot afford to be complacent on the basis of past or ongoing efforts. More remains to be done.



## **V. ATTITUDINAL BARRIERS**

### **A. Inhibitions**

26. There are several major internal attitudinal barriers the Bank must overcome, if it is to give corruption the attention it deserves. One is the Bank's own inhibitions about discussing the issue of corruption openly. These inhibitions stem from uncertainty about what constitutes crossing the line from agnosticism to infringement of political sovereignty; reluctance to rock the boat by confronting client counterparts; and an incentive system that rewards task managers up through Regional Vice Presidents for making loans and disbursing them, in spite of assertions by Bank presidents that the Bank must place quality and effectiveness above lending volume targets in measuring its own performance, and in spite of some progress in this area following the Portfolio Management Task Force Report. Management -- from the country department director level up to senior management -- should therefore resist pressure to lend, which can be exerted by developed as well as developing country member governments. And it must give the right signals to staff to ensure that effectiveness is rewarded. This calls for some fresh thinking in setting performance criteria for operational staff and management (see para. 65 below).

### **B. Skills Gaps**

27. As noted in para. 13 above, the current dearth of qualified accountants and auditors among operational staff in the Bank poses a major constraint to effective monitoring of project financial management and borrower compliance with financial covenants under Bank loans. CTR has flagged this issue before, notably in its FRAT Report. But little action has been taken, ostensibly due to the difficulties with recruiting new staff while cutting budgets, as well as the Bank's disinclination to redeploy resources.

### **C. Prohibitions**

28. The Bank's traditional, somewhat legalistic position vis-a-vis corruption has been a barrier to meaningful action, on the grounds that for the Bank to address corruption in its borrower countries constitutes political activity, unless specifically related to the use of Bank loan funds or at the request of the borrower, and the Bank's Articles prohibit political activities in its work. Bank management should revisit the cost of this position. It should reassess whether this is the proper stance for the Bank to take toward such an impediment to development, and whether there is room to manoeuvre into a more substantive, proactive position -- and one that acknowledges that politics cannot be completely isolated from economics (hence the academic field of "political economy"). In the interim, the Bank is encouraged to work with borrower governments to "fight corruption and increase transparency and accountability in public functions."<sup>14</sup> The Bank must therefore continue to use the tools already at its disposal -- e.g., policy advice, sector work, CASs, country performance ratings in the annual Lending Allocations Review. In the end, the Bank's actions must be driven by corruption's economic impact. Hence, the Bank must be vigilant to ensure that its initiatives to address corruption can be justified on economic grounds -- and clearly they can.

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<sup>14</sup>Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995, pg. 25.



## VI. NON-BANK INITIATIVES

29. The Bank is not alone in giving increasing priority to accountability as a means of fighting corruption. Some of the efforts by others in this area are described below.

30. Summit of the Americas. Heads of state discussed the issue of corruption at the Summit of the Americas in Miami in December 1994, and included in the resulting Declaration of Principles a section entitled "Combating Corruption," which states *inter alia* that governments will "give priority to strengthening government regulations and procurement, tax collection, the administration of justice and the electoral and legislative processes, utilizing the support of the IDB [the Inter-American Development Bank] and other international financial institutions where appropriate."

31. Inter-American Development Bank. The IDB recently established a State and Civil Society Unit which with the Inter-American Bar Foundation (IABF) is co-sponsoring a regional information exchange on public contracting and procurement, with the aim of establishing national chapters of the IABF to promote anti-corruption legislation and its enforcement. The IDB's State and Civil Society Unit is also planning to conduct a workshop with Latin American NGOs in early 1996, in collaboration with Transparency International (see para. 37 below).

32. USAID. USAID has sponsored two inter-American teleconferences on "The Problems of Fraud and Corruption in Government," the first in 1989 and the second in 1992, with participation by several heads of state, other government officials, the private sector, academics, journalists, professional associations, consultants, and a World Bank representative.

33. United Nations. The UN's Department of Technical Cooperation for Development co-sponsored, together with the Crime Prevention and Criminal Justice Branch of the UN's Vienna office and the Ministry of Foreign Affairs and Ministry of Justice of The Netherlands, an inter-regional workshop at The Hague in 1989 on the problem of corruption in government. Participants included representatives from developing countries in Africa, Asia, the Middle East, Latin America and the Caribbean, as well as from developed countries and NGOs.

34. OECD. The OECD passed a resolution in June 1994 that its member governments would review their respective anti-corruption legislation and toughen their sanctions against foreign bribery (including the elimination of tax deductions for illicit foreign payments). The OECD also held a symposium in March 1995 (attended by two Bank representatives, one of whom was a discussant) on "Corruption and Good Governance." Two outcomes of the symposium were the establishment of a network of international organizations concerned with corruption and of an OECD task force to coordinate OECD efforts on the issue.

35. USAID, the Inter-American Accountancy Association, and the Office of the Auditor General of Nicaragua co-sponsored an inter-American regional seminar in Managua in April 1995 on corruption in Latin America. The discussions focused on the causes of corruption and what reforms governments should implement to address them.

36. NGOs and Professional Associations. There are numerous international and national NGOs and professional associations undertaking institution building initiatives and/or information campaigns to address corruption: the National Republican Institute, the Center for International Private Enterprise, the World Press Institute, the Freedom Forum, the International Consortium on Governmental Financial Management, the Africa Leadership Forum, the Latin American Institute Against Corruption, the Institute of Public Administration, the Inter-American Accountancy



Association, the International Federation of Accountants, INTOSAI, the International Development Law Institute, and Transparency International (TI), to name a few.

37. Transparency International. TI is working to establish national chapters in as many developed as well as developing countries as possible, always at the invitation of the government. The purpose of a national chapter is for TI to work jointly with the government of the country to develop strategies for combating corruption, specifically foreign bribery payments. Recently TI issued its first "Corruption Index," based on seven surveys by risk analysts and business organizations, which ranked 41 countries from least to most corrupt. Established in 1992 by two former Bank staff (Peter Eigen and Frank Vogl), TI has garnered funding from a broad spectrum of bilateral and multilateral aid agencies, private sector firms in developed countries, and the Government of Ecuador. TI sought SGP funding from the Bank in 1994 but was declined, on the grounds that to be effective, its activities would need to be adversarial vis-a-vis the government of a given country -- rendering them political in nature and therefore ineligible for Bank support. It is now seeking to open a dialogue with the Bank to explore opportunities for collaboration, including funding from the SGP. TI's track record thus far should dispel the notion that it is a "watchdog" organization dedicated to exposing specific instances of corruption, and instead should demonstrate that it works in countries at the invitation of -- and in partnership with -- the government concerned.

## VII. MINIMIZING THE BANK'S EXPOSURE

### A. The Time is Ripe

38. There is clearly growing concern about corruption. Long relegated to neutral jargon reflecting the macroeconomist's view that money is fungible (e.g., euphemisms such as "commissions," "rent-seeking," "facilitation payments"), corruption is now increasingly and openly recognized as an obstacle to economic development. The proliferation of multi-party elections in developing countries and in countries in economic transition has led to public debate on a number of key issues, not openly discussed previously, including corruption. This was reflected at the July 1995 meeting of the Development Committee Task Force on the Role of the Multilateral Development Banks (MDBs), at which "there was a strong consensus that the MDBs should not invest in countries where corruption and waste were rampant..."<sup>15</sup>, and in the World Bank President's October 1995 Annual Meetings speech, in which he specifically called for the elimination of corruption. A conclusion of this paper is that the time is ripe for the Bank to take a more coherent, orchestrated, proactive, and visible role in this debate -- at the country, regional, and global level. It is too critical an issue to the Bank's basic mission of poverty alleviation and economic development, to ignore it or to delegate it completely to others. Indeed, ignoring the problem renders the Bank complicit through its inaction. As the derivation of the word instructs, all parties to corruption (direct or indirect) are *com rumpus*, i.e., "jointly broken." To take no further action beyond what the Bank has already done or is currently doing would jeopardize the Bank's reputation for financial integrity and in particular, its development effectiveness. The Bank is in a unique position to address corruption in a meaningful way. But to that end, the Bank must be willing to lose (at least temporarily) some of its lending volume. Moreover, the Bank has a fiduciary responsibility to lead by example. In many developing countries, the Bank's procurement guidelines raise the overall standard for transparency in international competitive

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<sup>15</sup>Record of Discussion, Development Committee Task Force on the Role of the Multilateral Development Banks, Third Meeting, London, July 10-11, 1995 (SecM95-866), para. 4.



bidding procedures. Similarly, the Bank needs to articulate its own anti-corruption strategy and policies, and enforce them. The demonstration effect could be powerful.

39. The Bank should consider a series of next steps, some to prevent and some to redress corruption, and organized around four aspects of accountability: (i) systemic accountability; (ii) accountability of suppliers, and their governments, under Bank projects; (iii) accountability of the Bank's borrowers; and (iv) accountability of Bank management and staff for monitoring the quality of project financial management at entry and thereafter, compliance with financial covenants and Bank procurement guidelines, and for use of the Bank's financial resources. Many of the recommendations below -- to be prioritized after due consultation with other VPUs -- are not new; they have been discussed and endorsed by management, but most remain unimplemented. Unlike past reports and action plans, the recommendations here are aimed at (i) galvanizing a concerted, visible and coordinated effort, at the highest levels of management and across the Bank, to address corruption issues affecting the Bank both as a lender and as an employer; (ii) going beyond mere exhortations to enforce the Bank's own policies and procedures more systematically, to a monitorable action plan with the active engagement, commitment and budgetary priority of management; and (iii) linking the Bank's anti-corruption strategy to the Bankwide COSO initiative's emphasis on effectiveness and accountability for financial controls. And while this paper focuses on IBRD and IDA, management should consider the following recommendations in the context of articulating a Bank Group strategy and action plan (i.e., to include IFC and MIGA as well), since corruption is a threat to the mission and effectiveness of the Bank Group as a whole.

## **B. Systemic Accountability**

40. Corruption is a way of transacting business that can permeate the commercial, social, and political fabric of a society. It is unrealistic to expect that Bank projects could be immunized by foolproof Bank procedures and controls from the surrounding economic environment. Furthermore, no country is spared from corruption. It is not a problem unique to developing countries, as evidenced by recent events in Korea, Germany, the United Kingdom, Italy, Japan, and the United States, to name a few. Nor is corruption perpetrated only by the recipients of illicit payments. The party willing to pay a bribe is equally complicit or very often, even the driver. Therefore, while the Bank should take immediate actions to strengthen its efforts to ensure the financial integrity of projects undertaken with proceeds from IBRD loans and IDA credits (discussed in paras. 59-67 below), the Bank must also take a more inter-disciplinary, holistic, and necessarily longer term, approach to the issue of corruption. A multi-country as well as a country-specific approach is needed.

### **(i) Multi-Country Initiatives**

41. Linkage. The recently leaked draft discussion paper on a possible multilateral debt relief initiative has triggered several negative reactions in the press, on the grounds that such a scheme would essentially constitute a "gift" to corrupt Third World leaders and would condone their form of governance. Of course, rejecting such a plan does not compel repayment of the outstanding debt by those who have siphoned off funds for private gain; the debt burden still falls on the poor. More to the point, when made by a developed country that officially condones the payment of bribes to foreign officials by domestic firms bidding on donor-financed projects, this argument is hypocritical. Management should consider linking a multilateral debt relief initiative (should one materialize) to the articulation and implementation of a coherent anti-corruption strategy on the part of the Bank. Because corruption is prevalent in many borrower countries that would not be



eligible for debt relief, such linkage would need to be made carefully, with the Bank pursuing debt relief and an anti-corruption strategy as parallel, complementary endeavors.

42. Collaboration. By their nature, multi-country activities are generally not feasible through the Bank's lending program. But there are alternatives. The Bank should step up its efforts to support the development of international accounting standards, and best practice guidance for accounting and auditing, and for establishing legal and regulatory frameworks (particularly for banking and commerce) as well as enforcement capacity. It can do this via increased grant support from the Special Grants Program (SGP) for international NGOs and professional associations. (See para. 36 above for a list of potential recipients.) In addition to grant support, the Bank should engage in collaborative efforts with some of these organizations, such as cosponsored conferences and workshops. Building on its work to date in the area of transparency and accountability, EDI should host a series of seminars on these issues, specifically targeted at government officials from borrower countries (rather than Bank/IMF staff and academics, as in the past). These seminars should be led, at least in part, by non-Bank experts (again, ref. para. 36 for a list of possible sources). EDI should also give priority to procurement training courses for borrowers. The Vice President and Controller should actively liaise with international professional associations and multilateral and bilateral donors to harmonize standards for financial accountability -- which currently differ and hence stretch developing countries' limited capacity in this area even further.

43. Awareness Raising. The Bank must be willing to play a lead role in the international debate on the economic consequences of corruption. Although a good deal of work has already been done on the economic aspects of corruption and how to combat it, notably by Robert E. Klitgaard, the Bank should undertake a major research initiative such as a World Development Report (WDR) on this issue. A major research paper on corruption published by the Bank would raise awareness and put the issue squarely on the development agenda, where it belongs from both the donors' and borrowers' standpoint. To take advantage of the existing expertise outside the Bank, research efforts should include the involvement of others such as Professor Klitgaard, Professor Susan Rose-Ackerman (a Yale law professor currently on a Visiting Research Fellowship at the Bank), and TI. The Bank's 1983 WDR dealt with "Management in Development," and included an informative chapter on "Reorienting Government" with a box on corruption. But the subject is so crucial to the development process, it should constitute a freestanding WDR theme in itself.

44. The purpose of such an endeavor would be to improve understanding of the dynamics of corruption; its implications for private sector development, public sector management, and macro policy dialogue and reform; and options for addressing it. Research would focus on the economic determinants of corruption (e.g., a civil service that is politically based, poorly paid, and inadequately skilled), the impact of decentralization, deterrents (e.g., deregulation), and the economic implications. Regional variations and comparative implications would be examined for developed, developing, and transitioning countries, in terms of distribution of illicit payments (e.g., domestic consumption versus capital flight and consumption of luxury imports), transaction costs (i.e., the extent to which some bribes are efficiency enhancing, while others are efficiency inhibiting), the incidence of petty versus grand corruption, and the impact on poverty alleviation and on private sector development and the attraction of private investment (foreign and domestic). The research would include an assessment of the divergent yet parallel interests of both developed and developing countries in wrestling with how to combat fraud, bribery, and corruption. The study would also include an assessment of the impact of (i) the United States Foreign Corrupt Practices Act and the anti-bribery laws of Peru, Singapore, and Ecuador, their enforceability, and the consequences of compliance as well as noncompliance; and (ii) the *de facto* "pro-corruption" laws of developed countries, allowing tax deductibility of bribes paid abroad. A comparative analysis of domestic versus transnational bribery would also be made.



## **(ii) Country-Level Initiatives**

45. Bank action to address the issue of corruption systemically at the country level is also needed. To complement the multi-country initiatives described above, the Bank should collaborate with the IMF, other multilateral development banks, and borrowers to include the enactment and enforcement of anti-corruption policies in economic and regulatory reform programs, and give priority in development strategies to building local capacity in accounting and auditing, and legal and regulatory frameworks and enforcement, based in part on Country Financial Accountability Assessments. Capacity building should be approached in several ways: (i) more technical assistance loans (freestanding or components) to address weaknesses in these areas; (ii) capacity building components in financial sector and private sector development loans to help establish an effective Auditor General's Office (i.e., competent, independent, and adequately funded and staffed), and adequate pay scales and training for civil servants working in governments' accounting, auditing, and legal agencies or ministries (e.g., the Auditor General's Office, the Attorney General's Office); (iii) more Institutional Development Fund (IDF) grants for building national capacity in these areas; and (iv) high level country visits by the Bank's Senior Vice President and General Counsel and Vice President and Controller, respectively, to raise borrowers' awareness of the importance of institutional development and professionalism in these areas to effective governance, poverty alleviation and economic development.

46. It is equally if not more important to address corruption by working to eliminate the incentives that spawn it: burdensome and excessive regulations, licensing, significant authority vested in bureaucrats, multiple layers of approval required for transactions with government, monopolies, monopsonies, and lack of public awareness of the costs of corruption. The Bank must continue to work with its borrowers to design public and private sector reforms aimed at eliminating these incentives, and at promoting a transparent, competitive investment climate.

## **C. Accountability of Suppliers and their Governments**

### **(i) Pro-Corruption Laws**

47. Some choose to portray the context for corruption as one in which an official of the procuring government demands a bribery payment, as a requirement for awarding the bid to a given firm. But very often the tables are turned, and it is the other partner asking to "dance the tango." That is, a representative of the bidding firm (whether an employee or a contracted third party) initiates the corrupt transaction, by offering a bribe to a government official. And these firms are encouraged to do so under their governments' policy (common in many European countries) of allowing corporate tax deductions for the payment of foreign bribes -- in contrast to the payment of domestic bribes, which is considered a criminal offense. These tax deductions are at the expense of taxpayers in their home countries, and inflate multi-fold the debt burden of the poor in the world's developing countries.

### **(ii) Anti-Corruption Laws**

48. To address this complicity of a number of donor countries, the Bank together with the IMF and other multilateral development banks should work with the OECD and the European Community, to put pressure on their respective member countries to adopt anti-corruption laws (e.g., the equivalent of the U.S. Foreign Corrupt Practices Act). At a minimum, the Bank should seek repeal of the tax deductibility, on the books in many donor countries, of foreign bribes. Such laws could be designed to go into effect only after a significant number of major countries has enacted them, in order to avoid undue advantage to those not enacting such laws.



Such an initiative is crucial to the success of any effort on the part of the Bank to address corruption. Without tackling this side of the equation, the impact of the Bank's related initiatives will be greatly diminished. The Bank's President should therefore take the lead in engaging the donor countries -- specifically his counterparts, their Finance Ministers -- to confront this issue openly and frankly, and its implications for development and for the cost effectiveness of the MDBs they help to support.

49. The Bank could also push for universal adoption of an international convention negotiated by the World Trade Organization (WTO) that would make transnational corruption (bribery in particular<sup>16</sup>) a crime. The treaty could include an international grievance mechanism, similar to that in the GATT Agreement for Government Procurement. Drafts of such a treaty are already under consideration by several regional organizations (the Council of Europe and the Organization of American States), but it would clearly have the greatest impact if it were signed more broadly and included the G-7 countries as signatories, as they account for such a large share of transnational bidding. Once this treaty was in effect, the Bank could take the further step of limiting bid eligibility for procurement under Bank projects to firms based in countries that have signed the treaty. The Bank should also ask the UN Commission for International Trade Law (UNCITRAL) to draft a model Foreign Corrupt Practices Act (taking account of lessons learned through the United States' experience with such a law<sup>17</sup>) for national governments to enact.

### **(iii) Technicality and Integrity**

50. Some, TI in particular, have called for the Bank to adopt a "no bribery pledge" as a requirement for suppliers' eligibility to bid on Bank projects. This was rejected by OPR and LEG on the grounds that it violated the Bank's current procurement guidelines regarding qualification, which state that a bidder may be disqualified (pre or post bid) only on "technical" grounds (i.e., the bidder does not have the "capability and resources ... to perform the particular contract satisfactorily"), and they felt that this aspect of the guidelines should not be changed. OPR and LEG also concluded that a pledge on the part of bidding firms would be ineffective without the force of law behind it in their home countries. And because the payment of foreign bribes is allowed under the tax laws of many member countries to enhance their firms' competitiveness abroad, the Bank's Board would not likely approve a "no bribery pledge" requirement by the Bank for bidders on Bank projects. OPR and LEG therefore concluded that it was preferable for borrower governments to adopt a law banning corruption (or bribery more specifically), as has been done in Peru, Singapore, and Ecuador. It is more enforceable than a voluntary pledge, and has the support of (at least some members of) the borrower government. And as noted in para. 19 above, the Bank's Instructions to Bidders have been adapted to situations where such a law exists.

51. But the Bank should avoid legalistic escapism. Disqualification on "integrity" grounds is just as valid, as doing so on "technical" grounds. Therefore the Bank's procurement guidelines and bidding documents should include a no-bribery pledge, to be signed by a senior official of the bidding firm. Such a signature is not meaningless without the force of law behind it in the firm's home country. (If it were, letters of representation to external auditors would be meaningless.) In summary, the Bank should tackle the issue from both sides -- i.e., the legalistic approach with donor governments and the integrity approach with bidding firms. And if successful with the

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<sup>16</sup>Bribery would need to be broadly defined, in order to encompass less obvious bribes, such as inflated bids, contributions to officials' favorite charities, etc.

<sup>17</sup>See a 1995 study entitled "The United States Foreign Corrupt Practices Act: The Effectiveness of a Unilateral Act," by Jill D. Rhodes, consultant to the Bank's OPR Department.



former on a global basis, the latter may no longer be necessary. Until then, both are needed, as complementary initiatives to address the accountability of suppliers and their governments.

#### **D. Accountability of the Bank's Borrowers**

##### **(i) Immediate Actions**

52. The borrower is responsible for ensuring sound project financial management at entry and financial covenant compliance, but these are often lacking. There are several corrective actions the Bank should take, some of which could be taken immediately:

(a) Make proper project financial management a precondition for loan effectiveness by requiring, for every loan and credit, regional sign-off prior to project implementation on the adequacy of the project accounting system in place; offset some if not all of the associated costs by relaxing requirements for project audits (e.g., require more limited reviews rather than full audits), which even if submitted on time, are completed well after the period covered and are therefore of limited value in terms of project management.

(b) Include a mandatory review of financial accountability issues relevant to a given project at the key review stages (Initial Executive Project Summary, Final Executive Project Summary, and Loan Committee), highlighting outstanding issues flagged in reports of the borrower's Auditor General; have the Internal Audit Department (IAD) conduct a compliance and effectiveness audit of these reviews on a periodic basis.

(c) Include in all Public Expenditure Reviews not only an assessment of (i) the allocation of resources, but (ii) the government's institutional capacity to manage budgets and public expenditures, (iii) the accounting framework within which government funds are accounted for and controlled; and recommendations on how to address weaknesses.

(d) Make Board consideration of new Bank loans to a given borrower contingent on financial covenant compliance under all Bank loans under implementation in that country.

(e) As is done with overdue payments, make it official Bank policy to suspend disbursements if an audit (or more limited review, per (a) above) is overdue by a given number of days (e.g., 90 days -- a slightly more relaxed timeframe than the 60-day policy in the event of an overdue payment).

(f) Require that written terms of reference for all audit engagements in connection with Bank-financed projects be submitted to the Bank for no-objection review, prior to the audit engagement (as is already done with engineering consulting assignments).

53. The Bank's current Instructions to Bidders for projects in countries with an anti-bribery law say that violation of that law "may" result in disqualification. Similarly, the Bank's Standard Bidding Documents (SBDs) state that any attempt by a bidder to influence the bid processing, evaluation and award "may" result in bid rejection. The word "may" leaves open the possibility that bribery could be tolerated. This gives a bad signal and could also serve as a loophole. OPR should revise this wording, by changing "may" to "will," to eliminate the ambiguity.



**(ii) Longer Term Actions**

54. Accountability Performance. The Bank should make proper financial management a development objective in its own right and as such, a priority for Bank financing. A more aggressive schedule for conducting Country Financial Accountability Assessments should be implemented, with such an assessment to have been carried out for each borrower country by the year 2000 and updated every five years.<sup>18</sup> The purpose of these reviews should be not only to identify possible areas for institution and capacity building, but also to serve as direct input to the Country Assistance Strategies, discussions at Consultative Group meetings, and the annual Lending Allocations Review. With respect to the latter, DEC should consider explicitly integrating the results of these assessments into its country performance ratings for IDA borrowers.

55. Bidding Grievances. The Bank's procurement guidelines say that "if a Borrower has awarded a contract after obtaining the Bank's approval on a 'no objection' basis [i.e., the Bank has conducted a prior review], the Bank will declare misprocurement only if the 'no objection' was issued on the basis of incomplete, inaccurate or misleading information furnished by the Borrower..." Elsewhere in the guidelines, it states that the current process for determining whether this was the case in a given situation is for the complaining bidder to submit its complaint in writing to the Bank, and the Bank then takes responsibility for resolving the matter. However, if a complaint is made regarding the award of a contract subject to post (as opposed to prior) review by the Bank, the Bank turns over the matter to the borrower government for response and any appropriate action, which will then be reviewed by the Bank's task manager during the next supervision mission (perhaps as much as three to four months later). While about one-third of the dollar value of Bank-financed procurement contracts are subject to post review, in terms of numbers of contracts more than 80% are subject to post review. Therefore, with the vast majority of contracts subject to post review by the Bank, for most contracts resolution of a complaint can result in delays, and is the responsibility of the party against whom it has been made, namely, the borrower government -- with the likely effect of either discouraging complaints from being filed in the first place, or unofficial blacklisting of the complaining firm by the borrower government.

56. The Bank should therefore consider revising its grievance procedures for would-be suppliers alleging procurement malfeasance under Bank projects, and it should consolidate a description of those procedures (for prior and post review contracts, prior and subsequent to contract award) in a freestanding section in the Bank's procurement guidelines. OPR should lead this effort, in cooperation with LEG, CTR, IAD, and the Regions. One option for revising the grievance procedures would be to facilitate recourse to the Bank (e.g., via a hot line, with the Bank then turning over the matter to one or more independent firms contracted by the Bank, or continued use of the Inspection Panel). Whatever mechanism is selected, it will be important to ensure adequate capacity for handling complaints objectively but expeditiously, so as not to cause undue project delays. In addition, the grievance mechanism for suppliers should be described in the Bank's Instructions to Bidders.

57. Policy Dialogue. In the context of policy dialogue (including Policy Framework Paper discussions), and private sector development and financial sector work, the Regions should explicitly discuss corruption, anti-corruption enforcement capacity, and linkage of these issues to the country's economic performance; and encourage borrowers to adopt an anti-corruption law and to put in place the capacity to enforce it. At the same time, as stressed in para. 46 above, the Bank must continue, in its policy dialogue with client countries, to press for the elimination of the

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<sup>18</sup> Due to competing priorities Country Financial Accountability Assessments (recommended in the FRAT Report) have had a slow start, relative to Country Procurement Assessment Reviews which are required for each country every four years.



incentives that spawn corruption, and for the promotion of a transparent and competitive investment climate.

58. Teeth. Suppliers can be “blacklisted” by the Bank for misprocurement. But borrowers are held to a lower standard; funds used for misprocurement are to be repaid in full, and the amount of an investment loan is reduced by the amount of funds used for misprocurement. Management should therefore establish stronger sanctions -- with penalty clauses beyond the amount misappropriated -- for borrowers that have willfully engaged in misprocurement. And the Bank could also consider discontinuing or severely curtailing its lending to borrowing countries not enacting anti-corruption legislation or not signing an international convention, on the grounds that official condonation of corrupt practices is a major impediment to country performance.

## **E. Accountability of Bank Staff**

### **(i) Financial Management and Covenant Compliance**

59. Drudgery. While the borrower is responsible for *ensuring* sound project financial management at entry (crucial to sound project management) and financial covenant compliance thereafter, Bank staff are responsible for *monitoring* them. The record of borrowers’ performance in these two aspects of project implementation is weak, in part due to weak institutional capacity in a number of borrower governments. But a second major factor is inadequate monitoring by the Bank. Task managers are usually not qualified in this area (they are more likely to be macroeconomists than financial analysts or accountants); they have little time for such responsibilities during supervision missions; the current incentive structure promulgated by management puts task managers under some pressure to disburse and does not motivate them to delegate these monitoring responsibilities to others (e.g., consultants, Technical Department staff). Independent *ex post* field review of SOEs (e.g., by local accounting firms) was recommended by the Portfolio Management Task Force, but has not generally been implemented, as Country Departments generally focus far more on substantive project implementation issues rather than the relative drudgery of accounting systems and process compliance -- even though poor financial management and breach of compliance at the project level are often a sign of more systemic accountability weaknesses.

60. Diagnosis. To address these problems, the Bank should take several actions. First, the Regions should follow the Africa Region’s lead, and assemble a Regional team to perform more in-depth review (including some physical verification, not just cursory document reviews) of SOEs, for a sample of problem projects identified in collaboration with LOA. The findings should shed some light on the nature and extent of faulty SOEs. This diagnostic approach would form the basis for a Regional strategy to strengthen the Bank’s monitoring of borrower accountability. But this is only a start; the Regions should apply more scrutiny to the procurement process (see paras. 66-67 below). And in aggregate, the Regional findings -- together with input from the Bank’s procurement and disbursement specialists as well as supervision task managers -- could contribute to some quantification of misprocurement under Bank-financed projects.

61. Focal Point. While all of the Regions already have on staff at least one accounting and auditing expert -- and these staff meet monthly with ACTCO management -- this expertise is fragmented and has no functional leadership from the Regional Vice President’s office. This expertise currently resides in a Technical Department division in four Regions and in a Country Department Director’s front office in two others. To provide Regional leadership and a focal point at the Regional Management Team (RMT) level, there should be a structured position of Regional Accounting and Auditing Adviser, housed in the front office of each Regional Vice President. This



Regional Accounting and Auditing Adviser would oversee the Region's efforts to monitor the quality of project financial management at entry and financial covenant compliance thereafter, work with task managers and ACTCO to identify and address borrower accountability issues in the Region (including independent SOE verification), assess the Region's staff skills in accounting and auditing (currently there are about 100 formally qualified accountants in the Bank, of whom two-thirds are in the Regions), make recommendations -- to be discussed by the Controller with the Regional Vice Presidents and MPS -- for filling skills gaps through training and recruitment, and provide the impetus and intellectual leadership for a more aggressive timetable for Country Financial Accountability Assessments. Like the Regional Procurement Adviser, the Regional Accounting and Auditing Adviser would report to either the Senior Operations Adviser or the Regional Vice President, and would have a dotted line reporting relationship with ACTCO.

62. Accountability and Compliance Specialists. As noted above, just as task managers are not currently motivated to give priority to carrying out all of their monitoring responsibilities themselves, similarly they are not motivated to oversee delegation of them to others. As evidenced by the Bank's experience in acting on the recommendations of the Portfolio Management Task Force Report to establish more of an "implementation" culture in the Bank, it is a very difficult and slow process to change internal incentives. This is not to say that no effort should be made to move away from undue emphasis on commitment and disbursement volume; indeed, incentives should be changed to promote quality at entry and development effectiveness (see para. 65 below). But the current reality is overloaded task managers, who perceive the accountability and compliance aspects of their monitoring responsibilities as drudgery in relation to the more creative work of project design and the technical challenges of project implementation. To address this problem, the Regions should consider forming a team of financial, accounting, and procurement specialists in each Regional Technical Department, who would serve as consultants to task managers. Task managers would delegate to this team responsibility for monitoring project financial management at entry (a team member would participate in each appraisal mission, for this specific purpose) and thereafter compliance with financial covenants and procurement guidelines. Each member of this team would be responsible for monitoring financial management and compliance for a given portfolio of projects. They would have a dotted line reporting relationship to the Regional Accounting and Auditing Adviser.

63. SOE Reviews. The Regions should institute systematic independent *ex post* field review and verification of SOEs, on a routine and random sample basis. To help ensure an arm's length relationship with the borrower, this independent verification should be under the Bank's direction, whether at the Bank's expense or funded by the borrower via Bank loans or counterpart funds. The Bank should take advantage of its own reputation and procurement clout, by engaging large international accounting firms to undertake independent SOE review and verification work, within a contract framework negotiated with these firms' worldwide headquarters (rather than on an *ad hoc* and local basis, as is currently done). This should lead to lower costs and enhanced quality of such certifications.

64. Internal Audits. IAD should randomly select a fixed, preannounced number of divisions per Region per year, in which to audit supervision reports for a two-month period, to determine whether task managers are in fact having investment loan SOEs (which are accounting for an increasing share of IBRD/IDA disbursements) independently reviewed (including some physical verification) systematically on a random sample basis. The same internal audit practice of random sampling should be instituted for project audit compliance.

65. Incentives. Building on the work of the Portfolio Management Task Force, CTR should work with the Regions, Central Vice Presidencies, and MPS to change the incentives, such that both managers and staff are motivated to report and address corruption, rather than ignore it (which can lead *inter alia* to low morale), even if it is at the expense of commitments and/or disbursements.



The incentive system (in particular, the performance rating system) should be changed to reward outcome rather than output -- e.g., establishing quality at entry in project financial management, flagging accountability issues and taking corrective measures to enforce financial covenants, as opposed to rewarding favorable portfolio ratings. Performance Management Process (PMP) forms should be amended accordingly; for example, competencies should explicitly and positively value (i) the identification of breaches of Bank policies and guidelines in Bank projects, and (ii) implementation of appropriate sanctions and/or corrective measures. Management contracts should not just relate dollar inputs to outputs measured in terms of the number of loans, reports, and Country Assistance Strategies (CASs); rather, they should also include benchmarks for the unit's ability to monitor project financial management and financial covenant compliance, and to ensure systematic independent review of investment loan SOEs. In other words, there should be explicit linkage of a unit's self-assessment under COSO to the performance evaluation process.

## **(ii) Procurement**

66. Post Reviews. Under current procedures, task managers are responsible for random post reviews of procurement contracts with a dollar value below a threshold specified in the loan or credit agreement. These contracts totaled \$6 billion in FY94, and represented 36% of the total dollar value of Bank project procurement contracts, but a disproportionate 82% of the total number of such contracts. Many of these contracts are for local procurement, with documentation in local languages or dialects, and provide a tremendous opportunity for misuse of funds. As with reviewing SOEs, it is unrealistic to expect task managers to give review of these numerous contracts high priority. CTR therefore supports OPR's proposal to EXC that post reviews be conducted on a systematic, sampling basis by Bank field offices, with the necessary local staff or consultants and supervisory resources totaling \$2-3 million per year. The Regions would be responsible for ensuring that this work was done, and task managers could delegate this responsibility to the accountability and compliance specialists in each Technical Department, proposed in para. 62 above. To ensure greater independence, post reviews should be at the Bank's expense, and not paid for by the borrower. IAD should include review of this procedure in its field office audits.

67. Whistle Blowing. While the Bank's Code of Professional Ethics calls for Bank staff to "report to supervisors any departure by other staff members from ...[the Bank Group's] policies, rules, or procedures," there is currently no policy regarding how staff are to handle reports or suspicions of violation of the Bank's procurement guidelines on the part of borrowers and/or suppliers. This is an important issue, particularly given the role that task managers play, either in directly selecting consulting and accounting firms or in influencing their selection by the borrower. CTR and OPR should establish Bank staff's obligations in this regard, determine what mechanisms would need to be in place in order to follow up appropriately on such leads, and with input from MPS and LEG, address these issues clearly in the Staff Rules. Relevant language should also be included in the "integrity letter" (see paras. 68-69).

## **(iii) Bank Financial Resources**

68. Integrity Letters. In addition to being responsible for monitoring project financial management and borrower compliance with financial covenants, Bank staff are accountable for their use of the Bank's own financial resources. (They are also accountable for resources entrusted to the Bank, for which a trust fund letter of representation was already introduced.) To reinforce the importance of one's accountability, management might consider adopting a practice in the commercial banking industry, of having every staff member sign an "integrity letter" not only



prospectively upon appointment, as is currently done,<sup>19</sup> but retrospectively on an annual basis. The text of the "integrity letter" upon appointment would be amended to include a pledge to abide by certain standards (not merely to have reviewed and understood them, which is the current wording). Furthermore, the substantive text of both letters would be integral or annexed to the letters themselves, and not merely referenced therein; and the addressee would be the President of the Bank rather than the Manager of the Staff and Consultants Appointment Unit in MPS.

69. The annual "integrity letter," which would cover the prior year, would state that the staff member is not aware of (i) any unreported matters potentially embarrassing to the Bank; (ii) any instances of fraud or corruption committed either by Bank staff related to the use of Bank or fiduciary resources, or by borrowers in the context of the Bank's lending program or other services; or (iii) any breaches of professional confidence by Bank staff (including leaking of confidential papers) -- apart from any exceptions to be noted at the end of the letter by the signing staff member. There will, of course, be gray areas (e.g., suspected, rather than known, fraud or corruption). In that event, the relevant Staff Rule (see para. 67 above) should require the staff member to consult with the Ethics Officer or IAD. And the annual "integrity letter" would include a statement that in matters of uncertainty or doubt, such consultations have taken place. As part of this initiative, the text of Staff Principle 3 ("General Obligations of Staff Members") and Staff Rule 3.01 ("Outside Activities and Interests") should be amended to address specifically the issue of Bank staff's independence, *inter alia* from firms (in particular, consulting and accounting firms) engaged by the Bank and/or by the borrower. The agreed final text for both "integrity letters" would need to be cleared by MPS, the Ethics Officer, CTR, IAD, OPR and LEG.

70. Whistle Blowing. Management should also consider revising the Code of Professional Ethics, so that it not only obliges staff to report to supervisors any departure by other staff members from the Bank's policies, rules, or procedures but, more specifically, any departure by other staff members from "due regard to the appropriate use of World Bank Group resources." Management should consider establishing a "hot line," either to IAD or the Ethics Officer, for reports of suspected or known misuse by staff of the Bank's financial resources (budget or trust funds), including for the selection of consultants in line with the Bank's guidelines.

71. Preventative Post Mortem. The Ethics Officer should make reports to the Auditor General on the underlying causes and circumstances (motives and opportunities) which led to each case of a breach of the Bank's Staff Rules and/or the Bank's Code of Professional Ethics, so that IAD may assess whether preventative measures are needed. Currently, there is no such formal mechanism in place to link the efforts of the Ethics Officer with those of IAD. As fraud is not only an ethical problem but also a financial control problem, IAD will continue to involve CTR as appropriate in matters under review by the Ethics Officer.

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<sup>19</sup>The current procedure is for each staff member and long-term consultant, upon becoming an employee of the Bank, to sign the following statement, addressed to the Manager of the Staff and Consultants Unit in MPS: "I have reviewed and understand the World Bank's Staff Principle 3, 'General obligations of Staff Members,' and Staff Rule 3.01, 'Outside Activities and Interests.'"



## VIII. COSTS AND BENEFITS

72. Perhaps the most tangible obstacle to addressing corruption is the budgetary cost of implementing the recommendations put forward in this paper. If Bank management agrees in principle with the approach proposed, PBD will work with the Bank's VPUs to develop a costed "business plan." Most elements of the proposed approach are not expensive, although the costs might be higher at the early stages of implementation. And over the medium to long term, these costs will be more than offset by (i) more efficient project implementation, and (ii) real, albeit not easily quantifiable, improvements in the Bank's effectiveness and development impact.

# THE WORLD BANK

Chief of Staff

Accounting treatment

Rescheduling in

Refinancing

Clearances - keep them  
in non-account.

Does this imply rescheduling?

Shubert calls this  
the

refinancing

RACHEL LOMAX

Is this considered work IS?



## THE WORLD BANK

Donors - interest arrears

Chief of Staff

Sumner's letter to IFIs

drafting

What is the power of this?

Should we send it all?

Some of them can't

beschering by their

Articles.

Can them, talk or  
margin of MAB.

RACHEL LOMAX

# THE WORLD BANK

Chief of Staff

Jim

When this is updated  
for future cleavage  
management, Bosnia,  
+ may be under a power  
it will look pretty  
good.

In real life this is the  
agenda for the next few years,  
in large part. At present,  
quite a lot of hammering up,  
won't stop to come. R.

RACHEL LOMAX



# THE WORLD BANK

Chief of Staff

f

1. Package

2. Bosnians

3. The Board

RACHEL LOMAX





# OFFICE MEMORANDUM

DATE: November 14, 1995

TO: James D. Wolfensohn, President, EXC

THROUGH: Rachel J. Lomax

FROM: J Graham Joscelyne, Auditor General, IADDR

EXTENSION: 85412

SUBJECT: **Follow up on Yesterday's Meeting  
Allegation of Fraud**

Firstly, thank you for the lunch. Through the discussions, I trust you were able to get a clearer picture of how we are discharging our responsibilities. Also, you were clear on your requirements which already are being worked on.

Attached is a necessarily brief document about a **current fraud investigation**. As we are still working on this case we do not yet have the full picture. I hope this information suffices for your purposes at present. We will also keep you informed at the matter progresses.

*Jim*  
*I am having*  
*lunch with this guy*  
*soon R*  
*J. Graham Joscelyne*



# Record Removal Notice



|                                                                                                                                                           |                                        |                                                                                                                                                                                                                                                                                                              |                                        |                               |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------|-------------------------------|
| <b>File Title</b><br>President Wolfensohn - Briefing Book for President's Meetings - Meeting Material - Calendar - Corruption Meeting - December 15, 1995 |                                        | <b>Barcode No.</b><br><br>30485621                                                                                                                                                                                                                                                                           |                                        |                               |
| <b>Document Date</b><br>November 14, 1995                                                                                                                 | <b>Document Type</b><br>Brief document |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Correspondents / Participants</b>                                                                                                                      |                                        |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Subject / Title</b><br>Summary of IAD Fraud Review in Progress Concerning Senegal Project                                                              |                                        |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Exception(s)</b><br>Information Provided by Member Countries or Third Parties in Confidence<br>Deliberative Information                                |                                        |                                                                                                                                                                                                                                                                                                              |                                        |                               |
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| <b>Withdrawn by</b><br>Diego Hernández                                                                                                                    | <b>Date</b><br>March 13, 2025          |                                                                                                                                                                                                                                                                                                              |                                        |                               |







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| <b>Document Date</b><br>November 13, 1995                                                                                                                 | <b>Document Type</b><br>Memorandum |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Correspondents / Participants</b><br>To: Mr. Jules Muis<br>From: Ibrahim F. I. Shihata                                                                 |                                    |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Subject / Title</b><br>The C... Word                                                                                                                   |                                    |                                                                                                                                                                                                                                                                                                              |                                        |                               |
| <b>Exception(s)</b><br>Attorney-Client Privilege                                                                                                          |                                    |                                                                                                                                                                                                                                                                                                              |                                        |                               |
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| <b>Withdrawn by</b><br>Diego Hernández                                                                                                                    | <b>Date</b><br>March 13, 2025      |                                                                                                                                                                                                                                                                                                              |                                        |                               |





# OFFICE MEMORANDUM

DATE: August 29, 1995

TO: Mr. Wolfensohn, President

FROM: Marianne Fay, Economist

EXTENSION: 87200

SUBJECT: Ethics

You have  
already  
seen the  
attached.  
Quite good  
piece.

Attached is the short piece on ethics, which you requested after your meeting with the YPs. This was written by Monika Weber-Fahr and myself, and benefited from comments from many others. It failed, however, to generate a consensus among the YPs, and should not therefore be considered as emanating from the group.

Several YPs felt it was pure hubris on our part to pretend to pass judgment on a "mature institution" we barely know. Some believed a different (economic or other) framework of analysis should be used. Others thought that it was dangerous to include specific examples in a paper whose circulation we could not control. Most, however, agreed that ethical issues are important, and worth a discussion.

Our paper does not aim at an exhaustive analysis of ethics problems at the Bank, or in the field of development. Nor does it seek to provide all the answers. Indeed, you will see that the main recommendation we offer is that ethical issues be openly discussed. This may seem a rather vague or weak suggestion. However, the most striking discovery Monika and I have made while working on these few pages is how useful these discussions are. We also discovered how differently different individuals think about ethics, and how enriching it can be to hear others' opinion on the subject.

We hope that you will read these pages in the spirit they were written: not as a critique of the World Bank, or even as a preliminary assessment of its ethical conduct, but as an honest and humble attempt at starting an open debate on a difficult issue. Our paper is no more than one point of view, and one that only reflects Monika's and my limited professional and personal experience.



## WHERE ETHICAL ISSUES ARISE FOR BANK STAFF AND WHY A NEW APPROACH MAY BE NECESSARY

*"Nice" companies are prone to much greater  
damage if they suffer an ethical lapse.  
The Economist, 8/19/95*

### I. WHY WORRY ABOUT ETHICS?

1. **Ethical questions arise in a variety of ways in the course of most World Bank staff's day-to-day work.** They arise whenever a decision risks being made for the benefit of an individual, or of the World Bank itself, rather than in the interest of development. This can be straightforward, as in the making of procurement decisions, or more complex, as in the design of projects (is this a project that makes a division look good, or is this the best possible way of utilizing scarce resources to help our client?). Such issues are potentially political dynamite when they involve corruption in the client country —should we impose our deontology on a client government?— and pose painful dilemmas when they involve conflicting goals of above-board behavior and “getting results in the field.”

2. **Ethical behavior is even more important for the World Bank than for other institutions.** First, higher ethical standards are expected from the Bank than from other institutions out of responsibility for the dream that led to its creation. Second, the Bank is a quasi-monopoly for whom no true regulatory agency exists. This implies a particular responsibility for self-defining and self-enforcing the code of behavior its mandate entails. Third, the role of the Bank as a leader in development implies that as a leader it should —and does— set an example for other institutions' and countries' behavior.

3. **Ethical standards, and the need to adhere to them, are becoming increasingly important, yet more complex for the Bank.** For example, increased dealings with the private sector has enlarged the number of activities occurring at the public-private interface, where corruption is most likely to occur. Also, the Bank has grown substantially in terms of staff and lending volume. Yet, in many ways it is still run as if its staff is a small, tightly, knit group of idealists. Finally, the cynicism and disillusionment surrounding institutionalized aid and development efforts, makes it ever more important for donor agencies to ensure that the funds entrusted to them are properly used.

### II. ETHICAL QUESTIONS FACING THE BANK: FROM GRAY TO BLACK & WHITE

#### A. Gray areas

4. **Gray areas can be gray because there is no simple answer to the question they raise.** Staff members often have to make choices that entail a trade-off between project delivery and strictly ethical behavior. A classic case is the insistence by a recipient government that a project contain unnecessary vehicles for high ranking civil servants. Another frequent occurrence is the insistence that local recruits be paid high salaries, refusal of which could affect a whole project or, at the least, entail time, energy and at times disagreements with a manager who may be worried about disbursement ratios. However, accepting such requests can have long term deleterious consequences for the Bank's work, for the recipient countries and for other donors. Another example is given by the recent insistence of a client government, that a substantial portion of a higher education loan be used for a state of the art library, to “reward” the Government for taking crucial, but politically difficult, measures. In this case, what is right or

wrong: the measures were very important, will have long term positive effects, and were politically risky; on the other hand, are we in business to “reward” governments for taking necessary decisions?

5. **Gray areas can be gray because they fall short of entailing serious wrongdoing, or appear as well meaning.** However, the lines are finely drawn. A manager implicitly convinced of the good of his project can decide to “cut corners” in order to get a project through. This is socially acceptable behavior within the Bank where “cutting corners” is sometimes seen as a game of “Let’s beat the bureaucracy for the sake of the client.” Yet such behavior can take unethical proportions when it entails tampering with data, dropping important conditionalities or withholding relevant information. It can be hubris, and the true motivation sometimes is the greater glory of the manager/division, rather than the good of the client. However, as long as the Bank’s bureaucracy remains as unwieldy as it is today, little change can be expected in this area.

6. **Gray areas can be gray because no explicit policy has been developed to take a stance.** Here the grayest area of all remains the issue of corruption in the client country, which is seldom openly discussed within the World Bank. Concern exists though, that we are sitting on a time bomb, as we make loans to kleptocratic governments.<sup>1</sup> Several years ago, a staff member compiled information on the “price” of higher civil servants and members of Government in a client country. This almost cost him his job, but did not result in any changes in the Bank’s dealings with the client country. The Bank now believes that a proper macro-economic and policy environment is crucial for the success of any project. A logical continuation of this line of thought is that a reasonably lawful and honest government is indispensable to the success of development assistance. In a time of reduced concessionary flows, it may be time for the Bank to take a more candid and open position on this issue. The recent creation of Transparency International<sup>2</sup> shows that the world is moving in this direction.

7. **Gray areas are dangerous because they are conducive to more serious wrongdoing.** Gray areas can create an environment where individuals do not hold themselves personally accountable, or at the very least, may discourage them from taking a firm stance on issues that may need it. They can lead to a culture of tolerance towards what may be wrongful behavior, because too many fine lines must be navigated.

## **B. Black & white issues: wrongdoing within the Bank**

8. **There is substantial *potential* for corruption in the Bank’s day-to-day operations.** Such *potential* typically arises in the selection of consultants and in the procurement of goods and works for Bank financed projects. For both procedures, the Bank has developed an extensive and well-disseminated system of rules and regulations. However, rules are only as good as the individuals responsible for their application. This is particularly true at the Bank where task managers are, by necessity, given a lot of independence, and may be their counterpart’s only contact within the Bank. Another problem arises when rules put the need for checks and balance too far above practical concerns. This is very dangerous since it creates a socially (within the Bank) acceptable pretext to violate such rules.

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<sup>1</sup> An e-mail discussion of this issue started within the Bank last spring, expressing this particular fear.

<sup>2</sup> This organization recently published its first corruption index of countries.



9. **There actually have been remarkably few reported cases of corruption.** It remains unclear whether this results from the Bank's preventive measures (whether through the hiring of honest individuals, or through the dissuasive effect of sanctions), or from an ineffective system of detection.

10. **The Bank's detection system may not be effective.** Since even a careful audit may not be enough to uncover wrongdoing by an insider, detection depends to a large extent on a staff member or an outsider reporting wrongdoing. The whistle-blower is not, however, offered much protection, since the ethics officer cannot withhold his/her identity beyond a certain point. Recently, a consultant from a client country accused a staff member of rigging bids to go to those firms or consultants that had paid him a bribe. However, no direct investigation of the case could be made since the whistle-blower refused to put his name to this accusation. Since no guarantee could be given to him that his identity would be protected, we will never know whether his refusal was due to fear, or to the fact that his accusation was unfounded. While no one's reputation should be at the mercy of anonymous allegation—or perhaps because of that—the Bank may want to follow the *Economist's* recent advice of making “whistle-blowing a safer business.”<sup>3</sup>

11. **Sanctions are mild when they involve a politically sensitive case.** A staff-member convicted of wrongdoing is automatically terminated, and can be prosecuted if the Bank chooses to pursue the case. However, in politically sensitive cases, the Bank seems reluctant to do so. One result is that a staff member who was found guilty of corruption left the Bank to work for another multilateral agency. This raises an important question: does the Bank have a moral duty to ensure that bad apples are thrown out for good, or is it more important—particularly in today's political context—that the Bank's good name be preserved? A second result is that such sanctions are hardly dissuasive. Depriving itself of one of the main tools of law enforcement, the Bank therefore needs to invest more in detection and preventive measures.

*What we need to do is to work to expand and strengthen our ethical sense, not by promulgating more rules or more elaborate codes of conduct, but by thinking about what ethics are and why they are important to us.*  
Eric V. Swanson, *Bank's World* / July 1995

### III. WHAT IS TO BE DONE:

12. **Ethical issues need to be discussed openly.** This would help satisfy three needs: identify areas in which current Bank rules are in need of reform; prepare individuals for the day when they may encounter a difficult situation; develop a clear cut position on issues such as corruption in recipient countries that are to a large extent taboo. Such open discussions could be conducted informally through brown-bag lunches, or articles in *Bank's World*, or formally through workshops and case-studies.

13. **The Bank—that is all of us—needs to have access to an ethical tool kit.** This means individuals must develop their own professional moral code, but also, that an institutional framework exists for individuals to draw on, when they need advice, or protection. In this context the Bank may want to re-think the incentive structure of managers and the role of the ethics officer. A staff member finding out about wrongdoing can be at a loss as to whom to turn.

<sup>3</sup> The Economist, p55-56, August 19, 1995.

A division chief? A director? Why should they welcome an accusation that makes their shop look bad, could spoil a project considered a success, delay disbursements, and/or affect relations with a client country? The ethics officer? His powers are limited, and his mandate is such that he is caught between a need to protect staff members' rights when accused and the goal of shedding light on accusations brought to his attention.

14. **An institutional moral code can only be effective if there is clear, courageous, and active support from the Bank's management.** Management must start taking leadership on this issue, and cannot simply respond to individual initiatives. The Africa Region Draft Paper on Corruption only came out after a staff member "became very forceful in encouraging his colleagues to address the problem" and "produced on his own time a paper" on the topic<sup>4</sup>. Why did the staff member have to be so "forceful", and why did the Draft Paper come only as a response to this person working on his own time if, as the Draft Paper says, "the Africa Region of the Bank has long been aware of corrupt practices in African governments and donor-financed projects"?

15. **An institutional moral code can only be effective if it makes individuals responsible for the actions they take or tolerate.** This will require making sure that individuals feel personally comfortable with the institutional moral code, and that the incentive structure within the Bank supports individual responsibility. It is in this context that open discussions of ethical issues can be most useful. They are the best antidote to the idea that individuals who do no more than protest an action they consider incorrect have done the extent of their duty.

16. **The Bank needs to follow an active policy of developing and encouraging the moral fiber of its employees.** A narrow dependence on the innate moral fiber of staff may have been adequate in the pioneering days of the Bank when most staff knew each other personally, problems were simpler, and peer pressure could be used, but it seems insufficient today. Yet, because the Bank's strength lies in its employees, it must develop a human resource strategy that places greater emphasis on ethics.

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<sup>4</sup> Africa Region Draft Paper on Corruption, June 16, 1995



1476

UNDERSTANDING CORRUPTION:  
IMPLICATIONS FOR WORLD BANK STAFF  
(An OPR Consultant Report)

Herbert H. Werlin  
Independent Consultant  
5910 Westchester Park Dr.  
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PHONE: (301) 474-2764

August 1994

1. INTRODUCTION: OUR OBJECTIVES

Economists assume rational objectives and behavior - that leaders (including politicians, decision-makers, directors, and managers) want to expand wealth or GNP, improve national standard of living and productivity, and meet or exceed development objectives. Those at the World Bank are generally trained and experienced in dealing with issues of poverty. What is far more difficult to understand and cope with is counterproductive behavior, manifesting itself in destruction, waste, lethargy, apathy, and the purposeful undermining of institutions.

It is this environment of counterproductive behavior that we will explore in this report. Based upon Robert Klitgaard's 1990 book, TROPICAL GANGSTERS, having to do with his experience during the 1980s directing a World Bank economic rehabilitation project in Equatorial Guinea, we might conclude that the leaders of dysfunctional countries are "a bunch of crooks (the politicians) who manipulate a bunch of idiots (the citizens)" (Alesina 1992, 3). Instead, we will suggest that these leaders suffer from a political disease, which will be described here as "secondary corruption." While many of our examples will be drawn from Africa, we believe that this concept of political illness is relevant to much of the world where the Bank is active.

We will begin this report with a definition of corruption, using a primary-secondary corruption distinction. This will be followed by an analysis of the implications of this distinction. We will then deal with the following questions that seem of interest to Bank staff:

1. Why is corruption less dysfunctional in More Developed Countries (MDCs) than in Less Developed Countries (LDCs)? What has been the experience of such transitional countries as Indonesia in this regard?
2. How useful are cost-benefit and functional-dysfunctional analyses?
3. How does the literature of institutional economics fit into an analysis of corruption? Should rent-seeking (an aspect of institutional economics) be considered a form of corruption?



4. What are the causes of corruption? To what extent are they cultural or political?

5. According to Bank staff, how might corruption be reduced?

6. Is democratization essential to reduce corruption?

7. For the Bank, what are the organizational implications of a serious struggle against corruption?

## 2. DEFINITION: A PRIMARY/SECONDARY CORRUPTION DISTINCTION

Heidenheimer, Johnston, and LeVine (1989, 8) classify definitions of corruption into three often overlapping categories: (1) misuse of money or favors for private gain; (2) inappropriate exchanges of money or favors for undue influence or power; and (3) violations of public interest or norms of behavior for special advantages or self-serving purposes. Each of these definitions is meaningful in MDCs where political systems are respected and, thus, statesmanship prevails.

In LDCs, on the other hand, the foundations for these typical definitions of corruption tend to collapse for reasons indicated in the fifth section. They do not adequately take into account that "greed," however repugnant in the abstract, cannot easily be judged "immoral," in the absence of civilized or institutionalized governance. After all, what does corruption mean, first to all, in Hobbes's "state of nature," where the life of man is "solitary, poor, nasty, brutish and short" and, subsequently, under his Leviathan (where those in authority are unchallengeable).

Even in MDCs, we need to be realistic as well as moralistic in regard to corruption. As Rose-Ackerman (1978, 9) points out, "One does not condemn a Jew in Nazi Germany for bribing his way out of a concentration camp." The larger the gap between social norms (what ordinary people consider appropriate) and legal stipulations, the more likely corruption is to flourish. Rent control, for example, has often been undermined by corruption because it is generally considered an unpersuasive form of power, violating the economic laws of supply and demand and appearing to be a "tyranny of the majority." Likewise, rigid forms of zoning (e.g., disallowing subdivisions of single-family houses or small-sector commercial establishments within low-income communities) are often "quite rightly" unenforced. In both New York City and Tokyo, the police are often bribed to allow illegal parking by delivery trucks. Until policies are changed to be more realistic about parking problems (allowing, for example, special hours for delivery and parking), corruption of this sort cannot be easily diminished.

In MDCs, however, we can usually understand what corruption is: violations of legal or formal norms of official conduct, to use a 1989 definition by Lowenstein. But in LDCs, where the



political system not only facilitates but requires such behavior, the conventional definitions of corruption become meaningless. In other words, when there is no clear manifestation of public interest, and the prescribed norms and procedures are themselves corrupt, we need to look for another way to define corruption. Otherwise, it is easy to become blase about corruption, suggesting nothing more than a cost/benefit or functional/dysfunctional analysis.

The definition suggested here for political and administrative corruption - partisanship that challenges statesmanship - arises from the clash of the two meanings of politics found in Sheldon Wolin's commentary on Western political thought (1960): (1) the struggle for competitive advantage (i.e., partisanship) and (2) the struggle for consensus (i.e., statesmanship). Since Plato, Wolin points out (p. 42), political scientists have struggled to reconcile these two diverse meanings of politics: "a science that is at odds with its own subject matter." (We will return to the clash between these two definitions of politics in examining the relationship of corruption to democracy.)

Our definition of corruption suggests two types of corruption along the lines of the distinction earlier noted between primary and secondary corruption. Primary corruption is simply "greed" or excessive partisanship or selfishness that is subject to official punishment or popular condemnation, as suggested in the typical definitions of corruption. Secondary corruption, on the other hand, refers to greed (or merely manifestations of ambition and survival) in the absence of viable governance. It thus tends to be systemic or "standard operating procedure." Yet, it would be wrong to suggest that corrupt acts which have "become institutionalized through the decrees, laws, and rules adopted by public officials themselves" may no longer be considered corrupt (Gardiner and Olson 1974, 5). Indeed (as will be elaborated in the next section), destigmatized or secondary corruption is a political illness, whereas primary or personal corruption is a political problem.

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#### Box 1

##### BASKETBALL FOULING AND CORRUPTION: AN ANALOGY

Imagine watching two basketball games. In each of them, we recognize what "fouling" is - physical contact with a ballhandler, for example. However, as our eyes shift from one game to the other, our conception of fouling becomes discombobulated in ways that may help us understand the confusion associated with corruption.

In Game A, a National Basketball Association professional game, for example, fouling has a detailed and legalistic meaning and is



enforced by carefully selected and trained referees. Distinctions, therefore, between accidental, fragrant, intentional, technical, and other forms of fouling can be made. A losing team may deliberately foul to "catch-up," hoping for a missed free throw, and would thus be infuriated if the foul were not called.

In Game B, on the other hand, where the referees are known to be easily bribed and partial to the team paying them the most, fouling becomes amorphous (done with indifference towards the rules or in contempt for them) because teams must not only foul to win but pay the referees to facilitate their fouling. The distinctions between types of fouling made in Game A become almost meaningless in Game B. Moreover, under these conditions, players cannot be "blamed" for fouling. They no longer know what they can legitimately do or not do.

After watching these two games of basketball, one might reach three conclusions about fouling in basketball that are relevant to political corruption:

(1) Fouling is a necessary part of the game. After all, in each type of game, we expect fouling to take place. If it does not, our reaction is likely to be: "they are not trying very hard," and "it's a dull game." Keeping fouling out of basketball is as impossible as keeping partisan politics out of administration or elections.

(2) The significance of fouling cannot be separated from the systemic characteristics encountered. As we shift our attention from Game A to Game B, our normative conception of fouling is undermined. We can no longer be certain that fouling should even be punished, much less what the number of free throws should be.

(3) Amorphous (vague, careless, or irresponsible) fouling is still fouling. Amorphous fouling may be considered the most dysfunctional form of fouling inasmuch as it indicates lack of respect, not only for the officials, but also for the sport itself. Those most victimized are spectators, rather than opponents, insofar as the game is fraudulent. While coaching and practicing may go on under Game B conditions, they are unlikely to be taken seriously. The outstanding teamwork and athletic feats that we associate with top-level basketball will probably disappear. The sport is thus imperiled. Why play it? Why work to improve performance? Why pay to see it?

Our basketball analogy brings us to a distinction between primary and secondary corruption. Primary corruption (such as fouling in Game A) refers to partisan behavior that challenges statesmanship but still respects it. We try to get away with what we can but expect to be punished if caught. There is fear and regret (even when, as in basketball, seldom shame) associated with it. Secondary corruption (fouling in Game B) is partisan behavior



that is carried out in the absence of viable statesmanship (respect for legal or normative requirements). There is little concern about punishment or feelings of disgrace inasmuch as the political system facilitates or condones corruption.

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### 3. THE IMPLICATIONS OF SECONDARY CORRUPTION.

Secondary corruption has an impact on economic, social, and political problems similar to the effect of substance abuse, such as alcoholism, on more apparent medical, social, and psychological problems. Just as alcoholism sometimes requires a carefully trained medical and psychological analysis to detect, secondary corruption needs to be observed and treated with scientific skill. However, until the victim is willing to acknowledge his affliction and seriously do something about it, there is no real cure for either alcoholism or secondary corruption.

Alcoholism is, of course, a disease of individuals, whereas secondary corruption is a disease of governments. Just as alcoholism is common among certain families and societies, secondary corruption affects certain parts of the world more than others, particularly Africa, Latin America, South Asia, the Middle East, and Eastern Europe. Why this is so remains unclear.

Some analysts point to culture in regard to both alcoholism and corruption. For reasons later to be indicated, I believe that politics, more than culture, is primarily responsible for secondary corruption.

Because secondary corruption affects governments, rather than individuals, it is possible for leaders, who are relatively uncorrupt, to be undermined by a corrupt political system. This seems to have been the case in Zambia during the 1980s, according to several reports done for the World Bank by Ravi Gulhati (1991). In October, 1985, President Kaunda, under IMF pressure but financially supported by the World Bank, agreed to a market-determined exchange rate, based upon an auction, which he had to abandon in May, 1987, dismissing in the process officials and politicians who favored the reform effort. While Bank officials recognized the "vested interests in the status quo" of the victorious "dissenters," they seemed unaware of the extent of corruption among the dominant party leaders and heads of parastatals. Thus, they took seriously the arguments of the "dissenters" regarding Zambia's humanist and socialist ideology, the suffering of the impoverished majority, and the evils of neocolonialism, failing to realize that these arguments were really "smokescreens" for the desire of leading Zambian officials to maintain access to cheap foreign exchange which they could then allocate for profiteering and patronage purposes (see OED Report No. 12100, "Zambia - Economic Recovery Credit," June 29, 1993).



With democratic elections in Zambia and a change in government in October 1991, World Bank officials hoped that there would be an improvement in administrative performance. This has not been the case, according to a 1993 report by Coralie Bryant:

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"Scarcity characterizes the work environment; buildings are not maintained, toilets do not work, nor do the telephones work reliably. There are no internal newsletters, few copiers and computers, and little paper. It is hard to know what is going on, where the history of a problem can be learned, or how to proceed to solve it. There are no workprograms, statement of objectives for bureaus, or mission statements for ministries."

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It can be argued, as does Bryant, that the Zambian government lacks the funds, administrative capacity, and political power to dismiss or pension-off unneeded and unqualified civil servants, to reorganize administration, to properly train and equip officials, and to do what is necessary to make the system function. However, we will suggest here that the Zambian government (as is true of so many other governments) is UNINTERESTED in better administrative performance. In other words, the Zambian government is so undermined by secondary corruption that (similar to an alcoholic) it BOTH CANNOT AND WILL NOT reform. This conclusion was also reached at the end of 1993 by foreign aid donors who threatened to withhold nearly \$100 million from the \$860 million pledged Zambia unless effective action was taken against high-level drug trafficking and corruption (Lorch 1994, A10).

Much like alcoholism, political corruption is an uncomfortable topic, Klitgaard points out (1989, 4), particularly when it is raised by World Bank staff with leaders of borrowing countries: "Denial, evasion, counteraccusation, declaration of moral relativity, and questioning of one's motives will often be encountered, almost as an intellectual reflex." However, in avoiding the nasty topic of political corruption, both academic and World Bank literature can be misleading. This can be seen in some literature having to do with the World Bank's relationship with Tanzania.

In a 1993 WORLD DEVELOPMENT article, Goran Hyden and Bo Karlstrom emphasize the "strong antimarket philosophy" that has pervaded official thinking in Tanzania, undermining relationships with the World Bank and the IMF and reinforcing opposition to structural adjustment. Consequently, they advocate "a research focus on the dynamics of the policy process itself," as it affects interacting streams of problems, solutions, choice opportunities, and economic or political interests. A 1990 OED study of the Bank's relationship with Tanzania, 1961-1987 (Report No. 8329, January 16, 1990) supports the Hyden/Karlstrom



analysis, criticizing Bank studies for not giving "sufficient attention to Tanzania's overall development strategy and to the implication of its internal contradictions for the performance of individual sectors" (p. ix).

Both the academic article and the OED report fail to fully take into account the extent to which African socialism, as practiced in Tanzania during the Nyerere years, was simply a cover-up of systemic corruption. Parastatals could not be reformed, not so much because of inappropriate price setting procedures and misuse of monopoly power, but because of the persistent use of these parastatals for patronage and self-enrichment. Scarce foreign exchange was used, not for needed imports, but for cigarettes, beer, and luxury items. As a result of "misused" World Bank recommendations, the current account deficit increased from \$19 million to \$446 million and the overall balance went from a surplus of \$170 million to a deficit of \$230 million between 1977 and 1978. Because of the failure to maintain monetary and fiscal restraint, inflation hovered around 32% during 1986-88, as against a 10% target. The opposition to privatization in Tanzania, as elsewhere, stemmed officially from ideological and practical reasons, but really from "self-serving purposes" and concern over "loss of remuneration, power and prestige" (OED Report No. 12922, April 1, 1994, 38).

The concept of "political illness," as used here in connection with corruption, may seem to the reader farfetched. Yet, what if you observed someone who, after taking his car to a local mechanic for repair, reacting to an analysis of the car's problems, by accusing the mechanic of "an insult" in presenting these problems? Surely, this reaction would be considered so irrational as to be considered paranoid, particularly if it led to avoiding local mechanics in favor of foreign ones or avoiding repair work altogether in the hope of a new car (particularly in the form of a gift). Yet, this is exactly what Klitgaard observed when, following a seminar of leading officials concerned with the problems of Equatorial Guinea, one of the participants accused the others of "criticizing the government." Other manifestations of political illness observed by Klitgaard include:

**\*PURGING OF THE EDUCATED.** Under Francisco Marcias Nguema, who ruled from 1968 to 1979, from one-quarter to one-third of the population were killed or forced to leave, including a high percentage of the most qualified and educated. The greater affluence of the educated, combined with ethnic differences, made them more independent and, therefore, more dangerous. Poor pay, limited economic and professional opportunities, and dismal living conditions contributed to the persistent brain drain.

**\*UNDERMINING OF THE BANKS AND BUSINESSES.** Top politicians and officials seized much of the most highly productive land (though actual landownership remained doubtful). They then demanded loans from the banks to use this land, but they never bothered to



repay these loans. Likewise, they never paid for electricity and other products or services, undermining parastatals and private businesses. Prosecution and punishment for nonpayment was inconceivable because to do so would have been politically destabilizing.

**\*DISCOURAGEMENT OF COMPETENT PERFORMANCE.** Those with integrity and competence tended to find themselves in trouble with the existing power elite, ending up imprisoned and sometimes tortured or killed. This happened to several of the most highly respected ministers and a leading auditor. Inter-ethnic and factional conflicts contributed to this situation. Consequently, taxation, government charges, and import-export regulations, among other activities, were hopelessly corrupt. Much foreign currency was wasted on liquor (occupying nearly half of market space) or on drugs and medical equipment that were ultimately stolen for sale abroad.

So widespread is the political illness described here that, according to Peter Eigen of Transparency International (1992), Less Developed Countries (LDCs) may be giving more foreign aid to More Developed Countries (MDCs) that they are receiving, particularly if the impact of the "brain drain" and drug profits is taken into account. Eigen suggests that Swiss banks may be holding an amount in excess of \$20 billion on behalf of African leaders.

Big time corruption has "become almost universal in major international contracts between the North and the great majority of South countries," according to George Moody-Stuart, a senior executive for British agro-industrial companies in Africa (Keatley 1993, 1). This may account for the fact alleged by recent Sierra Leone commissions of inquiry that ex-president Momoh had about 170 million pounds sterling in a UK bank, which amounted to more than seven times the annual support level obtained by Sierra Leone from the IMF during the late 1980s (Kpundeh 1993, 242). The public sectors and private sectors of developing countries place more than \$80 billion annually into the U.S. economy (Bradsher 1994, pp. 1,4). While much of this may be legitimate investments, some must be considered "laundered money" and invested here because of the absence of local investment opportunities, which have been undermined by secondary corruption.

Those who benefit from international corruption are not simply heads of state. Various amounts are distributed according to one's position in the hierarchy. This is made possible by the practice of donor governments guaranteeing the sale of entire industries, products, and technology to LDCs, with the understanding that bribes will be paid to middlemen and officials. Many governments have well-established arrangements in this regard. Much of the military equipment sold to Nigeria is intended for pay-off purposes, not for real use (Coll and Shiner, 1994). The most recent Bank study of the Nigerian structural



adjustment program (No. 13053-UNI 1994, 25) reports a large number of industrial projects, such as the Ajaokua Steel Complex, inappropriate or excessively expensive because of "padding by foreign suppliers." In the case of the Ivory Coast, these arrangements allowed President Houphouet (the "Old Man") to use gifts "as a system of government and a mode of development" (Carbogo 1993, 169). Thus, it has not been unusual for donor countries "to look the other way when their favored clients diverted money given as aid" (Harsh 1993, 39).

Possibilities for ending or controlling this corrupt (or "farcical") international game are to be the subject of a future OPR report. What concerns us here is its intensification of the political illness referred to as secondary corruption, particularly the extent to which it is responsible for the apathy towards development and the counterproductive behavior so often encountered by World Bank staff.

LDC leaders must be asking themselves, "why worry about business development when funds will flow to us automatically from kickbacks?" The debt that is being built up to many donor countries, amounting to about 40 percent of sub-Saharan Africa's debt structure, as of 1989, is increasingly seen as a "gift." "Altogether, 25 sub-Saharan countries rescheduled their debts 105 times during 1980-88" (Cheru 1992, 503). However, in the process, capitalism in the form of productive use of assets, rather than non-productive activities dependent on state privileges, has become discredited.

African protesters often insist that governments should "repatriate the funds of those who have have enriched themselves," rather than agree to the taxation demanded by the World Bank and the IMF (Harsh 1993, 45). Inasmuch as the Swiss and other European governments secretly hold African funds, they argue that these governments should be responsible for whatever debt has been incurred. Moreover, these protesters increasingly blame the World Bank and the IMF for being "complicit in the corrupt dealings of their clients" (Harsh 1993, 40). Yet, if it is true that secondary corruption is similar to alcoholism, to substantially retire the debt of countries to multilateral institutions (see Cheru 1992, 509) would simply be "to feed the habit," and thereby more certainly harm and even kill the patient.

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## Box 2

### URBAN DEVELOPMENT: TAKING CORRUPTION INTO ACCOUNT

A recent OED Review, TWENTY YEARS OF LENDING FOR URBAN DEVELOPMENT, 1972-1992 (No. 13117, June 14, 1994) points out that the World Bank had shifted its emphasis over the years from holding governments directly responsible for shelter delivery and



infrastructure to establishing an enabling environment, facilitating the efficient functioning of private sector housing markets, including businesses and non-governmental organizations.

However, when corruption is taken into account, the old Bank urban literature may not be so bad and its revision may not be any better.

When a government is relatively noncorrupt, as is Singapore, it can successfully undertake a massive public housing program (benefitting about 85 percent of the population) and a large-scale subway system, contrary to World Bank advice. On the other hand, when a government is highly corrupt, no policy is likely to work. In Kumasi, Ghana, for example, foreign donors have assisted a political organization to introduce improved public pit latrines, for which they charge a small fee for management and expansion of the system (Whittington ET AL., 1992). However, because about half of the funds received are retained as "profits," not enough is being spent to maintain and expand the system. In Lagos, Nigeria, the Bank assisted the local solid-waste disposal board to privatize solid waste management. Unfortunately, these contractors, using corrupt methods, were often able to avoid carrying out agreed-upon services, steal spare parts from the public sector for repairs, and dump their refuse carelessly or covertly (Cointreau-Levine 1992). The lesson thus emerging from all this is that Bank advice may not be very useful unless the implications of secondary corruption are recognized.

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### Box 3

#### Can Anything Be Done About Fraudulent International Contracts?

In 1975 the Nigerian government ordered over 20 million metric tons of cement - ten times the volume which planners estimated should be annually imported and four times more than could be handled by the Lagos/Apapa port (Riley 1993, 254). Because of kickback arrangements and high demurrage fees, Nigeria lost \$2 billion in 1975 from these contracts, which amounted to about one quarter of that year's total oil revenue earnings.

With the coming of a new government to power in Nigeria as a result of this cement scandal, it attempted to escape obligation for payment on the grounds that the shipments had not been properly authorized. Based upon cases in the United Kingdom, the Federal Republic of Germany, and the United States, courts concluded that the Central Bank of Nigeria was responsible for these contracts and, as such, they could "neither be modified nor cancelled without the agreement of all concerned" (Efros 1983, 147).



It should be added that, according to the Multilateral Investment Guarantee Agency (MIGA), commercial contracts are with STATES and not GOVERNMENTS. This means that, unless international law is changed along the lines advocated by Transparency International, a new government cannot escape the debts (even if clearly corrupt or fraudulent) of its predecessors.

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#### 4. OFFSETTING FACTORS ASSOCIATED WITH PRIMARY CORRUPTION

Our distinction between primary and secondary corruption enables us to answer the following questions raised in the literature: (1) why worry about corruption in LDCs when there is so much of it in MDCs without preventing their economic development?; (2) to what extent is corruption blameworthy when it is, not only functional, but also expected and required?; and (3) "what is dishonesty in an environment where the possibility of punishment is remote?" (Dey 1989, 506). We will also use this distinction in examining in a later section the literature of institutional economics, particularly "rent-seeking behavior."

It can be argued that corruption has not stopped the economic development of the United States, Japan, Italy, and many other MDCs. Why not? The answer, as here indicated, is that, seeing corruption as the result of harmful political bacteria, we have antibodies to work with, providing some immunity to corruptive elements. Above all, there are meaningful legal and formal norms of official conduct. As such, existing corruption in MDCs tends to be "primary corruption," as indicated in the following examples. However, secondary corruption also exists in the United States and other MDCs (see Box 4). Indonesia has been included as a transitional state, between primary and secondary corruption, suggesting enough offsetting factors for socio-economic development to take place but not enough to overcome environmental problems (see Section 6).

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#### Box 4

##### PRIMARY AND SECONDARY CORRUPTION IN THE U.S.

THE WASHINGTON POST (June 9, 1994) contained two articles about Congressmen relevant to corruption. One of the articles showed pictures of items (chairs, luggage, beer mugs, crystal vases, etc.) found in the Chicago apartment building owned by Representative Rostenkowski, which he is alleged to have improperly purchased from the House Stationery Store with government funds. If this allegation against the Congressman is eventually proven in court, it would be a clear example of "primary corruption" (illegally diverting to his own use about \$40,000 worth of government property).



The second article had to do with Representative Martin Lancaster of North Carolina who used his position on the House Armed Services Committee to prevent the construction of a fuel pipeline to Air Force bases in his district because of potential loss of port, railroad, and trucking jobs. This action is estimated to cost the taxpayers annually \$4.1 million. It can, of course, be argued that Rep. Lancaster is doing nothing more than his job, practicing politics and protecting the interests of his constituents. But he is also taking advantage of a weakness in the political process - the lack of an agreed-upon procedure to overcome this sort of wasteful behavior - which, as such, can be considered "secondary corruption." (The military base-closing procedure developed by Congress does show what is possible in this regard.)

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4a. THE UNITED STATES. In the United States, as so many books point out (see Green and Waldman 1984 and Smith 1988), money plays more of a role in political life than in any other major democracy. National elections in 1982 are estimated to have cost more than \$300 million, as against \$3 million for the British 1979 elections. Elections have become much more expensive over time, rising from \$72 million in 1974 for House and Senate seats to about \$450 million in 1986. Consequently, politicians have become increasingly concerned and preoccupied with fund-raising. As businesses compete with one-another in campaign contributions, the decision-making process inevitably becomes distorted.

Many generations of scholars studying the United States have wondered, as did Max Weber, how the U.S. could flourish economically in spite of "its lack of political and administrative morality" (Heidenheimer 1986, 583). Yet, there were always (and increasingly) offsetting factors: the public education system, the free press, competitive elections, a powerful middle class, professional and specialized associations and organizations, constitutional restrictions and separation of powers, and multiple power points that can be used by discontented and well-organized interest groups. (The various factors causing the rise of "big city bosses" after the Civil War and then their decline after World War II are listed in Box 5.) While Congressmen must cooperate with wealthy and powerful interest groups, they need to avoid such excessive ties to particular ones as to prevent them from reaching agreement with supporters of competing groups essential for legislation and administrative action.

In looking at the American "pork barrel" process, Hird (1991) shows that the nation suffered substantial losses as a result. However, he also suggest that efficiency and equity considerations were not neglected. This happened because: (a) the Army Corps of Engineers was careful to select viable projects; (b) recommendations of the Corps had to be considered in the



President's annual budget proposal; (c) a number of committees in both Houses of Congress had to agree; and (d) legislators were willing to substitute more viable projects or more equitable objectives when their original ones encountered opposition.

In their book on American whistleblowers (Glazer and Glazer, 1989) emphasize the uphill struggle which they face in exposing or challenging corruption. What they do is analogous to putting the brakes on a fastmoving vehicle inasmuch as they are under tremendous pressure to conform to the requirements of their organizations, regardless of their personal feelings. Their actions would be even more difficult without the cooperation of sympathetic interest groups, investigative committees, public interest lawyers, a free press, television broadcasts, independent agencies, and the legislative and judicial branches of government. Whistleblowers have also been able to take advantage of such relatively recent developments as the Inspector General Act, the Civil Service Reform Act, and state protection laws and boards.

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#### Box 5: THE AMERICAN BIG CITY BOSS

Until well into the twentieth century (surviving in some cases the New Deal and World War II), most large American cities were dominated by political bosses and machines which used appointments, contracts, and favors to maintain their power. The rise of the Big City Boss is associated with the post Civil War years. Until then, the "high ideals of competence, impartiality, integrity, and responsibility" associated with the Federalists were largely respected throughout the new country" (Leonard White 1955, 15).

The factors causing the rise of the big city bosses include:

- (1) Urbanization. By 1920 the majority of Americans were urbanized but were unprepared for urban life inasmuch as one-third of urban residents (as of 1910) were of rural origin and relatively uneducated.
- (2) Immigration. Immigrants came at a rate of over one-half million annually between 1870 and 1920 so that by 1910, the majority of children in the largest cities had foreign born fathers. These immigrants were often unemployed, impoverished, illiterate, unable to speak English, and discriminated against by the white, Protestant, middle classes. Insofar as they settled in ethnic communities, they could be easily organized. Because there were inadequate official sources of help, they depended for assistance on the political bosses and machines.
- (3) Cooperation of businesses and unions. With the development of cities, there was an increasing need for infrastructure. In return for contracts, businesses provided funds and political



support, often in cooperation with corrupt union leaders. The power of the big city bosses and machines could be used to overcome the structural weaknesses of American local governments.

(4) Corrupt elections. While universal manhood suffrage had been established in the 1830s and 1840s, the secret ballot was unusual until the twentieth century. Votes could easily be bought.

(5) The patronage system. The police and civil service were largely unprofessional. Inasmuch as state and federal levels were also corrupt, they could not exercise much control over the situation.

The American big city bosses were probably never as dysfunctional as their current LDC counterparts because, to survive, they needed a close working relationship with the business community. Infrastructure and services, however inflated in price, had to be of reasonable quality. In his study of New York's Boss Tweed during the 1860s, Nathan Miller (1992) notes the useful impact of the free press, the judiciary, public interest groups, "muckrakers," and ultimately elections. A variety of other factors gradually reduced the power of American bosses and machines, without completely eliminating urban corruption: (1) immigration restriction; (2) upward mobility and suburbanization; (3) political and administrative reform; (4) the increasing impact of the federal government; and (5) growing competition among cities and suburbs for business and affluent groups.

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4b. JAPAN. "Bribery is built into Japanese politics," according to Iga and Auerback (1977, 556), referring to money which is made available extralegally to holders of political power. Members of the ruling faction of the Liberal Democratic Party (LDP) were estimated during the 1980s to have had access to about ten times their official income and expenditure allowances.

The fact that the LPD was increasingly undermined by scandal caused it in 1993 to be rejected by most Japanese voters.

The Japanese have an elaborate system of gift-giving, which clearly affects the political process. Most politicians are tied into a system of contracts and factors, according to van Wolferen (1989, 134): "When a Diet member gets a government subcontract or work from a large company for a constituent, the beneficiary is expected to pay at least 10 percent of the total price of the contract, and sometimes as much as 20 percent." Other factors, according to van Wolferen, responsible for government corruption, include: arbitrary and secretive authority, discouragement of individuality, excessive promotion of obedience and passivity, intimidation of minorities, and suppression of conflict. The high cost of Japanese election campaigning (about \$3 billion in 1990, as against \$400 million for American presidential candidates in 1988) should also be noted.



Corruption may be partly responsible for the fact that Japanese urban living conditions are not as good as they are in Singapore, despite Japan's much higher per capita income. The impact of corruption, particularly the practice of "AMAKUDARI" (retiring from the bureaucracy for lucrative private sector jobs) has prevented agencies from dealing with rapidly escalating land prices in the 1980s (Pempel and Muramatsu 1993, 40). In 1980, only a minority of Japanese (44 percent) indicated happiness with their living conditions, whereas 80 percent of Singapore's population did so. As of 1982, only 30 percent of Japanese houses were connected to a sewer system, as against 72 percent in the United States and over 90 percent in Western Europe (Calder 1988, 385). The fact that, not only foreign brand-name goods and food, but also Japanese products are far more expensive in Tokyo than in American and European cities may stem from corruption.

Yet, in Japan, as in the U.S., there are offsetting factors that minimize the impact of corruption. Among the most important of these factors is the integrity of the civil service. The Japanese civil service is relatively small in size (representing about half the percentage of total employment compared to the situation in the U.S. and Western Europe) but carefully selected.

Those who survive the competitive process to get into senior positions, particularly into such ministries as Finance and International Trade and Industry (MITI), "tend to be among the best that Japan's educational system has to offer to that country's perspective employers" (Koh 1989, 253).

The prestige of the civil service helps "to protect the organization's autonomy from external forces" (Campbell 1989, 122). The fact that Japan's various agencies are, not only competent, but also competitive with one another, "instills a strong dose of creativity and individual responsibility." (Pempel and Muramatsu 1993, 19). Bureaucrats recognize that their failure to maintain a degree of autonomy and neutrality in the face of special interests will damage their reputation with the public, undermining their relations with other agencies, and their ability to carry out their duties. Consequently, civil servants have great power to draft legislation and to foster economic growth and increased international competitiveness.

What also reduces corruption in Japan is the competitive process under which companies work together in associations pushing up proposals that eventually are backed by the consensus of members before being taken to the advisory councils of MITI (Ouchi, 1984). Government therefore is seen as a trusted source of assistance and guidance, rather than merely an imposer of rules, procedures, objectives, and targets. What prevents any one actor from gaining too much power is a process of careful restraint, mutual scrutiny, and a devotion to "wa" (harmony). Thus, the competitive struggle is controlled by a strong conviction on the part of the Japanese people that "bureaucracy is a neutral instrument, a conviction bordering on religion (Koh



1989, 205).

This emphasis on harmony may explain why it is that, while the Japanese tend to be very tolerant of influence-peddling by politicians, they strongly react to evidence of dishonesty within their public bureaucracy (MacDougall 1988). Despite the country's one-party dominance prior to 1993, the law enforcement agencies and the courts have dealt harshly with bureaucratic corruption. Thus, the frequency of corruption among Japanese civil servants, according to the National Personnel Authority, is remarkably low (Koh 1989, 223).

4c. ITALY. Significant reduction of corruption in Europe did not really come about prior to the nineteenth century. Before then, Caiden (1969, 34) points out in regard to Great Britain, autonomous local authorities were so firmly entrenched and the upper classes so apathetic that the public bureaucracy rarely functioned beyond London. Historical studies suggest the importance of a number of merging historical developments: nationalism, imperialism, militarism, capitalism, urbanization, industrialization, and democratization (see Theobald 1990). What occurred in Great Britain, write Wraith and Simpkins (1963, 208) in explaining the gradual decline of corruption was the spread of education to enlighten public opinion regarding malpractices, the growth of commerce and industry to encourage a middle class opposed to corruption, the rise of professional groups anxious to raise their status, and the improvement of auditing and other supervisory procedures. Emerging from these developments (and contributing to them) was the nonpartisan, professional, and meritocratic civil service.

Italy is interesting in this regard because of the persistence of widespread corruption despite offsetting historical developments. Michael Porter in his 1990 book on comparative economic development notes (p. 421): "Italy's overall growth in world export share is second only to Japan among leading nations." What is so surprising is that, considering how prosperous Italy is, its quality of public services (education, health, social security, justice, transport, etc.) "is exceptionally low" (Hine 1993, 255).

Italy has paid a heavy price for its corruption and low quality of public services (Hine 1993). "Telecommunications and postal services have been poor, financial services slow and archaic, and transportation and logistics often a nightmare" (Porter 1999, 437). However, the price has largely been paid by the seven most southernly regions of the country, all of which had levels of per capita gross domestic product below 85 per cent of the European Community average during the 1980s. In contrast, Italy's ten regions of the center-north had levels of per capita GDP above 115 per cent of the Community average. It is also in the South, where corruption is greatest and the Mafia, most powerful, that public services are weakest and least reliable.



What has enabled Italy to be economically so successful is that aspects of the administration work extremely well. Particularly important and useful has been the Bank of Italy. Recruitment is highly selective; training, rigorous; and research work, outstanding. Thus, the Bank remains "an island of excellence in a public administration where excellence is not always in abundant supply" (Hine 1993, 248). As such, it has, not only maintained considerable freedom from partisan politics, but also great influence among government ministers and senior civil servants.

4d. INDONESIA. Samuel Huntington (1968) asserted that corruption tends to increase in a period of rapid growth and modernization because of changing values, new sources of wealth and power, and expansion of government. Indonesia seems to illustrate this point, while challenging us to reconsider the supposed dysfunctional impact of corruption. Since 1960, when its per capita annual income was only \$50 (among the lowest in the world), its GDP growth-rate has been almost 7% annually, among the ten fastest in the world (World Bank 1994a, 2). Yet, according to a survey of corruption in Asia, Indonesia ranks first in this part of the world in "rents extracted by state officials for issuing or granting the myriad of permits...essential for doing business" (Mehmet 1993, 1). How do we explain this paradox?

The literature on Indonesia points to a number of factors, in addition to those suggested by Huntington, in accounting for high levels of corruption, including:

\*THE WEAK BUREAUCRACY. Salaries range from under \$200 per month for top echeloned officials to as low as \$50 a month for primary school teachers (Mehmet 1993, 1). "The decline in civil service pay relative to private sector salaries reflects in part the three-year freeze placed on civil service salaries as a necessary part of the Government's adjustment effort in the mid-1980s" (World Bank 1994, 148). Low pay, combined with an emphasis on seniority rather than performance, has discouraged the best people from entering the bureaucracy. In return for loyalty (not competence or merit), superiors distribute among subordinates revenues from corruption (rent-seeking activities).

\*AN INADEQUATE LEGAL SYSTEM. Laws, regulations, judicial decisions, procedures and other legal information are often confusing, contradictory, and unavailable. "Even experienced lawyers spend costly hours trying to unravel or assimilate details of regulations" (World Bank 1991, 70). There is also no reliable information on land records and transactions, on property or security, or on public credit. Courts tend to be slow, inefficient, and contradictory, and they have difficulty enforcing decisions.

\*UNRELIABLE TAXATION AND COST RECOVERY. Indonesia's ratio of taxes to total revenue remains below that of most other Asian



countries. The total revenue from tariffs has been increasingly reduced by smuggling, underinvoicing, and bribery. Estimates during the 1980s indicated that only about half of potential tax revenues were collected. The yield of the property tax in Jakarta was less than 20 percent of its potential yield (Devas 1989, 247). Part of the problem stems from the "legal morass that surrounds land titling, sale, and use" and part from shortcomings in accounting, auditing, and professional standards (World Bank 1994a, 95, 139).

Corruption has clearly had a serious impact on the quality of Indonesian life: industrial pollution is extensive; the urban poor continue to depend on polluted or expensive private water sources; human and solid waste disposal and drainage are badly neglected; and, at the same time, local authorities spend much of their budgets on general administration and office buildings. (Also, see Section 6.) Yet, there exists offsetting factors to explain why it is that corruption has not done as much economic damage to Indonesia as might be expected:

**\*THE ENCOURAGEMENT OF PRIVATE SECTOR DEVELOPMENT.** Following the decline of oil income during the 1980s, the Indonesian government took a number of useful steps to open up the economy: decreasing protection of the industrial and agricultural sectors; reducing non-tariff barriers; improving the incentive system for the private sector; keeping inflation and government related debt relatively limited; and supporting essential infrastructure and agricultural services. Economists have been better trained (enabling them to do graduate work in top foreign universities) and more highly respected in Indonesia than many other LDCs (Bhattachya and Pangestu 1993). President Soeharto has taken a personal interest in certain industries, such as textiles, overcoming existing problems and barriers (Macintyre 1991).

**\*HUMAN RESOURCE DEVELOPMENT.** Between 1970 and 1990, the percentage of the population in absolute poverty has declined from 60% to 15%, thereby achieving "one of the fastest reductions in poverty and improvements in key social indicators among all developing countries" (Bhattachya and Pangestu 1993, 43). Great progress has been made in infant survival, life expectancy, literacy, school enrollments, and access to health services. Women have particularly benefitted, with 48% of all primary school students and 45% of all secondary school students being female (highly unusual in an Islamic country). Indonesia has also had a very successful family planning program.

**\*DEMOCRATIZATION.** In explaining the success of Indonesia's textile industry, becoming Indonesia's largest manufactured export and reaching a 3% share of world exports, Macintyre (1991) points to the importance of parliamentarians, the press, industry groups, and community-based non-governmental organizations. The World Bank played a useful role in economic liberalization; but it was very much assisted by progressive technocrats within the bureaucracy, including some elements of



the Armed Forces. The growing participation in business of ethnic Indonesians (the "PRIBUMI") seems to be important in this regard, combined with various forms of political liberalization and pluralization of power. It should also be noted that the employment of university graduates rose by 48% between 1988 and 1992, suggesting the slow shift to a meritocratic administration.

These off-setting factors may explain why it is that Indonesia did so much better economically than Nigeria between 1970 and 1990, more easily overcoming the 1981 collapse of oil prices. Whereas in 1965 Indonesia's GDP was below Nigeria's, it was three times that of Nigeria in 1990 (World Bank 1994, 17). Unlike Nigeria, it did not allow corruption to undermine effective exchange rate management, tight monetary and budget controls, and the development of nonoil exports (Nyatepe-Coo 1993). And it used its investments far more effectively for infrastructure, education, agricultural development, and capital-intensive industry. The truth is, Indonesia is far more serious about development than Nigeria, suggesting that corruption in Indonesia remains a problem, rather than an illness, as in Nigeria.

## 5. SECONDARY CORRUPTION: GREED WITHOUT GOVERNANCE

Is it too much to assert that the World Bank's call for "good governance" (accountability, transparency, rule of law, enlightened policymaking, human rights, etc.), as set forth in the 1994 GOVERNANCE publication, is nothing more than "commonsense?" This would seem to be the case, if we look at typical business administration textbooks, emphasizing the importance of: establishing acceptable goals, hiring qualified personnel, encouraging training, delegating responsibility, stimulating motivation and competition, paying attention to morale, expanding two-way flows of communication, promoting legitimacy, maintaining supervision, cultivating contractors, protecting independent spheres of authority, and developing conflict-resolution procedures. We can go on to indicate that the quality of relationships (here called "political software") between managers and subordinates will suffer to the extent that these steps are neglected or mismanaged.

In viewing public administration problems as resulting more from political software inadequacies than problems of organization or political structure (called here "political hardware"), we recognize that people do not conform automatically to the expectations of their leaders. They must be persuaded, induced, or coerced. Political elasticity theory (Werlin 1992) suggests that leaders are most effective when they can integrate and alternate soft and hard forms of power (for example, incentives with disincentives). Their power then becomes elastic in two meanings of the term: (1) loosened inasmuch as authority



is delegated and relaxed without losing the capacity to be tightened or reasserted and (2) expanded indefinitely to influence systematically and predictably the behavior of ever wider circles of participants. (For example, see Box 7.)

Secondary corruption arises out of the inadequacy of political software, referring to the weakness or absence of governance. It is therefore a functional reaction to this inadequacy, much like fever is in response to disease. (Without the capacity for fever, we would be dead!) Therefore under conditions of weak governance, doing cost-benefit or functional-dysfunctional analyses of greed or primary corruption (which writers on corruption sometimes recommend) may be meaningless as well as useless (see Box 6). At the same time, secondary corruption (referring here simply to greed uncontrolled by governance) has a corrosive effect on political software (intensifying distrust of and hostility towards government). Thus, to quote Ouma (1991, 473), regarding Uganda: "political instability, corruption, and underdevelopment are mutually reinforcing." Let us see how this is so:

\*IMPROPER POLICIES. In many LDCs, policies are not intended to be taken seriously. In India, as shown by Wade (1985, 480), state ministers are less interested in making policy than in "modifying the application of rules and regulations on a particularist basis, in return for money and/or loyalty." The same situation existed in Ghana from 1972 to 1982 (beginning with President Busia's overthrow) so that, by 1982, "the government of Ghana had become inexorably separated from its people, acting like a switchboard without connections; the lights blinked, but the wires led nowhere and the interaction between force and order, delicate in any society, had completely collapsed" (Smillie 1986, 24).

The drastic consequences in Ghana of allowing inflation to get out of control (causing the exchange rate to be overvalued by an estimated 816 percent, as of 1982) manifested themselves in severe production decline, infrastructure collapse, institutional demoralization, public sector mismanagement, and deterioration of human services (Werlin 1991). Economists came away from interviewing President Acheampong, who ruled Ghana during much of the 1970s, with the impression that he "reminds one of a drunk on a motorway driving against the flow of traffic: the crash was only a question of time" (Huq 1989, 28). However, Acheampong's policies were guided by his dependence on those who enriched themselves from the inefficient system of price controls, licensing, and administrative allocations.

Even when policies are "officially" changed to meet the requirements of foreign donors (as in Liberia during the 1980s under President Doe), they may actually not be changed. Secondary corruption accounts for the fact that, when USAID sent in a team to Liberia in 1987 to control wasteful expenditure, giving as an incentive \$40 million in economic and military aid,



it could not prevent misuse of the budget, with massive kickbacks sent abroad (Werlin 1989). The same situation existed in Niger, according to Amuwo (1986, 301), causing "a yawning gap ... between self-perception and self-reality, between proclamations of intentions and concrete results."

**\*APPOINTMENT OF PERSONNEL.** Levine (1975) explains how Nkrumah captured the Ghanaian bureaucracy by getting rid of independent experts or neutralizing them, replacing them with a "creative corruption system," under which administrators - with their tribes and extended families - were linked into a patronage system. In Bangladesh, according to Dey (1989, 508), people "offer bribes to get jobs with high bribe potential." Thus, "the bribe here is similar to an entry fee that one has to pay to join a club and become entitled to its benefits and facilities." The same is true in the Dominican Republic, where government jobs are seen even by the public as a legitimate way of enriching oneself (Ruffing-Hilliard 1991, 309).

The effect of this patronage system is to deepen public disrespect for public policy. In most LDCs, local government revenue estimates tend to be unreliable and unrelated to priorities (Dillinger 1991). There is seldom any significant financial planning, and no meaningful accounting for sums expended. Even when local governments employ large numbers of tax collectors, their success remains meagre. Ibadan, for example, has 158 revenue collectors and only two technical officers. Since the cost of enforcement generally outweighs the modest revenue received, payment is seldom rigorously pursued. Moreover, much of what is collected is lost by poorly kept receipt books and deficiencies in the supervision of the collection system. The situation here is similar to one described by Alan Riding (1987), in writing about Brazil, pointing out that the bureaucracy is seen primarily as a source of jobs and only secondarily as a provider of services.

Under conditions of secondary corruption, shifting to a meritocracy becomes extremely difficult. While the rulers sometimes take action to prevent the petty functionaries from misappropriating public funds and resources, the upper cadres of both the military and civil bureaucracies are left free from political racketeering (Dey 1989). In some cases, governments hesitate to arrest lower-level bureaucrats for corruption when this could implicate the ruler's inner circle and family, strain the courts and penal system, alienate the bureaucracy, slow down the functioning of government, and generate public cynicism. "The higher the target," write Gillespie and Okruhlik (1988, 70), "the closer the association with the head of state."

**\*MOTIVATION OF PERSONNEL.** Barbara Nunberg and John Nellis (1990), among others, have shown clearly that in most LDCs, civil service inefficiency and ineffectiveness stem from excessive wage bills, surplus numbers, inadequate salaries, and wage compression. In Uganda, civil servants are paid barely enough to



cover "the cost of a large bunch of bananas" (Battaita 1988, A 15). Gould (1980) found that in Zaire in 1978 that less than 10 percent of civil servants earned enough to feed their families. Outside of Africa, we see the same situation of poorly paid civil servants so often that Klitgaard (1989a) refers to it as "Incentive Myopia."

When civil servants are paid poorly, they will find numerous ways to "corrupt" the system. This situation was recognized by President Mobutu who advised Zairian civil servants: "if you want to steal a little, do so in a nice way" (Gould 1980, 71-72). One way to do so is to arrange for extra salaries, using fictitious names. Two-thirds of Zairian civil servants in 1979 were "ghosts" (fictitious employees), drawing an estimated 20 percent of the budget in 1978. In Lusaka, only half of the employees were actually working, according to that city's senior governor (THE ECONOMIST, September 15, 1990, 28). In Uganda, most of the country's estimated 300,000 civil servants in 1988 spent "office hours" tending private agricultural plots or trading goods in order to make ends meet (Battiatata 1988, A15). In Tanzania, Liebenow (1987, 2) found salaries to be so low that "absenteeism, rather than shoddy performance alone, is a key element in the problem of productivity."

With the motivation of Zairian civil servants so low, Gould (1980, 122) points out, they could not be expected to provide needed services: "Instead of stimulating productivity, the state bureaucracy incarnates nonproductivity and indeed counterproductivity...." Since officials here were allowed to keep any unspent budgetary funds at the end of the fiscal year, they had no incentive to spend these funds on what they were budgeted for. In Uganda, Battiatata (1988, A15) quotes the government's inspector general as saying that "senior civil servants have become accustomed to siphoning off most, in not all, of the public money that flows through their offices. As a result, nothing new is built and old things fall apart." A more recent study of Uganda (Langseth 1994, 7) suggests that, as a result of political breakdown during the 1970s and 1980s, corruption and malingering "were no longer punished but became an intrinsic part of the reward system, fully exploited by everyone." Outside of Africa, Klitgaard (1991) reports the same situation in many countries. In Bolivia, for example, "the incentives facing public employees erode, and this results in a brain drain, inefficiency, moonlighting, demoralization, and corruption" (p. 92).

**\*THE INADEQUACY OF SUPERVISION.** In Zaire, as in many countries, supervision is impossible because of nonexistent telephone service, impassable roads, unavailable vehicles or automobile parts and gasoline, and travel funds (Gould 1980). In Uganda, government offices try to manage "without the most basic equipment and ordinary office furniture such as chairs, tables functional typewriters or copying equipment" (Langseth 1994, 6).



Lack of supervision is also a result of what Dey (1989, 507) calls, "asymmetry of information between subordinates and superiors..." In regard to sales taxes, for example, it is easy to manipulate tax rates when the technical characteristics of the goods are not rigidly defined, or cannot be ascertained in a foolproof fashion." Klitgaard (1991, 30) also insists on the importance of information "about the quality of goods and services, labor and housing, risks and portfolios, or whatever happens to be traded."

Since administrative performance is seldom measured or recognized, various forms of corruption become encouraged. For example, administrators are inclined to cooperate with the importers of contraband goods, to withhold funds that are collected, or to extract bribes from innocent citizens (Dey 1989, 506). In the case of Nigeria, this situation was responsible for an estimated governmental loss of US \$480 million in 1976 from smuggling goods to neighboring countries (Lamb 1988, 304). In Uganda it is very difficult to get relief supplies into the country without a high percentage ending up for sale in urban markets (Ouma 1991, 481). In the Ivory Coast, officials "often turn a blind eye to customs regulations in exchange for a bribe..." (Cabogo 1993, 167). And we could go on with examples from many parts of the world.

Ahmed and Bamberger (1991) note that good Monitoring and Evaluation (M&E) systems are rare in LDCs. In South Asia, M&E efforts have been undermined by duplication of effort, lack of contact with top policymakers, intimidation of line agencies, unrealistic or irrelevant data, and excessive cost. Here and elsewhere, there seems to be little demand for, or interest in, monitoring data. In a 1993 case study of Nigerian financial management and accounting practices, Steve Berkman notes numerous examples of misuse of project accounts, all of which were ignored by the Nigerian Auditor-General. According to Olowu (1993a, 101-2), fraudulent practices are prevalent in most ministries and departments in Nigeria, including: deliberate destruction of relevant documents by fire to conceal information; disposing of large sums of money for corrupt purposes at the end of every year; and circumventing tender procedures or paying contractors for work never done.

To expect good supervision when it might embarrass those in power, including the head of state, is clearly to expect too much in many countries. During the 1980s, both Uganda and Tanzania investigated acts of corruption, but very little happened as a result. In regard to Francophone Africa, Laleye (1993, 250) points out that authorities are rarely committed to implementing corrective measures and enforcing sanctions. While some hope exists in Senegal following the introduction of an Ombudsman-like institution, modeled on French lines, "it will not be easy to allow it to make a significant impact" (Laleye 1993, 252). Kpundeh (1993, 239-240) makes the same point in regard to Sierra Leone, noting that during the 24 years of APC rule,



"accountability was only to the President and his top party officials."

\*THE ILLIGETIMACY OF LAWS AND REGULATIONS. Legislation in LDCs is often designed, not to be universalistic, but to benefit particular regions, groups, and individuals, particularly the dominant ruling class (Alam 1989). While there may not be a ruling class in Africa, as in Latin America, leaders exercise a personalised form of control so that legislation and regulations become "whimsical," shifting from day to day in accord to the presidential mood (Hyden 1983, 453). Thus, regulations are difficult or impossible to administer. Since decrees in Nigeria often take a verbal rather than a written form, many people are not aware of what they have done wrong when law enforcement officers arrest or threaten them. And, inasmuch as people are impoverished and illiterate, they are at the mercy of society's "mad dogs" (referring to police and soldiers) and their "privatized repression" (Agbese 1990, 239).

In Peru, the existing laws and executive orders (exceeding 500,000) "flow from the President and government departments that conceive them ... with no interference, no debate, no criticism, and often enough, without the knowledge of those affected by them (Llosa 1987, 46-47). In China, as in Peru, excessive regulations are combined with bureaucratic discretion to provide opportunities and incentives for civil servants to extract "rent." Consequently, the saying that goes back to classical China continues to be repeated: "Money is the horse that leads the way, gifts are the troops that overwhelm the fortress" (Harris 1988, 4).

\*LACK OF INDEPENDENT SPHERES OF POWER. In Africa, Jackson and Rosberg (1985, 34) point out, "since independence most constitutions have been honored in breach - either by civilian rulers attempting to retain power or by soldiers attempting to seize power by unconstitutional means." However, in the case of Kenya, Cohen (1993, 442) notes, the situation has worsened: "In a perverse way, the apathy, irrationality, and incompetence that characterizes many of Kenya's public servants is a direct result of their seeking to survive in a fragmented bureaucracy that has been cowed by Moi and his faithful supporters, fragmented by very competitive tribal and regional cliques, and affected by increasing tolerance of public servants reaping personal benefits while balancing these competing pressures." Under these circumstances, to expect either the legislature or the judiciary to reduce corruption is clearly wishful thinking. In Sierra Leone, for example, under the APC government, decisions on pending cases were made by "political judges" before they were tried in accordance with governmental directives (Kpundeh 1993, 242).



## DOING COST-BENEFIT AND FUNCTIONAL-DYSFUNCTIONAL ANALYSES

Caiden (1990, 150-151) summarizes the arguments of analysts, indicating that corruption may at times be functional: (1) to speed up the administrative and legislative process; (2) to make the bureaucracy more humane and approachable for those who have not yet adjusted to the modern way of life; (3) to overcome excessive bureaucratic inflexibility, sluggishness, and bungling; (4) to integrate otherwise alienated groups (particularly, politically weak ethnic, religious, and racial elements) and, thereby, be an alternative to violence; and (5) to enable entrepreneurs to function within a difficult business environment. In a 1967 article Nye suggested using a cost-benefit matrix, within which corruption can be considered harmful or helpful based on its impact on (1) economic development; (2) national integration; and (3) governmental capacity. In 1986 Nas, Price, and Weber used the Nye approach to suggest that, if corruption has a positive impact on social welfare, it should be considered beneficial; otherwise, detrimental.

Using the distinction presented here between primary and secondary corruption, it appears that such analyses are far more likely to be meaningful under primary than secondary corruption. For example, while the bribery of senior civil servants, judges, or MPs is unheard of in England, "the granting of planning permissions yields a steady stream of abuse" (THE ECONOMIST, July 3, 1993, 58). Under these circumstances, it is possible for a businessperson to do a cost-benefit analysis with regard to a possible "financial contribution" or "arrangement." In Russia, however, according to a recent article by Marshall Goldman (1994, F9), simple forms of bribery are useless. Secondary corruption manifests itself in more than 4,000 racketeering gangs; unfair legal and commercial rules; a dizzying array of arbitrary taxes; the unreliability of local banks and currency; etc. Goldman therefore concludes: "unless a company has answers to or high tolerance for these difficulties, now is not the time to invest." (This underscores the difference between paying a service charge or tip at a restaurant and having to pay a bribe for each item of food, for which we have no guarantee of delivery or quality.)

Caiden (1990, 152) suggests that corruption is a "functional dysfunction." What is indicated here is that, under conditions of secondary corruption, the more functional corruption appears in the short run, the more ultimately dysfunctional it is. In many countries, for example, businesses need to bribe bank officials to get a loan (de Juan 1991). Because these businesses are seldom forced to repay their loans, "zombie banks" are not uncommon in LDCs. Under these circumstances, efforts of foreign assistance agencies to foster credit programs for business development usually end in failure.

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## 6. LINKING INSTITUTIONAL ECONOMICS TO CORRUPTION



The New Political Economy (NPE) points to the political factors that "have economic consequences contrary to the economist's objectives" (Meier 1991, 23). This NPE literature, together with the rent-seeking literature (noted later), are aspects of what has come to be called, "institutional economics." Various economists emphasize different factors relevant to corruption. North (1984) stresses institutional constraints on behavior (particularly enforcement problems) resulting in deviations from existing rules and regulations. Jagannathan (1986) emphasizes the inefficient enforcement of property rights and regulations, causing property to be used unproductively. Ostrom, Schroeder, and Wynne (1993) note the impact of corruption on incentives, including such perverse manifestations as "free riders" (those who take advantage of services without paying for them). Klitgaard (1991) summarizes the literature having to do with the "principal-agent-client model," showing how corruption can undermine the delegation of authority essential for the delivery of social services.

Political elasticity theory (noted earlier) fits in with this NPE literature. This theory enables us to overcome the confusion in the literature regarding the meaning of "the soft state" and the distinction between coercive and persuasive power (see Ruttan 1991). Secondary corruption prevents the integration and alternation of soft and hard forms of political power, particularly, incentives and disincentives. This results in political inelasticity, undermining any form of decentralization and reliable or widespread influence (the requisites for expanding political power).

I also need to remind the reader of my distinction between political hardware (the objective forms, rules, procedures, and methods of organization) and political software (the subjective relationships between leaders and followers, including attitudes, prejudices, emotions, and other forms of human response). As secondary corruption damages political software, it prevents political hardware from functioning properly. This can be seen in a comparison of public enterprise (PE) performance in South Korea and Ghana.

Despite extensive privatization, S. Korea's PEs continued (as of 1986) to possess about 15 percent of the country's fixed assets (Sakong 1993, 80). To motivate a higher level of performance, the government introduced a bonus system (amounting to as much as three months' salary) in 1983. This system included: (1) annual performance reports; (2) agreed-upon criteria and a system of scoring each criterion; (3) the use of outside experts, primarily from universities, as evaluators; (4) the publishing of rankings in the press; and (5) the use of the results to flag problems and deficient departments or divisions (Shirley 1989). This system is considered so successful that it is now being used in Pakistan and other countries. As a result, a number of reforms followed, including more promotion opportunities for middle-level managers, greater autonomy and



accountability, and more rational administrative controls and regulations. Consequently, managers now feel more personally responsible for results.

In Ghana, on the other hand, performance contracts and incentive bonuses are meaningless because performance remains unmeasured and bonuses are given automatically. Indeed, PEs here survive in a discombobulated and highly corrupt atmosphere, without much control over (or knowledge about) debts, loans, taxes, dividends, arrears, grants, or other forms of governmental assistance and reimbursement requirements (Sherif 1993). A 1990-91 survey of 127 PEs showed their 1989 losses to be about US \$62 million. Among the reasons given for poor performance include: lack of management authority to make decisions; arbitrary and unpredictable political interference; inability to select and control staff; inadequate expertise and respect for professionals; useless grade and occupational classifications; irrational use of personnel; deficiencies in financial and cost accounting; and failure to audit transactions.

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#### BOX 7

##### NIGERIA AND JAPAN: ILLUSTRATIONS OF INELASTIC/ELASTIC POWER

The theory of political elasticity enables us to understand why military regimes, undermined as so many are by secondary corruption, appear so very weak. Nigeria, for example, which has been under strong military control since 1983, seems unable to do what many medieval and ancient kingdoms were able to do - collect garbage from their streets on a regular basis. It was estimated during the 1980s that only one-half of Lagos's domestic refuse generated daily was being collected (Bartone, Bernstein, and Wright 1990, 60). Large areas within the city, containing an estimated one-third of the population, received no refuse collection service. Even in areas where service was available, many households dumped their garbage illegally on the roadside near their dwellings, thus impeding vehicular flow and endangering health. Because there is inadequate delegation of responsibility and control over what goes on (see example in Box 1), the Nigerian political system is clearly, "inelastic."

In many parts of Japan, on the other hand, a different type of trash is picked up each day of the week, most of it intended for recycling or conversion into energy (Hershkowitz and Salerni 1987). Every citizen and industry participates in some way, including the handicapped who thereby support their activities. Consequently, Japan is able to recycle about 50 percent of all categories of refuse, with two-thirds of the remaining waste burned for energy in several thousand incinerators. Because so much garbage is separated into categories and recycled, the Japanese can keep their waste-to-energy incinerators relatively small, inexpensive, and harmless. Based upon this example, their



political system (despite the primary corruption earlier noted) is obviously "elastic."

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The concept of "rent-seeking" is increasingly used in World Bank reports in place of the word, "corruption." This is partly because, as Klitgaard (1989, 18) notes, "Within the Bank itself, the subject verges on the forbidden." It is also because of the fact, as here pointed out, secondary corruption prevails in most of the countries that the bank is active in. Consequently, corruption as "greed" is concealed within the many manifestations of bad or weak governance.

If the argument presented here is meaningful, much of Bank literature referring to "mistaken policies," "weak implementation," "inadequate bureaucracies," "dubious commitment," etc. are actually manifestations of secondary corruption. As such, they are "deliberate," rather than "accidental" results of existing systems of government. To hide them within the term, "rent-seeking," referring to "the direct use or waste of economic resources for non-economic gain" (Gallagher 1991, 31), can be misleading.

The relationship of rent-seeking to corruption is perhaps most clearly presented in a 1991 Bank discussion paper, "Rent Seeking in Water Supply," by Lovei and Whittington, having to do with Jakarta. As of 1988, nearly one-third of Jakarta's eight million population had to depend on water vendors, who grossed annually about US \$20 million. An estimated 60 percent of this amount went to public tap operators, neighborhood officials, and water utility staff, producing a conspiracy to prevent more than 14 percent of households from receiving direct connections to the municipal water system. Manifestations of this conspiracy included: limiting competition from other water sources, restricting the resale of piped water by households, fixing the price of water, and discouraging consumers from obtaining water directly from public taps.

In several recent Bank reports on Senegal (Morin 1993; SENEGAL PRIVATE SECTOR ASSESSMENT 1993), the word, "corruption," is seldom mentioned. Yet, manifestations of secondary corruption are clearly evident:

\*During the 1980s, most of the major sectors of the economy were highly protected, costing the state annually an estimated \$173 million, representing about 20% of current budgetary receipts. This meant that cement was twice as high as in France; fuel and electricity, five times higher. The cost of protecting a government-supported sugar monopoly amounted to about US \$55 million annually.

\*Until recently, the Senegalese Labor Code put severe restrictions on wages, hiring, and dismissal. While reform of



this Labor Code is being considered, officials are unlikely to liberally or "helpfully" interpret whatever revisions that appear.

\*Until 1986, extensive quantitative restrictions and high tariffs affected imports. Since then, trade barriers have been supposedly removed and distortions eliminated. However, a degree of discretionary power has been given to customs officials, "allowing substantive protection to return through the back door." Consequently, smuggling, corruption, distortions, and the necessity for extra payments continue.

\*Irrational intervention by the State has made it difficult for businesses to operate efficiently. For example, existing industrial and export processing zones have been undermined by high user fees, restrictions on ownership of buildings and land, inadequate political and commercial risk coverage, weak financial services, and the other problems already mentioned.

\*Senegal's legal system is complex and unrealistic. Its judicial system is inefficient, confusing, and contradictory. Investors are doubtful about their claims being respected or enforced. Investors are subject to sudden and sharp increases in tax levies and elimination of incentives.

\*While twenty public enterprises (PEs) have been privatized since 1988, those that remain continue to be mismanaged and a heavy burden on the national budget. The real estate PE may never be privatized because it owns dwellings occupied by officials and civil servants. Performance contracts are seldom taken seriously either by the government or by PE management, and there is no "genuine political will" to reform.

Why these and other "distortions" of the Senegalese economy should be considered "purposeful" and therefore, "corrupt" is explained in a 1990 article by Catherine Boone. She points out (p. 427) that "rentierism is an activity open to the political class," reflecting "patterns of access to politically mediated resources." Using grants from the state, contracts, kickbacks, and other illicit sources of wealth, rentiers channel their income into various state-mediated non-productive activities. Because they are dependent on inducements and sanctions meted out by state agents, they become part of the "clientelistic system of political control." Insofar as this system is supported by France, it may be considered as "neo-colonial." At the same time, because it is counter-productive, it may ultimately endanger those in power.

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#### BOX 8

#### THE IMPACT OF RENT-SEEKING ON A WORLD BANK PROJECT

By recognizing rent-seeking behavior as a form of secondary



corruption, we can also see how it endangers Bank projects. Let us take the Nairobi City Council as an example. Under colonial rule and for some years thereafter, Kenyan municipalities had relied on a progressive personal tax. Because Central Government officials accused local officials of corruption, they disallowed this tax, with the promise of grants instead. Because these grants were not forthcoming, the municipalities were left bankrupt and demoralized. As part of a Bank urban development project here, Bank officials insisted on a revaluation and an increase of property tax rates to enable municipalities to pay for the project. Because African property owners refused to pay for public services, they undermined the project.

In the case of Nairobi, the Kenyan government took over the functioning of the City Council in 1983, claiming that it was corrupt and mismanaged (Stren 1989, 33). However, much of the problem stemmed from being deeply in debt (with rate arrears amounting to the then annual total recurrent expenditures) caused by the unwillingness of anyone to pay property taxes, including powerful politicians, senior bureaucrats, the Kenya Railways, and the Commissioner of Lands. Since the BWANA KUBWA (the powerful people) were not paying charges and taxes, residents of the Bank-sponsored Dandora site/service project strongly objected to paying the dues levied under this project. (Indeed, their rioting forced the mayor and the entire city council to resign!) Under central government control, the situation became much worse, particularly after a fire destroyed important records. But without cost-recovery, it is impossible for the Bank to sponsor more urban projects here, even though the Dandora project is considered a great success, leading to a large increase of income and accommodation as beneficiaries built additional rooms for rent.

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## 7. THE CAUSES OF CORRUPTION

Historical and cultural factors are often given as primarily responsible for corruption in LDCs, particularly in Africa. Mutahaba, Baguma, and Halfani (1993, 6-7), in a United Nations sponsored publication, point to colonial rule as fostering corruption inasmuch as it was authoritarian, exploitative, destructive of traditional values, and hostile to local participation and professional development. Without denying the validity of this argument, the fact is that many governments inherited well-functioning bureaucracies and that, only after a number of post-colonial years, did they deliberately undermine these bureaucracies. Langseth (1994, 2), for example, points out that the Uganda Civil Service was hailed during the 1960s as one of the best in Africa (well-paid, properly equipped, and efficient), whereas, by 1980, it was inefficient, demoralized, and unresponsive. While the Nigerian civil service was highly respected and relatively uncorrupt during the early 1960s, it soon became "the most bureaupathologic in the area" (Caiden 1991,



257). In any case, colonial rule would not explain why so many Asian countries have overcome its dysfunctional impact, whereas African and Caribbean countries have not.

In considering Africa's slow economic progress or retrogression, we cannot dismiss the assertion that cultural barriers are primarily responsible. In describing the bureaucracy prevalent in most African countries, Mamadou Dia (1993, 20) writes: "The whole system encourages lethargy and clientelism rather than dynamism and entrepreneurship." Nepotism, excessive gift-giving, and extreme family or clan ties are seen to be the result of counterproductive traditional values. Aspects of the so-called "traditional way of life," influenced by the work of Talcott Parsons (1960), include: ethnocentricity; primordial rather than functional associations; the sanctification of customs, beliefs, and practices; the discouragement of individualism; the emphasis on authority by birth rather than by merit; customary rather than contractual relations; supernaturalism; the unwillingness to accept personal responsibility for development; and social rather than legal sanctions. It should be noted, however, that this traditional way of life was as much encountered by scholars in Asia (where secondary corruption has decreased) as in Africa.

If we stick to the widespread definition of culture as persistent patterns or systems of behavior and belief characteristic of particular social and ethnic groups, we encounter serious disagreements about causation. To what extent are the causes situational (not directly affected by government) or political in origin? While situational factors tend to be emphasized, culturalists remain uncertain about the priority among possible causes: ideological, socioeconomic, and historical. Culturalists, however, have the most trouble with political factors. While leaders are clearly guided by societies, they can also manipulate them.

Acculturation can be molded as well as hastened by political processes. Within a relatively short time at the end of the eighteenth century, Josiah Wedgwood had turned a traditionalist work force (used to drinking on the job, working flexible hours, and working at their own discretion) into an efficient, diligent, and reliable work force (Langton 1984). A more recent example can be found along the Mexican-United States border, where Mexican workers, thought to be affected by a "culture of poverty," have proved highly productive and internationally competitive in "maquilas," when properly trained and organized (Rivera and Goodman 1981).

While cultural barriers to development are difficult to overcome, these barriers are often politically created and, as such, overcome by political action. For example, the Malawi government in the 1960s banned the use of modern contraceptives following widespread fears that they would cause sterility, but it reinforced these fears in doing so (Kalipeni and Zulu 1993,



116). After 1984, when it changed policies toward family planning, it was both reflecting and encouraging the revision of cultural attitudes. However, a comparison of the equally impoverished neighboring countries of Tanzania and Malawi in regard to road maintenance and repair can perhaps better illustrate the impact of politics on culture (Moeller 1990).

In Tanzania, as of 1990, about 45 percent of paved roads and 60 percent of unpaved roads were in poor condition, making reconstruction costs and vehicle operating costs far higher than would otherwise be the case. A World Bank study noted such administrative problems as weak accountability, low salaries, and mistaken reorganizations (Moeller 1990, 41). The fact that infrastructure created by British colonial institutions deteriorated so rapidly after independence in Tanzania seems to support Landell-Mill's point (1992, 473) "that the underlying cultural premises of these institutions were alien to the vast majority of Africans...."

In Malawi, on the other hand, President Banda made it clear that "there should be no potholes in my roads" (quoted, Moeller 1990, 15). Under his direction, workshops were established to set implementation objectives, the performance at all levels were reviewed on a quarterly basis, a computerized management system was installed, and an incentive system was introduced based upon comparisons among district supervisors. As a result, only 6 percent of Malawi's paved roads were in bad shape during the 1980s (as against an estimated one-quarter in Sub-Saharan Africa). Thus, the corrupt situation in Uganda (and so many other countries) of funds being spent on the repair of roads without any implementation has been avoided here.

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#### BOX 9

#### THE LINKAGE OF CORRUPTION, CULTURE, AND POLITICS - A COMPARISON OF BRAZIL AND CHILE

A recent World Bank comparison of the legal and regulatory environment of Brazil and Chile provides another example of how political systems affect both culture and corruption (Stone, Levy, and Paredes 1992). In Brazil, firms must contend with numerous problems: rapid and unstable inflation; a maze of contradictory, rapidly changing, and unknowable regulations; over 50 federal, state, and municipal taxes; and numerous filing and payment requirements. This results in a dualistic system, in which an "informal system" of bribery is used to get around the complex and expensive formal legal system. Consequently, corruption may have even worsened with the democratization process that began in 1985. Indeed, pressure from the World Bank and the IMF for decreased deficits may have forced the Collor administration "to supplement state resources with private tribute" to meet the demands of supporters (Geddes and Neto 1992, 659).



In Chile, in contrast, there has been an effort to deregulate and privatize the economy, establishing well-defined property rights, rationalizing tax and labor regulations, and reducing constraints on capital mobility and competition. This has resulted in much easier contracting and operating procedures, greater legal simplicity, more certain enforcement of contracts, and a far better environment for business. Above all, the culture of corruption, which once existed in Chile and seems so deep-rooted in Brazil, is no longer part of the Chilean way of life.

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#### 8. REDUCING CORRUPTION: OPINIONS OF BANK STAFF

A 1989 United Nations report, *CORRUPTION IN GOVERNMENT*, seems to have a discouraging message. On the one hand, it suggests that, when governments are seriously interested in reducing corruption, much can be done. On the other hand, "it is impossible to deal with corruption when it reaches the most elevated positions in the state's organization of power" (p. 24). Thus, it finds that success stories in the battle against corruption are often followed by failure stories. For example, Justice Plana's campaign against corruption in the Philippines Bureau of Internal Revenue (BIR) appeared to be successful because it included: (1) an agreed-upon performance evaluation system; (2) the collection of necessary sources of information about corrupt activities; and (3) punishment of high-level violators (Klitgaard 1991, 128). However, after Plana left the BIR, "corruption was reported to be on the rise again," because no one was prepared to take over for him (United Nations 1989, 49). This UN report thus indicates what Bank staff are up against in dealing with secondary corruption.

Klitgaard, in a 1989 report, "Corruption and the World Bank," summarized the ambivalence of Bank officials that he interviewed. While most felt that it is "almost an impossible problem," they seemed to agree that the "Bank should make it clear that it is a fundamental problem and take a strong stance against corruption." Bank staff, according to Klitgaard, are uncomfortable with any overt move away from the Articles of Agreement, disallowing interference in the internal politics of a country. Yet, they are also aware that such political interference is an inevitable byproduct of structural adjustment lending.

The reluctance of Bank staff to move away from the safety of technical economics in confronting corruption is increasingly being criticized within the Bank. Michael Cernea is among the Bank's most forceful voices questioning the "econocratic or technocratic models" used (1991). The inadequacy of such models is also expressed by Berkman (1994) and Steedman (1994) in regard to technical assistance. Unless more attention is paid at the highest levels of government and the donor community to such factors as lack of resources, lack of motivation, and local corruption, "then it is safe to conclude that technical



assistance will continue to be a solution that does not work" (Berkman 1994, 8). While the Bank and other donors are increasingly aware of institutional barriers to the success of technical assistance, Steedman (1994, 7) points out, "the published record of project development has traditionally tended to downplay the weaknesses perceived by those responsible for developing the project and to highlight the expected achievements of the project and the design of the inputs." Consequently, too many projects put excessive faith in "best practices" or "some supposedly generic basic package of computing or management skills" (Baker 1994, 54).

However, even when Bank staff are encouraged by the 1994 GOVERNANCE report to come to grips with corruption, they are understandably reluctant to do so. After all, an attack on corruption may be seen, not simply as an attack on the existing political system, but also as destabilizing the government the Bank wants to help. Soldiers in many countries have threatened those who attempt to investigate their corruption. This is why it is that, only after weighing the "pros and cons" of the Ugandan situation, does Langseth (1994, 26) conclude: "there is more political risk involved in not taking on corruption than there is taking it on." In doing so, the following possibilities need to be explored:

\*TESTING COMMITMENT. Heaver and Israel (1986) emphasize the importance of encouraging political commitment by: insisting upon commitment prior to a project; isolating opposition to reform; and evaluating progress based upon performance. They advocate, if practical, breaking a project into small operations, with continuation of the project or future assistance dependent on results. This means that Bank staff must be prepared to cancel projects or suspend disbursements if progress becomes difficult or promised reform, undermined.

There are, of course, disadvantages to confronting corruption in this way. Nelson (1992, 45) points out that turning aid off and on intensifies problems of administering economic development. To ask staff, consultants, and contractors to wait for institutional reform may endanger their jobs or be counterproductive, as staff activities need to be carefully scheduled and consultants and contractors given adequate notice for work to be properly done. Funds also have to be spent or lent in a predictable way so that they can be withdrawn from financial markets without excessive loss.

The Bank's Operations Evaluation Department (OED) also advocates the constant testing of borrower commitment, noting that "legal covenants in projects have proved to be an ineffective substitute for genuine commitment" (OED 1988, xvii). However, the actual dilemma of dealing with shifting borrower commitment because of changing social, political, and economic factors are most clearly presented in a recent OED study of industrial sector reorientation in East Africa (Report No 12922,



1994, 128): "should the Bank continue to support a vacillating and ineffectual political leadership whose policies are not working...? Or, should the Bank retrench, question the wisdom of its further involvement, and even suspend lending?" The conclusion suggested is to involve Bank managers at the highest levels in striking a balance between opposing views and interests.

In regard to corruption, David Steedman argues that "donors often fail to enforce the few elements over which they have some control with the result that bad habits are reinforced rather than changed by the provision of aid" (1990 and 1991 internal communications). While recognizing the need for realistic expectations, he concludes that the Bank could insist upon certain reforms and targets in the processing of goods, the disciplining of agents caught in illegal activities, and the postponement of certain desired equipment and training until definite progress had been achieved, adding: "At what point does imperfect compliance on the part of a client and his related failure to prove accountable for expected results, become complicity in the wrong doing on the donor's side?" The Bank has indeed shown that it can fight corruption. When officials in Zaire allowed new computer equipment funded by the Bank to be stolen and destroyed in 1992, the Bank eventually suspended this project (Dia 1993, 36).

**\*ENCOURAGING COMMITMENT.** Carol Lancaster prepared for the World Bank in 1993 a study of national conferences in Francophone Africa intended to bring together leaders of major sectors, associations, political parties, and governmental agencies to discuss governmental failures, problems, and reform possibilities. Such conferences might be useful in bringing to the attention of the public the sources and implications of corruption, using the results of commissions of inquiry. However, these commissions of inquiry run the risk of simply calling for the dismissal of corrupt officials and the recovery of public funds without getting to the roots of corruption. For example, a number of Kenyan civil service reform commissions recommended many improvements, including salary increases; but their recommendations, except for the salary increases, tended to be ignored (Oyugi 1990, 69).

Klitgaard (1988), in his study of the Hong Kong anti-corruption effort, has argued that reducing corruption requires a three-prong attack: a special investigating unit; an effort to get to the roots of corruption; and a public-information program on the dangers of corruption. In many countries, people seem to think it is all right to violate the public interest; to become rich off government service; and to use the government merely as a source of employment and charity. For example, a survey in Sierra Leone indicated that 80 percent of the public considered routine stealing from the government to be acceptable behavior (Homet 1993, 279). Consequently, efforts to carefully select civil servants and to reduce the size of bureaucracies through



examinations have not received much public support. In the Central African Republic a Canadian consultant working with the Livestock Ministry to develop a personnel testing program had to be protected by a bodyguard from attacks by angry civil servants (Nunberg and Nellis 1990). Until the public in LDCs becomes more aware of the importance of a meritocracy in administration, it may not be possible to eliminate the patrimonial systems that prevail in much of the world.

The case study presented earlier of Indonesia suggests that, once a government becomes seriously interested in business development, secondary corruption can be reduced or controlled. Unfortunately, in many parts of the world, particularly Africa, capitalism continues to be seen as alien, exploitative, and neo-colonialistic (Harsh 1993). In some countries, such as Tanzania, the anti-business climate seems deeper than in others. In Kenya, for example, where horticulture export has been successful, Bank officials might have worked harder to mobilize these exporters in dealing with the apathy of Kenyan officials in regard to an Export Promotion Technical Assistance Credit which had to be canceled (OED Report No. 8573 1990, 48). It is the conclusion of Klitgaard (1990) that Bank officials in Equatorial Guinea could have done more to support cocoa exporters in overcoming the many problems that they faced. However, the Bank's Private Sector Development Department has been doing useful surveys of political impediments to economic reform in Russia and Eastern Europe (see, for example, Webster and Charap 1993). It might be possible to follow this up with "institutes for business development" along the lines of the one established in Peru by Hernando de Soto (1989).

**\*BYPASSING CORRUPT BUREAUCRACIES.** Ideally, the way to reduce corruption in government is to reform the bureaucracies of these governments. So far, the Bank has not met with much success in this regard. Based upon a 1990 study of 19 Bank public sector management reform projects in Africa, only five were judged successful. While there have been some progress in improving pay and reducing staff in a few countries, these have seldom led to improved performance (de Merode 1991, 19). Even improving statistics, auditing, and accounting (the mechanical aspects) has not led to institutional development. The barriers to better governance and thus, less corruption, seem overwhelming. Consequently, Bank staff have had to turn to alternatives for their projects:

(1) Special project units or agencies. To say that there are no easy answers to the problems of LDCs may seem a silly cliché. Yet, even the most sophisticated and experienced analysts get hopelessly confused in their effort to provide such answers. For example, Elliot Berg (1993, 223-224) points to the dangers of Project Management Units (PMUs), which typically rely upon locally recruited professionals, seconded (or borrowed) civil servants, and foreign experts (all of whom are provided good salaries, benefits, and working conditions): spreading of



resentment; postponement of overall administrative reform; draining of most qualified personnel; decreased likelihood of sustainability; and fragmentation of the bureaucracy. Berg's critique is supported by OED's 1992 EVALUATION RESULTS and by the Operations Policy Department's 1993 HANDBOOK ON TECHNICAL ASSISTANCE.

Unfortunately, not to use PMUs is an invitation to disaster.

Both the World Bank and USAID in their urban work (e.g., the Bank's Bustee Improvement Program in Calcutta and USAID's Helwan Project in Egypt) found that, as soon as PMUs were discontinued, slum upgrading efforts faltered. It should also be noted that, when LDCs are themselves serious about an undertaking, they also rely upon PMUs. A good example of this is the Ethiopian Airlines Corporation (EAL) which was created by imperial charter in 1945 under a contract with Trans-World Airlines (TWA). By the mid-1970s, when the TWA contract was terminated, EAL was completely Ethiopianized but also highly professional, efficient, and profitable. As of 1991, it had 32 hundred employees worldwide, two pilot schools, the best repair and maintenance depot in Africa, and annual profits of about \$25 million.

(2) Non-governmental organizations (NGOs). David Beckmann (1991) points out that there has been a great increase in Bank use of NGOs in project work, rising to nearly 100 annually, as against an average of 14 projects annually for fiscal 1973-1988. There are many success stories: the Aga Khan Foundation in Pakistan; BRAC and the Grameen Bank in Bangladesh; FUNDASAL in El Salvador; etc. While the reasons for their success will vary in any detailed presentation, they fundamentally go back to the factors earlier mentioned in connection with good governance.

Because successful NGOs require good governance, they often elicit from the existing civil servants the same hostile response as successful PMUs, "especially when NGOs are administering an increasing share of foreign assistance or ... are better paid and equipped than government offices" (Beckmann 1991, 143). Clark (1993, 7) also notes that governments "may not want to foster a healthier NGO sector for fear of bolstering the political opposition." For example, the government of Bangladesh has attempted to undermine the functioning of its internationally acclaimed NGOs because of their liberalism and support of impoverished women. Fortunately, the Bank and various international donors have in this and other cases successfully offset governmental hostility.

(3) Less government. The New Development Administration (NDA) emphasizes decentralization, community control, deregulation, privatization, minimal government, popular participation, and debureaucratization in all possible forms. It has emerged from disillusion with the optimistic, scientific management, faith in government, and Western orientation of the 1960s. It also builds upon the collapse of communism in the



Soviet Union and the greater willingness of LDC leaders to rethink their commitment to socialism, large-scale government, centralization, and one-party rule. "The pendulum of opinion has swung toward the market," Klitgaard (1991, 3) points out, partly because of World Bank/IMF pressure, but also because of ideological changes.

What the NDA seems to overlook is that LESS GOVERNMENT is not a substitute for GOOD GOVERNMENT. "The fact is," to quote Klitgaard (1991, 5), "neither the interventionist state nor the minimalist state has guaranteed rapid development." What is essential is an "enabling environment," within which deregulation, decentralization, popular participation, and privatization can be successfully carried out. Such an environment cannot exist under the conditions of secondary corruption here described.

## 9. SECONDARY DEMOCRACY VERSUS SECONDARY CORRUPTION

Lord Acton's famous aphorism, "Power tends to corrupt, and absolute power tends to corrupt absolutely," is often quoted in the literature on corruption. Why this is so may be explained by neoclassical economics (Grabowski 1994). The power elite, inasmuch as it monopolizes the use of violence, is in a position to extract surplus to support its interests at the expense of the majority of society.

It would follow from this explanation that democratization is essential to reduce corruption. To what extent is it true? Charlick (1993, 178) notes that few analysts "would contend that liberalization or democratization in and of itself is sufficient to curb systemic corruption," adding: "Clearly improved governance and democratization are not identical or necessarily synchronous processes" (1993, 178).

Confining our attention to Africa, we see, on the one hand, many examples of predatory states in which governance is essentially a matter of survival rather than development (Jackson and Rosberg 1982, 18) and, on the other hand, "that there may not be an ineluctable connection between democracy and limiting corruption" (LeVine 1993, 272). Lancaster (1991-1992) observes the absence in Africa of the generally considered requisites for democracy: widespread literacy, high levels of per-capita income, a sizeable middle class, strong public institutions, nationally based political parties, a tolerant political culture, etc. Thus, while three-fourths of African countries have experimented with political liberalization, there is much doubt about the durability and significance of this development. Nigeria's Second Republic (1979-1983), for example, proved to be hopelessly corrupt and inept. "Ethnic and primordial interests were once again at play confronting one another over the distribution of the national cake," Olugbade (1989, 248-249) points out, adding (253): "Thus it was with open arms and jubilation that Nigerians



welcomed the military."

Outside of Africa, we see time and again that elections alone will not bring about a reduction in corruption. In Guatemala, for example, the 1985 elections brought into power congressmen who regularly accepted bribes to favor particular companies. This gave the President an excuse (which the population apparently accepted) to purge both the legislature and the judiciary (Scott 1994, 4). This means, to quote Harsh (1993, 47), "only a profound transformation in social and political relations is likely significantly to weaken corruption's underlying causes...."

We will suggest here, that while democratization is indeed essential for reducing corruption, it must initially take the form of "secondary democracy," rather than "primary democracy." This distinction between primary and secondary democracy goes back to the two sides of politics earlier noted: the struggle for competitive advantage (partisanship) and the struggle for consensus (statesmanship). If politics consists of nothing more than "raw political power" - "the well-being of the few at the expense of the many," in Grabowski's words (1993, 414) - it appears to be the intoxicating beverage of the Hobbesian Leviathan, causing the political illness noted at the beginning of this report. Just as secondary corruption refers to an absence of governance, secondary democracy refers to "a mutual respect among competing groups and between leaders and followers and consensus on governmental goals and procedures" (in other words, a high quality of governance). Consequently, we can conclude that ANYTHING WHICH IMPROVES GOVERNANCE AUTOMATICALLY REDUCES THE WORSE MANIFESTATIONS OF CORRUPTION.

Without secondary democracy, primary democracy tends to be meaningless, much like an Olympics without the necessary conditions for sporting events and rules for participating, competing, and officiating. Another way of making the distinction here presented would be the "two ideals of democracy" suggested by Mansbridge (1991, 7): "one based on conflict, the other on commonality." Until politicians are prepared to ask, "how can we work out our disagreements?," they are unlikely to reach "democracy," as defined by Diamond, Linz, and Lipset (1989, xvi): "meaningful and extensive competition among individuals and organized groups...."

Those of us in the liberal tradition see primary democracy (particularly, competitive elections, majority rule, empowerment, and confrontation) as our ultimate goal; but, for the reasons indicated, it depends upon secondary democracy, which is, after all, closer to the Athenian conception of community or polis: continuous discussion in various forums, political education in civic virtue, and recognition of a shared fate (Euben 1993, 479).

Under secondary democracy, "rule by the people" takes the form, not of domination, but of persuasion, including: influence of the



people, respect for the people, and acceptance by the people. Thus, we stress "the five C's" put forward by Adebayo Adedeji, the former head of the Economic Commission for Africa: consent, consensus, conviction, commitment, and compassion (Lemarchand 1993, 99).

In LDCs the dangers of excessive democracy stem more from the inadequacy of secondary democracy than primary democracy. The truth is, according to Sangmpam (1992) that, while democratization is highly desirable, its benefits cannot be realized under the conditions of an "overpoliticized state," characterized by lack of compromise, use of violence, and manipulation of the state apparatus. Until oppression, exploitation, and discrimination are significantly reduced, democracy will remain "pro-forma," even when it includes various types of elections (Imam and Ibrahim 1992, 17).

While insisting upon primary democracy is often inappropriate, encouraging secondary democracy may be more useful. In this regard, the United States did play a constructive role in East Asia. In Taiwan, foreign aid leverage was used to strengthen the role of the private sector, to reduce discrimination against mainlanders, and to facilitate land reform (Wade 1990, 83). In South Korea, the U.S. and the World Bank encouraged political and institutional reform, even though leftist, populist, and labor movements remained suppressed (Koo 1987, 169).

If the argument here presented is correct - that secondary democracy is essential for the reduction of secondary corruption - foreign aid agencies might facilitate it in various ways. We can here reiterate a number of possibilities for connecting leadership to followership through better governance - promoting legitimacy, accountability, transparency, respect for human rights and the rule of law, decentralization, and participation (Operations Policy Department 1994, 3). The following are examples of these possibilities, including the difficulties involved:

**EXPANDING TWO-WAY FLOWS OF COMMUNICATION.** In a number of cities (e.g., Buenos Aires, Cairo, and Calcutta), associations or unions of privately owned taxis and minibuses provide much of the public transportation (Roth and Wynne 1982). By promoting and negotiating with these associations, governments can help develop organizations that are strong enough to impose essential rules and regulations. By failing to overcome the opposition of the Kenya Bus Service, the World Bank's effort to develop a safe and reliable paratransit system in Nairobi was unsuccessful during the 1980s (Lee-Smith 1989). This opposition prevented the recognition and financing of paratransit ("matatu") cooperatives and the establishment of separate bus terminals, passenger stops, and labor standards for them. Without the necessary organization and incentives for membership, neither the cooperatives nor the government could impose upon matatu drivers



and owners parking or traffic regulations, insurance requirements, and safety conditions.

The Bank is now paying increasing attention to two-way flows of communication, even when this means compromising its original objectives. Since 1984, there has been a requirement that the needs of intended beneficiaries be included in the processing of its projects (Cernea 1991, 34). In diverse urban areas - in Burundi, Ecuador, and Thailand - Bank staff found that residents preferred paying more for trucked water than accepting long-term loans for piped water and the home improvements necessary for it (World Bank 1992, 6-18). In Mauritius, however, the Bank agreed to a moderate increase in the standards of housing and plot layout to avoid branding a low-cost settlement scheme as "undignified" in the minds of the public (Gulhati and Nallari 1990, 60).

To facilitate two-way flows of communication, the Bank has employed trained local social workers to live in areas being assisted for extended periods, enabling them to engage in confidential discussions with members of the community about their perceptions, fears, and problems (Salmen 1987). The Bank has used this "qualitative research" approach (developed by Lawrence Salmen) in a large percentage of its anti-poverty projects in Bolivia (Marc, Graham, and Schacter 1992, 75).

Whether the Bank can go farther than this, in regard to two-way flows of communication, by cooperating with donor countries to insist upon press freedom, is not yet clear. A recent article in THE WASHINGTON POST (Richburg 1994) noted that the African press has become more endangered in the last few years, with campaigns against the press in Kenya, Uganda, Zambia, Nigeria and other countries. While the African press remains weak or government sponsored and controlled, it continues to be "one of the vanguards for probity, accountable public performance in African countries," Olowu (1993a, 233) writes, suggesting that foreign donors could help the non-governmental media companies that have been launched or reestablished in some countries.

**SOFTENING FORMS OF POWER.** To get governments to shift from coercive to persuasive forms of power is seldom easy. While the many reasons for this have already been presented, cooperation cannot be expected when promised services are not provided. In Ghana, for example, "citizens do not see why they should pay for services they do not receive" (Garnett, Merrill, and Miller 1988). On the other hand, a private Ivorian water-supply company (SODECI), which provides service close to the standards of industrial countries, has enough revenue from sales to fully cover capital and operation and maintenance costs (World Bank 1994b, 63).

To encourage a softening of political power, the World Bank has conducted surveys in 24 countries, showing how unnecessarily burdensome certain tax and labor regulations are, taking up more



than one-fourth of senior management time in one instance (Operations Policy Department 1994, 8). Based upon these surveys in Latin America, the Bank has supported revenue administrative reforms to make tax and customs regulations more easily comprehensible as well as acceptable.

Creating appropriate incentives is, of course, essential in softening political power. Examples can easily be found. In Zimbabwe Robert Mugabe created an effective grain marketing board which encouraged farmers to more than triple maize production between 1978 and 1985 (Harrison 1987, 88). In contrast, President Kaunda undermined and neglected African farmers in Zambia after independence, so that by the end of the 1970s, the country became increasingly dependent on imported grains (Gulhati 1991). As the terms of trade went against Zambian farmers, the government was unable to induce higher productivity.

In Indonesia's Kampung Improvement Program (KIP), funds were provided to urban communities by the central government without a requirement for local cost-sharing. As a result, beneficiary communities did not feel enough "ownership" of investments to maintain or improve them. Building on this experience, more recent KIP projects use a combination of incentives and disincentives to "persuade" communities to maintain infrastructure and utility services provided (World Bank 1992, A7-16). This, of course, means decentralizing responsibility to these communities; but, as has been true of anti-poverty projects in Egypt, central government officials often undermine such efforts (Marc, Graham, and Schacter 1993, 51).

**REDUCING CONFLICT.** In Nicaragua a major impediment to advancing both democracy and development has been the Government's inability to resolve most of the ownership claims on property seized by the Sandinistas (Golden 1993, A6). This is where foreign assistance could be useful, including land registration, an arbitration arrangement, and appropriate compensation. This was done in Kenya after independence in transferring land from European settlers to African farmers through British assistance. (And it needs to be done now in South Africa and Zimbabwe to promote inter-racial harmony, while maintaining agricultural production.)

The Bank has been helping Ghana reduce the opposition of chiefs and other traditional authorities to market-oriented and entrepreneurial uses of urban land (Farvacque and McAuslan 1992).

This has led to agreements for long-term leaseholds under common law and customary tenancy to reduce the uncertainty, delays, and corrupt practices associated with traditional tenure. So far, however, not much progress has been made here. "In Ghana's courts, an estimated 15,000 to 20,000 lawsuits over land are pending," causing the land market to break down and urban financing to collapse and resulting in terrible urban environmental damage (Coll 1994, A15). According to Mabogunje



(1992, 25), the usual tardiness of the bureaucracy has slowed down the process of land surveying in many African countries. The Bank has had greater success in Thailand and other Asian countries in attempting to provide secure tenure to rural landholders, thereby, not only reducing conflict, but also facilitating their access to institutional credit (World Bank 1992, A7-8).

The politics of land reform illustrates the fine line here emphasized between primary democracy and secondary democracy. In each type of democracy, we have a "struggle;" but where this struggle is seen simply as a "win-lose" situation, then it is clearly a "struggle for competitive advantage." In South Korea and Taiwan, however, where the previous landowners were properly compensated and the new landowners were carefully and fairly selected, the situation eventually became a "win-win" situation. Democratization was evident inasmuch as the leaders had to reach out for approval to all segments of society.

Other efforts to reduce conflict might be mentioned. In Venezuela the judiciary has become practically useless in resolving legal disputes because of extensive backlogs in the courts. A 1992 \$30 million Bank project here is attempting to improve administration of the court system by computerizing operations, raising salaries, and improving information about laws and legal requirements (Operations Policy Department 1994, 29). Components for developing and strengthening legal institutions relating to property rights and contracts were approved for loans and credits to seven African countries between 1991 and 1993 (Adamolekun and Bryant 1994, 11). A project in Burkina Faso concentrates on the public procurement code and commercial laws. In Uganda the Bank is trying to make the judicial system work better for women. And in Argentina, it has supported the hiring of a NGO to monitor complaints by the public and their resolution by the recently privatized telephone companies.

**\*ENCOURAGING POPULAR PARTICIPATION.** Popular participation can, of course, take both a confrontational form and a conciliatory form. Particularly when communities consist largely of impoverished and uneducated people and when there are deep-rooted social and ideological divisions, there is a danger of an "excess of democracy," tyranny of the majority, undermining of business and the functioning of government, and unreasonable expectations. However, in their book on American participatory democracy, Berry, Portney, and Thomson (1993, 50) point out that few people "want to get involved in organizations that are highly conflictual and leave participants in an antagonized state."

The Bank increasingly recognizes that the sustainability of its projects is enhanced with participation by grass-roots institutions and beneficiaries (Bhatnagar and Williams 1992). The Bank's Environmental Department and EDI are expanding their funding and training operations in this regard. The problems of



doing so have also had to be taken more seriously, including lack of local funds, inter-ethnic conflict, and the opposition of powerful forces and elites (Yahie 1993). Particularly in dealing with corruption, the fine line between conciliatory participation (which Bank staff feel comfortable with) and confrontational participation (which Bank staff fear) cannot be easily avoided.

#### 10. CONCLUSION: ORGANIZATIONAL IMPLICATIONS

We cannot hope to eliminate corruption. Just as to eliminate disease, we would have to destroy life (because disease is essential to life by facilitating life-producing decay), we cannot eliminate corruption without undermining both partisanship (an essential aspect of politics) and profiteering (essential for economic development). Yet, as we can use science to control disease, we can use statesmanship to control partisanship and selfishness. In other words, using the definition presented here, we can suggest that the roots of corruption lie, not so much in excessive greed (as other definitions would have us believe), as in the failure of the political system to protect the public from the inevitable challenges or dangers of the competitive process. While various political hardware solutions (such as an Ombudsman or Quality Control Circles) can be recommended to reduce corruption, we ultimately have to confront the low quality of governance that is responsible for inadequate political software.

In searching for opportunities to improve governance, the Bank may need to look more carefully at the way it operates. Coralie Bryant, in her study of Zambia (1993, 21), points out that "Learning to work with indigenous institutions raises questions of staffing, capacity, research, and process," adding: "There are still too few Bank staff with management experience or professional education in management (and there are too few sociologists, or anthropologists)." In the Africa region, there are only ten Public Sector Management staff.

The practical problems of the Bank getting more involved in governance reform have been noted by many observers. "At best, civil service reform is a slow process," Bryant points out, (1993, 11), "not necessarily requiring much foreign exchange (which is what donors lend)..." thereby making it unattractive to ambitious managers in Country Operations Departments. Above all, it includes a "learning process," rather than a "blueprint" approach, which tends to be far more labor-intensive and expensive than is generally considered affordable. After all, most Bank staff continue to work out of Washington, D.C.; and they are shifted every three to five years. Without a considerable change in the incentive system, institutional and career goals will take precedence over the staff continuity required for the learning process approach (Bhatnagar 1992, 22). The complaints of the Bank's own Staff Association regarding "an assembly-line approach to project preparation," the overemphasis on quantitative goals involving the lending of large sums and



rapid disbursements, and the neglect of supervision and institutional development are found in an article by Clements (1993) but echoed in the OED 1992 EVALUATION RESULTS Report.

How the Bank handles these practical problems will determine its ability to reduce corruption. At the beginning of this report, I suggested that secondary corruption be considered somewhat similar to an illness, such as alcoholism. Using this analogy, Bank staff may have to approach the governments of LDCs much like social workers dealing with urban vagrants, not anticipating more than a slow step-by-step process. Berkman (1994, 12-13), in regard to technical assistance, argues for a "management by objectives" approach, with a "phasing out" process for the foreign experts and a "phasing in" process for the local counterparts. Such an approach will have to be combined with a sophisticated "institutional analysis" advocated by Steedman (1994, 18) "in the reality of socio-political, legal and bureaucratic contexts."

While we might also agree with Steedman that foreign advisors will probably continue to be needed for a long time, particularly in Africa, we can only hope that they bring to their work the same sensitivity and understanding that Klitgaard (1990) brought to his ordeal in Equatorial Guinea. Yet, such advisors need to be fully supported by the Bank in the terrible situation that they often face of having to maintain good relations with borrowers while stimulating sustainable economic and social development. They should be free to apply appropriate incentives and disincentives, possibly reducing funding or stopping projects affected by secondary corruption, without having their careers destroyed in the process. In this regard, Klitgaard (1989, 18) notes an incident in which a Bank official was forced to leave an African country for mentioning corruption by a Minister of Finance. What happened, we don't know. What should have happened was for the Bank to have HONORED its official and EXCOMMUNICATED that Minister of Finance!

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## OFFICE MEMORANDUM

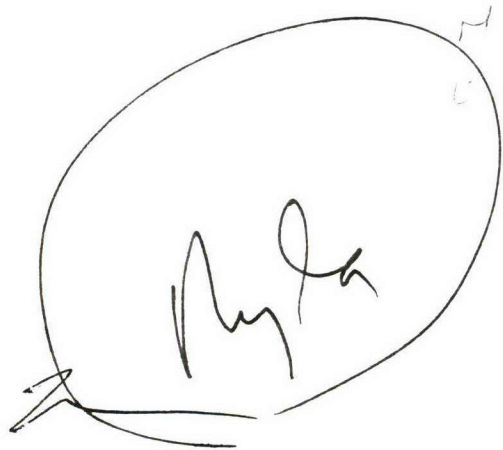
DATE: June 13, 1995

TO: Josephine Bassinette, President's Office

FROM: Kevin Cleaver, Director, Africa Technical Department

EXTENSION: 34595

SUBJECT: **Africa Region: Draft Paper on Corruption,  
and a regional action plan in response**



Mr. Junaid Ahmad informed the Africa Region Management team that Mr. Wolfensohn wishes to see the draft paper entitled "Corruption and its impact on Project Management", and the Africa Region Action Plan to deal with these issues. The draft paper, and the draft action plan, are attached.

The Africa Region of the Bank has long been aware of corrupt practices in African governments, and in donor financed projects. This is a part of the problem of development. Project supervision missions find and report such practices, as do audits undertaken for Bank projects. We have a variety of remedies when problems are encountered. Most often we seek remedy with more senior Government officials. Sometimes the remedy is the replacement of individual managers who are responsible. Sometimes it is requesting Government to suspend or take action against Government staff or private individuals working with the project but outside project management. When these traditional remedies do not work, we suspend loan disbursements, or even cancel parts of loans. In the worst cases, as recently occurred in Tanzania, our entire lending program is affected. Specifically, we put on hold new loans until satisfactory action is taken by Government to deal with the problem.

One of the staff in my Department, Steve Berkman, has had a long standing interest in corruption in Africa. He has become a one man zealot in identifying corrupt practices, and in encouraging his colleagues to address the problem forcefully. He produced the draft paper attached entitled "Corruption and its Impact on Project Management" to record his observations about how corruption occurs. This paper is not part of the Region's work program, and was undertaken entirely on Mr. Berkman's own time. We have asked him not to disseminate the paper outside the Bank as it is modestly damaging, and in the opinion of Africa Region management, somewhat exaggerated as to the degree of the problem in World Bank financed projects and in the lack of follow-up by Bank staff. The paper is better in identifying corrupt practices generally than in assessing the extent of the problem in Bank projects. Although Bank staff follow-up when corruption is identified more than Mr. Berkman allows, we believe that we need to do more, and to act more systematically.

In order to plan for more effective staff response to corrupt practices, Mr. Jaycox created a task force to develop an action program for the Region. Mr. Jaycox's decision was taken after consultation with Messrs Richard Frank, J. Muis, and a representative of the External Relations Department. I have supervised this task force. Mr. Berkman has been an active participant. The second attachment is the draft Regional Action Plan developed by this task force.

The actions proposed relate primarily to ways in which supervision missions can more effectively identify corrupt practices and deal with them. It recommends more systematic Bank response to non-compliance with financial covenants and procurement requirements, encouragement of anti-corruption policy in country dialogue, and greater attention to the development of country financial management capacity and audit capacity. It recommends a more extensive training program for Bank staff in these matters.

Mr. Jaycox and Mr. Denning met with the task force in late May 1995 to review the action plan. A representative of the Comptroller's office attended. The plan was approved, and the team was given the task of putting meat on the recommendations by indicating how staff and management are to carry them out. This work is well underway. We hope to have implementation arrangements spelled out by September. The obvious follow-up actions are already being implemented by operations advisors and procurement advisors.

In collaboration with the Managing Directors and Mr. Muis's office, we are thus taking steps to ensure that the energies of Mr. Berkman are channeled in constructive directions.

cc Messrs Jaycox, Denning, Ayub, Dia, J. Ahmad, J. Muis, Kaji, Frank



DRAFT  
AFRICA REGION ACTION PLAN

PUBLIC SECTOR FINANCIAL MANAGEMENT and PROCUREMENT:  
IMPROVING PERFORMANCE

Introduction

1. Increasing focus on governance issues in the Bank in general and in AFR specifically, has drawn greater attention to the importance of the proper management of public resources. Nowhere is this of greater concern than in the area of financial management and procurement whereby the flow of funds into, and out of, public sector institutions, is critical to the success of development lending operations and general assistance to borrowers.

2. Recognizing the need for further improvements in public sector financial management, AFR plans to increase our efforts in this area to ensure that public resources in general, and funds provided through the Bank's lending program in particular, are used as effectively as possible, with maximum transparency and accountability. To accomplish this in the coming months, we will seek to refine and improve the financial management tools and procedures that are already at the Bank's disposal as defined in the Financial Reporting and Auditing Task Force (FRAT) report and the Financial Accounting, Reporting and Auditing Handbook (FARAH). We will also seek to increase the use of these tools and procedures and most importantly, to make better use of the Bank's compliance regulations. It is proposed to accomplish these objectives through specific short term and long term actions as described below.

Short Term Actions

3. Immediate actions to be taken include the following:
- a. Project staff and borrowers to improve compliance with the current applicable financial management requirements including:
    - budget planning and execution
    - provision of counterpart funds
    - accounting, auditing and budget covenants
    - procurement policies/procedures
    - disbursement policies/procedures

- b. Increase Bank staff supervision and monitoring of the physical disposition of resources at the project level including:
  - supplier verification
  - delivery of contracted goods and services
  - use of goods and equipment as planned
  - execution of civil works
- c. Increase Bank staff supervision and monitoring of procurement including:
  - Statements of Expenditures
  - low value procurement
- d. Place more focus on project financial management (quality at entry) as emphasized in the FRAT and FARAH reports with special attention to the preparation and appraisal stages.
- e. Increase financial management training activities for borrower staff and TM's with emphasis on techniques for identifying fraud and appropriate corrective actions.
- f. Emphasize the Bank's response to non-compliance of financial covenants, procurement requirements, loan conditionalities and other fiscal requirements through stricter enforcement of remedial actions. Adherence to FARAH, procurement guidelines, and relevant OD's to be the guiding criteria.
- g. Establish procedures for a structured approach to desk reviews of audit reports and management letters by TM's and if necessary, by qualified auditing specialists.
- h. Establish formal reporting and information dissemination policies and procedures to permit timely and appropriate responses on the part of TM's and Bank management in cases of financial mismanagement and malfeasance.
- i. Emphasize and encourage anti-corruption policy formulation and enforcement in country dialogues.



### Long Term Actions

4. In addition to the continuation of the above short term actions, the following long term actions will be undertaken:

- a. Where relevant, provide greater coverage of in-country financial management capacity and performance issues in CAS', PER's, ESW, ARPP, CPPR and other non-lending outputs.
- b. Incorporate periodic regional internal reviews of compliance with applicable financial management policies and procedures.
- c. Conduct an analysis of staffing requirements and deployment in the area of financial management as defined in the FRAT report and implement its conclusions.
- d. Increase training activities for Bank TM's and borrower staff in financial management.
- e. Develop guidelines for an auditing framework for individual projects, including terms of reference for setting out specific scope and methodology for audits.
- f. Carry out country audit/accounting capacity assessments of audit firms and government audit agency suitability and performance as auditors for Bank assisted projects.
- g. Promote greater financial management accountability beyond the Bank's portfolio in Sub-Saharan African countries through the promotion of:
  - transparent and consistent accounting and auditing practices and financial reporting systems
  - independent auditing bodies as an essential part of public sector management efforts
  - projects to strengthen public and private sector accounting and auditing functions (e.g. Financial Sector Management projects, IDF grants, etc.)

h. Liaise and coordinate with other donors (especially with regard to broader sector investment operations) to implement a common approach for:

- Financial reporting requirements
- Assessment and selection of auditors
- Quality reviews of audit performance
- Establishing a common data base for financial information

Dominique Sjamsubahri, AFRSA  
Jean-Jacques Raoul, AFRSA  
Jean-Claude Fayd'Herbe, AFTCB  
Steve Berkman, AFTCB  
5/4/95



# CORRUPTION and ITS IMPACT ON PROJECT MANAGEMENT

## INTRODUCTION

1. The diversion and misuse of public resources is a fact of life in all societies and at all stages of development. While this condition is often examined in light of its moral, economic and sociologic aspects, its impact on the management of public sector projects is often overlooked. This aspect of corruption is of great significance in the development process as it poses enormous constraints upon the performance of public institutions.

Constraints which in many cases, prevent any success in building capacity, achieving institutional sustainability, or in the delivery of services to underdeveloped populations. Nowhere, is this condition worse, nor more damaging to progress, than on the African continent.

2. In examining this issue, it is evident that different groups tend to view it from different perspectives, thereby placing further constraints upon attempts to reduce its impact on economic development. In an effort to explore the various facets of this complex problem, the following paragraphs will attempt to define (i) the different forms of corruption, (ii) its affect upon public sector management, (iii) the ability of the Bank to respond to it, and (iv) options for dealing with it. For the most part, the observations, analyses, and conclusions that follow, are based upon the author's personal experience working on more than one hundred projects in sub-Saharan Africa over the past ten years, while additional viewpoints have been obtained from internal and external documents and articles on the subject.

## THE DIFFERENT FORMS OF CORRUPTION

3. What follows, is a sampling of corrupt practices that will not surprise any informed person. What is important however, is to understand the impact these activities have on the day to day management of public institutions. This sampling will then form the basis for further discussion of [the diversion of public resources for private gain] and how it affects the development process. The following examples are not in any order of priority, but are a composite selection of actual cases encountered in the Bank's lending operations in sub-Saharan Africa.

4. Contract Management. In many countries, it is a given condition, that no agreement between a private contractor and a public institution will be signed unless



some payment (in money, goods or services) is made by the contractor to the civil servants directly involved. Despite safeguards provided both in Government, and in Bank procurement regulations (ie; competitive bidding, review panels, inspection and audits), this practice diverts resources in the following ways:

- a. Outright Cash Payments. These can range from 10% to 30% of the cost of the contract, and may be arranged through (i) third parties (often to nationals based overseas posing as international firms)<sup>1/</sup>, (ii) local companies that are "supposed" to provide subcontracted goods or services, and sometimes by (iii) direct payments into foreign bank accounts. Typically, in order to cover the extra cost of these kick-backs, the contractor is forced to cut back on the quality and/or quantity of goods and services delivered. This is done with the tacit, and if need be, official approval of the civil servants involved, and the contractor usually has little trouble getting the necessary invoices and disbursement documents signed and processed by them.
- b. Overpricing. A variation on the above practice, involves contract overpricing. This is more common with local contracts which, when they are financed by project counterpart funds, are seldom supervised in detail by the Government or the Bank. In these cases, it is not unusual to find contract prices anywhere from two, to four or five times actual costs, and is usually accomplished by arranging for competing bids that are even higher than the chosen contract award. These higher competing bids may be submitted by (i) other contractors on the promise of future contract awards on the same basis, or (ii) non-performing companies (owned by the civil servants, their friends, or their relatives) that submit phony bids to create the impression of fair and competitive bidding.<sup>2/</sup>

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<sup>1/</sup> In one case, a winning international bidder on a \$25.0m contract was asked to employ a UK based national to ensure receipt of the award. The services to be provided by the national were of no use to the bidder, but his fee was to be \$3.75m (15% of the contract). There was ample evidence in this matter to show the complicity of the key civil servants involved in the award and management of the contract.

<sup>2/</sup> A typical scam involves contracts for maintenance or repair services which are poorly specified, time consuming to verify, and often very costly. In one case, over 30% of project counterpart funds were disbursed for various minor building repairs and maintenance which could not be verified, nor were they relevant to the project.



- c. Foreign Travel. In preparing contract specifications and/or terms of reference, civil servants often include foreign travel in the services to be provided by the contractor. This takes the form of (i) meetings at international locations, (ii) overseas training and study tours,<sup>3/</sup> and (iii) visits to equipment suppliers. While these activities can be legitimate in certain instances, there are numerous cases where large sums have been disbursed from contract accounts without proper justification or accounting.<sup>4/</sup>
- d. High Mobilization Fees. It is not uncommon for excessively high mobilization fees to be written into contract agreements. These fees (often between 40% to 80% of the contract price) are frequently found in local contracts, and wherever Bank oversight is marginal. Typically, the mobilization fee is paid immediately after the contract is signed, whereupon the civil servants are paid their kick-backs. Thereafter, the contractor has little incentive to proceed with the execution of the contract. As a result, some work is started but soon dwindles, and then often comes to a halt as the contractor disappears. After lengthy delays and feeble attempts to have the contractor (who is seldom, if ever, held accountable) return to work, the process is repeated, as the staff of the public institution seek additional funding to employ another contractor.

The overall impact of the above practices is to totally sabotage the effective management of contracted services in such a way that while scarce funds are diverted, unfinished civil works and other projects are left to rot. This is most evident in the many thousands of partially completed and/or otherwise unusable structures that can be found in various states of degradation throughout the continent. Thus, in addition to the contract funds siphoned off by the civil servants, the entire investment itself becomes victim to corrupt and ineffectual management with the result that

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<sup>3/</sup> In one case, a project director arranged for an individual (one-on-one) six week training course in "oral expression" in Paris for which \$40,000 was charged against the contract.

<sup>4/</sup> Over a three year period, one project director spent 80 days overseas on the pretext of verifying procurement activities which were managed by an international procurement agent. Records indicate that he seldom visited the vendors concerned, while the expenses for these trips came to over \$100,000 as charged against the project.



the goods and services contracted for, are seldom made fully or even partially available for use by the public.

5. Procurement. There are numerous ways in which public employees divert funds through fraudulent procurement practices. These practices are often interrelated with those in contract management as described above, and especially when the procurement of high cost items is involved. As with contracts, it is a given, that any purchases made by a public sector institution, will involve one form of kick-back or another as the following examples will show:

- a. Fraudulent Procurement. This is a common practice whereby purchase orders are generated to procure goods and services from complicit suppliers and/or from shell companies owned by civil servants, their friends, and/or their relatives.<sup>5/</sup> Invoices are submitted, approved and paid with little or no verification that the goods and/or services have been provided. In many cases, a few token items are delivered, while in others, nothing is delivered.<sup>6/</sup> In most cases, the prices for these goods and services are anywhere from two to five times competitive prices in the marketplace and in some cases, have even been beyond 1000% of market prices.
- b. Product Substitution. Whether through contract or general procurement, cases abound where higher quality/higher cost items are specified in purchase orders, invoiced, and paid for, while inferior goods are provided. This can involve changes in model numbers, changes in size and/or capacity, and even the provision of used equipment in the guise of new.<sup>7/</sup> This practice permits manipulation of competitive prices to provide greater margins for kick-backs and can be more prevalent where greater monitoring of the

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<sup>5/</sup> On one project, more than 50% of the local suppliers used to provide goods and services were not located at the addresses shown on the purchase orders and invoices, yet the project management and the tenders review committee had approved these suppliers as reputable and established firms.

<sup>6/</sup> In one case, sixty telephones were ordered, invoiced, and paid from counterpart funds, but only eight telephones were delivered for the eight person Project Implementation Unit office.

<sup>7/</sup> In one case, a purchase order for several pieces of new heavy construction equipment worth over \$250,000 was processed, yet used machines worth roughly \$60,000 to \$75,000 were accepted for delivery and paid for.



procurement process is carried out, but inventory verification is not.

- c. Excessive Quantities. Ordering excessive quantities of goods and materials is another way of diverting public funds. If the kick-back on one item is good, then ten items are that much better, and whether they are delivered or not is another matter. This practice also tends to be more common where quantities are consumed and difficult to verify (ie; office supplies, fuel, building materials, etc.). 8/
- d. Petty Cash and Miscellaneous Expenses. While individual cases of petty cash and minor procurement seldom amount to significant sums, in aggregate they can be a steady drain on the scarce financial resources of any African institution. They can range from the simple purchase of fuel for an institution vehicle whereby part of the purchase is put into jerry cans for private consumption, to inflated expense accounts submitted by senior civil servants.9/

The interesting thing about the abuses noted above, is that they occur within a variety of safeguards and control systems (ie; technical review committees, tender boards, inventory control, accountants and auditors) that should, but do not, prevent them. In fact, there is sufficient evidence to conclude that the more safeguards there are, the more abuse will occur. This is because more people are involved in the process, and thus have a stake in its success. Thus, everyone involved in initiating purchase orders, reviewing bids and prices, clearing invoices, issuing stores receipts, making payments, and managing the accounts, has a vested interest in maintaining the semblance of transparent procurement. Following from this, the amount of funds diverted through procurement becomes larger, as more and more individuals seek to collect their share of the pie.

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8/ In one particular case, a Water Board purchased a ten year supply of water treatment chemicals that had a shelf life of six months. By purchasing twenty times the amount needed, the management maximized their opportunity for personal profit, while purchasing materials that would soon be useless.

9/ In one case, a catering invoice was approved and paid for eighteen cups of tea and snacks in the amount of \$2700 (equivalent in local currency). In another case, a traveling project manager withdrew \$15,000 for "incidental expenses" (in addition to his per diem allowance) while on a one week mission to Washington.

6. Private Use of Public Resources. In addition to the various methods of diverting funds noted above, civil servants also divert both physical and human resources for their own personal gain in numerous ways. As noted in the following examples, the diversion of these resources poses additional strains on the ability of public institutions to perform their mandated functions:

- a. Use of Vehicles and Heavy Equipment. The private use and misappropriation of vehicles is one of the more widespread abuses by senior and mid-level civil servants. Vehicles desperately needed by field personnel to carry out their duties are routinely kept for the personal use of senior staff and their families <sup>10/</sup>, while construction equipment (ie; bulldozers, dump trucks, etc.) and its operators are often diverted for use on farms and other properties owned by themselves, friends or relatives. The cost of these actions is further increased by fuel and maintenance expenses which are borne by the institutions owning the equipment, not to mention the wear and deterioration while being used for personal gain.
- b. Repair of Privately Owned Vehicles and Equipment. Certain types of public institutions maintain workshop and repair facilities (ie; Ministries of Works, Transportation, Water Boards, Power Utilities, etc.) that are frequently used to repair privately owned vehicles and other equipment.<sup>11/</sup> These activities consume and/or occupy (i) worker time, (ii) spare parts, (iii) workshop supplies, and (iv) workshop space and equipment, that are all paid for by the institution. In many cases, parts are taken from government owned vehicles and equipment, for use on private repair jobs. Thus, in addition to the overt diversion of resources for these activities, the institutional vehicles and equipment are further rendered useless from the lack of usable parts and components.

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<sup>10/</sup> It is not unusual to find Bank funded vehicles, driven by civil service drivers, taking the children of senior staff to and from school each day, effectively taking the vehicles and the drivers out of service for roughly 25% of the working day for this one personal use alone.

<sup>11/</sup> In some cases, workshops can be entirely occupied with private repair work ranging from bicycles and motorcycles, to cars, taxis, trucks and buses, while desperately needed institutional vehicles remain sidelined and out of commission.



- c. The Use of Government Owned Housing. While African governments typically provide housing for senior civil servants, it is not unusual to find that they do not vacate after leaving the post for which the housing was provided. In other cases, housing owned by the government is overlooked in accounting and auditing exercises while they are rented out by senior officials. While the effect of these actions is more subtle, it nevertheless places further constraints on the government's ability to maximize its resources for the public good.
- d. The Diversion of Supplies and Materials. Generic supplies and materials (ie; construction materials, fuel, spare parts, etc.) procured by public institutions are often diverted for private use. This can range from a few sheets of corrugated roofing, to whole tanker truck loads of fuel.<sup>12/</sup> Spare parts, tires, batteries and other vehicle components are also popular targets for institutional theft. Given the difficulties of obtaining these supplies and materials in the first place, and the value of their foreign exchange component, the loss of these items seriously undermines an institution's ability to function.

While many of the above abuses are not as blatant as fraudulent contracts and procurement, they become a constant drain upon the institution, further preventing it from carrying out its mandate. As a result, vehicles and equipment in operating condition are not available, while those that are inoperable, cannot be put back in service due to missing spare parts. In other areas, power plants, water treatment plants and other public utilities, operate at less than full capacity (in part) because fuel, lubricating oil, and minor spares have been stolen.

7. Revenue Collection. Government institutions that collect monies from the public (ie; Customs, power utilities, water boards, etc.) are also prime targets for the diversion of funds by those who collect these monies. In this, each public employee at each stage of the collection process will attempt to divert some portion of the monies by:

- a. Preparing a bill of lesser amount and sharing the difference with the customer.

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<sup>12/</sup> In one case, a power utility recorded average monthly losses of 250,000 litres of diesel fuel from its power generating plant, yet did nothing to curtail the daily thefts openly conducted by its employees.



- b. Not billing and/or eliminating invoices and sharing the amount with the customer.
- c. Not entering paid amounts (either in their entirety or incorrectly) in accounts receivable ledgers.
- d. Improper transfer of funds, sidetracking funds while they earn interest, and foreign exchange manipulations prior to bank deposit.

These diversions of revenue can encompass large sums <sup>13/</sup> and are seldom, if ever, picked up by auditors.

8. Payroll Abuses. Another way in which resources are diverted from public institutions is through fraudulent payroll accounting. Typically, personnel rosters are inflated with the names of ghost workers, with paychecks going to friends, relatives, or fictitious names. Hidden behind poor personnel management practices, these abuses are widespread throughout the public sector.<sup>14/</sup>

9. The Interrelationship Between Corrupt Practices. As can be seen by the above examples, any public institution is quite liable to be plagued by many different forms of corruption at the same time. As each level of management and employee groups seeks to take their "share of the pie", outside political interests also seek to manipulate monies flowing to, and from, the institution for their own personal gain.<sup>15/</sup> Thus, while senior civil servants are seeking personal gain through contract and major procurement fraud, mid-level staff are arranging vehicle and building repair scams, while low level workers are stealing vehicle parts, tires, and fuel. The result of these actions in their totality is, in almost all cases, to completely negate any effective use or management of the institution's financial,

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<sup>13/</sup> In one case, out of revenue collections of \$64.4m, a customs agency deposited only \$40.2m and retained the \$24.2m for extra budgetary expenditures and distribution among its senior staff.

<sup>14/</sup> In the case of one parastatal, the Director of Personnel was unable to show exactly how many persons were employed, but estimated the number to be somewhere around 16,000. A confirmation of payroll records showed that roughly 20,000 persons were being paid each month. Yet despite these discrepancies, paychecks continued to be paid directly into unverified bank accounts on a monthly basis.

<sup>15/</sup> In one case, a Minister of Health arbitrarily ordered the Central Bank to transfer the accounts of a public hospital to his personal control without consulting and/or advising the hospital's Board or its chief administrator. The Central Bank illegally complied without the approval of the hospital's legally constituted Board, and the hospital was left without any further control of its finances.



physical, or human resources, which are usually already below minimum operating levels.<sup>16/</sup>

The enormity and extent of these practices within the public sector can best be demonstrated by the following summary of findings by an Auditor-General during an annual audit of a single Ministry of Finance. Of fifty five accounts reviewed by the Auditor-General;

- \* one account showed irregular procurement
- \* six accounts showed irregular payments
- \* fifteen accounts could not be verified due to missing, or unprovided documentation
- \* one account showed excessive overpricing
- \* four accounts showed improper contract awards
- \* six accounts showed that goods procured could not be verified through inventory records
- \* nine accounts could not verify revenue collected
- \* ten accounts could not verify revenue deposits

From this, one finds that only three of the 55 accounts were audited without incident, while the amounts involved in these irregularities came to more than US\$60 million. This, just in one year, in one Ministry. Even more interesting, is the fact that this information is published within the country each year, is available to the public, government officials, politicians, and the donor community, yet little, if anything is done with this information to address the corruption issue.

#### THE IMPACT OF CORRUPTION ON PUBLIC SECTOR MANAGEMENT

10. The problem with discussing corruption, is that it encompasses so many moral, legal, cultural, and political perspectives, that people tend to lose sight of the extremely damaging impact it has on the management and operation of public sector institutions. Whether corruption is just another way of redistributing wealth (as some would claim), an efficient way of "greasing the wheels" (a justification subscribed by some), or a way of compensating underpaid civil servants (as still others will say), it is a hard and inescapable fact that resources stolen from an institution reduce its ability to function. The more resources are stolen, the less the institution can deliver

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<sup>16/</sup> On one \$23.0m Bank project in which the Government was only able to provide roughly 30% of the required counterpart funds, the project manager and project accountant were found to be responsible for the diversion of almost all the counterpart funds provided (over \$1.0m) through various fraudulent practices. Despite concrete evidence of fraud provided by the Bank, the Government never accepted the Bank's findings, the monies were never returned, while the individuals were eventually transferred to other posts within the Ministry.



the services it is mandated to deliver.<sup>17/</sup> If this concept is accepted, then one must also accept that attempts to build institutional capacity will not succeed unless the corruption is dealt with in the same manner and intensity as other issues (ie; policies, planning, systems, etc.).

11. In order to address the corruption issue as it relates to public sector management, one must put aside the myriad excuses that concerned parties use to avoid taking concrete action. As far as the redistribution of wealth theory goes, it is only those few at the highest levels of power who really become wealthy. As far as "greasing the wheels", this certainly does not occur in Africa, for if it did, given the rampant corruption that exists on the continent, one would expect to see far more institutional success stories than we now have. And as far as compensating underpaid civil servants, one finds that those who steal the most, are those who do the least. So how can these actions continue to be excused in light of the overall degradation and failure of the African public sector?

12. Thus, if we dispose of the excuses, we must accept that corruption drains the very life blood of any institution, which is embodied in its financial, physical and human resources. Financial, in the diversion and manipulation of already meager budget allocations. Physical, in the theft and personal use of equipment, supplies, materials, and facilities. Human, in the lost productivity as public employees spend time corrupting the system, or are unable to work due to the corruption of others. Under these conditions, how can even the most honest and committed civil servants perform their duties when their management and co-workers are busy stripping the institution of its resources? Under these conditions, how can any investments in institutional development or capacity building achieve meaningful success or sustainability?

13. Finally, in looking at the corruption issue from a purely management perspective, one sees an endless stream of constraints that prevents even the most committed manager from managing effectively. The signing and effectiveness of contracts is delayed endlessly as various parties seek to obtain kick-backs. Contractors disappear after receiving high mobilization fees, or cheat on the quality of goods and services to make up for kick-back costs. Meager operating budgets are dissipated in the purchase of overpriced goods and services that are not essential to the institution's highest priorities. Salaries are paid to staff who are not present, or if they are, are underemployed due to lack of

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<sup>17/</sup> This impact can even have exponential proportions, as when a stolen carburetor (worth \$200) places a \$25,000 vehicle out of service, which in turn keeps a crew of six employees from working in the field, which in turn, further delays a large project operation.



supplies and materials. Equipment is rendered useless from having parts and supplies stolen. Revenue earned, is diverted from accounts receivable. And so on.

14. When these conditions permeate the institutional environment (as they frequently do), effective management becomes totally impossible. How then, can one expect to build institutional capacity, or strengthen management, by providing additional financial resources, technical assistance, policy advice, training, and all the other approaches that have been tried over the years, unless one also deals with the corruption factor? <sup>18/</sup> If the management of the African public sector is ever to become sustainable, it is imperative that corruption be dealt with on the same level as other development issues. This will require much greater accountability, transparency, and oversight by both governments and the donor community, than exists at present.

#### THE BANK'S ABILITY TO RESPOND TO CORRUPTION

15. The enormity of international donor aid to Africa<sup>19/</sup> is a critical factor in the corruption issue, for this aid either becomes a direct source of funding for corrupt practices, or frees up local funds for similar purposes. With billions of aid dollars flowing into the public sector, and with the existing propensity for corruption, it is to be expected that any and all activities connected with these flows, will be subject to abuse at all levels. How donors respond to the challenge of corruption, and its impact upon public sector management, thus becomes a key factor in the development process, for as noted earlier, it is not only the resources stolen that one must consider, but more importantly, the impact that the loss of these resources has on the utilization of remaining resources.

16. Because of the multitude of divergent interests in the development business, it is extremely difficult for a single donor, such as the Bank, to deal effectively with corruption as it relates to lending operations. While

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<sup>18/</sup> An interesting example of how this subject is avoided is found in a recent Bank study conducted on macroeconomic risk management in a country whose major source of income is from oil revenue. While expounding at length on exchange rate appreciation, market volatility, external shocks, risk transfer, and how the Government should manage its oil revenues, not one word is mentioned about missing revenue which, according to a recent international report, amounted to more than US\$12.2 billion between 1988 and 1994. This same report also indicates that roughly 10% of oil earnings continue to be paid into dedicated offshore accounts which are chiefly controlled by the Presidency.

<sup>19/</sup> As an example; Bank lending for FY92 and FY93 totaled \$6.8bn, while figures for 1991 show total donor aid at more than \$13.0bn.



governments appear to be intent on obtaining Bank financing for development, individuals within government are intent on using this financing for political and personal reasons that are often not in the best long term interests of the nation.<sup>20/</sup> Thus, while the Bank is intent on providing funds for development, these funds do not always translate into viable and/or successful projects.<sup>21/</sup> At the same time, other donors may seek to get on board with Bank lending by co-financing, or providing grant funds, for specific project components that may serve other agendas than those of the borrowers.<sup>22/</sup>

17. Thus, while the enormous extent and cost of corruption is tacitly acknowledged, and while numerous systemic, but often ineffective, safeguards are put in place to prevent it, it continues to seriously undermine the development of the public sector. This is due in part, to the fact that the Bank and the rest of the donor community have only recently begun to face the corruption issue head on and in the open.<sup>23/</sup> In order to expand upon this newly evolving recognition, one must fully accept that it is people, much more than systems, that cause corruption to exist. And unless people (on both the donors side, and the recipients side) are committed to dealing with corruption, systemic manipulation (ie; stricter accounting systems, audits, procurement regulations, etc.) can be helpful, but can never bring the present public sector chaos under control by itself. In this regard, an interesting and hopeful development is occurring in Uganda, where committed leadership at the highest levels is strengthening the Office

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<sup>20/</sup> This is evident in the numerous "white elephant" projects that are found throughout the region, and in the insistent requests by borrower staff for vehicles, overseas training, and other perks that are of much more benefit to the individual, than they are to the institution.

<sup>21/</sup> This is evident in the determination of lending operations that are more attuned to the availability of Bank funds, then they are to the borrowers ability to absorb them. Thus, Bank lending continues to outpace disbursements while also having an effect upon the overall negative transfer of funds to the region. While it is noteworthy that this condition has been recognized, and that some positive trends are emerging, the overall level of lending to the region is still well above the absorptive capacity of the borrowers.

<sup>22/</sup> Typical examples include the conditional co-financing of technical assistance, the provision of equipment, overseas training fellowships, etcetera, that may only be carried out by donor country firms and/or individuals. This can result in the the excessive use of costly expatriates, research that is seldom applied, the acquisition of overly sophisticated systems and equipment, irrelevant training, and other activities that bring little or no sustainable results to the development process.

<sup>23/</sup> This however, is still at an early stage, and has not yet reached a level of intensity or focus that the subject requires.



of the Inspector General to investigate, pursue, and prosecute cases of corruption.<sup>24/</sup>

18. How these various factors play out in the development and implementation of the Bank's lending operations may best be described through the following observations;

- a. The Political Excuse. Because corruption is so interrelated with national politics, and because the key borrower contacts are almost always politically appointed persons, it is difficult for Bank staff to raise the issue of corruption forcefully while attempting to process lending operations. Thus, any talk of corruption, if it should occur, is quickly dismissed by the recipients as interference in their local politics, while Bank staff are understandably hesitant to risk any confrontation that would delay lending operations. All this occurs under the general rule that the Bank can provide advice and assistance, as long as it does not get involved in politics.<sup>25/</sup>
- b. The Institutional Assessment. In all lending operations, the Bank conducts assessments of the recipient institutions to determine their management capacity and ability to achieve lending objectives. Typically, these assessments primarily focus on the resources needed to achieve project success and sustainability, but contain very little detailed evaluation of the institution's management culture and how managers and employees carry out their responsibilities and functions. In fact, if these assessments were more comprehensive and realistic, it is reasonable to conclude that a more selective lending program could have produced better institutional results over the past two decades.
- c. Counterpart Funds. As important as Bank funds are to project success, counterpart funds are equally important. For although they are of much smaller amounts, counterpart funds are critical to the day

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<sup>24/</sup> An interesting paper on this endeavor was presented by the Inspector General (Mr. Augustine Ruzindana) at a workshop in Kampala in November 1994.

<sup>25/</sup> This of course, is a selective issue, as the Bank frequently structures lending operations and places conditionalities in loan agreements that may at times, be contrary to the political interests or desires of the borrowers, but which they accept in order to qualify for the loans.



to day management of project operations. When however, these funds are not provided in their entirety, and when they are misused and diverted as noted above, project operations can be seriously affected. Despite recognition of this problem, the use (or rather misuse) of these funds is perceived as an internal borrower issue, and not something in which the Bank can, or should, intervene.<sup>26/</sup> As a result, little, if anything is done, and the abuse of counterpart funds on Bank funded projects continues to have a serious impact on the Region's portfolio.

- d. Getting the Project Approved. It is incredible to note that with occasional exceptions, lending operations are seldom rejected once they have been entered into the Bank's lending program. <sup>27/</sup> From the first instance when development funds are allocated, all tasks and actions that follow, are primarily geared to support continuation of the lending process. Project benefits are highlighted, while project risks are downplayed. Project objectives and outcomes are shown to meet critical needs of society and the economy, while past institutional history is poorly assessed and/or ignored. Vague statements are made about "management weaknesses", and most certainly, no assessments are made as to the impact of corruption upon the institution's health. Once the lending operation has gained its initial momentum, no appraisal report <sup>28/</sup> or review committee will reject it as being untenable. And it is in this way, that Bank funds flow to poorly managed and corrupted institutions.
- e. Financial Management Skills. While the Bank's main operational focus is on the provision and use

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<sup>26/</sup> A typical response by Bank staff, when confronted with evidence of stolen or misused counterpart funds, is "What can we do? After all, it's their money."

<sup>27/</sup> This is a critical issue, for in reality, it is very seldom that a borrower will approach the Bank with a reasonably coherent and developed project proposal. And although steps are being taken by the Bank to address this issue (ie; through developing greater client participation and ownership) the pressure to meet Bank lending quotas is still very dominant at the operational level. This is most evident in the nearly 100% success rate of appraisal missions, which almost always return with an approved project, no matter how badly the sector or the institution is being managed, and whether in fact there is any serious chance for success or not.

<sup>28/</sup> In reviewing hundreds of appraisal reports, the author has yet to see one report that recommended rejection of a specific project, or even a project component.



of its funds, its staffing composition tends to be very weak in terms of in-house accounting, financial management, and auditing expertise. <sup>29/</sup> Thus, while economists abound and smaller numbers of financial analysts exist, there tends to be very little true accounting and auditing expertise within its Africa Region ranks. As a result, and in addition to the disincentives noted above, Bank staff have very little professional interest in pursuing the time consuming and contentious issues connected with good financial management.

As can be seen from the above observations, despite the enormous impact that corruption has upon the health and management of public institutions, there are many reasons why staff avoid taking any effective action to deal with it. While privately recognizing the seriousness of the issue, they continue to be extremely hesitant to factor corruption into their assessments of institutional capacity and/or project feasibility. And, while criticisms of corruption are coming more into the open within the Bank, there does not yet appear to be a comprehensive plan to deal with it at any time in the near future. As a result, the wrong message is being sent to the politicians and civil servants, often acting out of personal interest in the name of their governments, that corruption is either tacitly accepted by the Bank, or at least is something the Bank does not wish to involve itself with. Under these circumstances, there is little evidence to show that the damaging impact of corruption upon public sector management, at least as a function of Bank intervention, will diminish over the coming years.

#### OPTIONS FOR DEALING WITH CORRUPTION.

19. Recognizing that corruption can never be eliminated entirely, but also recognizing that it is a critical constraint upon the effective management of the public sector, the Bank, if it is truly serious about governance, capacity building, and sustainability, should seek to address this issue when and where it can, and at whatever levels it can. Most importantly, a change must occur in the Bank's culture that will impact positively upon the borrowers cultures. That change must focus upon the proper management of institutional resources, with all the necessary commitment, safeguards and accountability that are

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<sup>29/</sup> At the end of 1993 there were eight accounting specialists employed in the Bank's Africa Region with a (FY93) portfolio of 656 projects and an undisbursed balance of \$13.1bn.



required.<sup>30/</sup> Borrowers must come to understand that the Bank is serious about financial management and that the flagrant abuse of public funds will no longer be ignored. For if this message is not fully understood by the borrowers, then one can only predict further deterioration of the public sector in Africa and with it, further deterioration of the Bank's portfolio.

20. Thus, the most effective actions that can be taken by the Bank to counteract corruption, involve greater focus on the assessments of management capacity and commitment, more realistic project design, and the day to day implementation of project operations, for this is where projects either succeed or fail. And while the Bank has begun to take steps in this direction, there is still a long way to go before real changes can occur. The following examples are not listed in any order of priority, but will serve as suggested actions in this regard:

- a. Financial Management Supervision. Although the Bank insists upon the establishment of accepted accounting systems and practices, oversight of these activities usually tends to be weak and inadequate. In order to improve this situation, financial supervision criteria should be established that would provide task managers with step by step guidelines on what to look for in project accounts,<sup>31/</sup> how to verify accounting entries, and how to address accounting problems. Supervision can also be enhanced through related actions as noted below.
- b. Computerized Accounting. Because handwritten ledger entries and general bookkeeping tends to be extremely poor <sup>32/</sup> in the public sector, all accounting on Bank funded projects (ie; special, project, and interest accounts) should be entered on pre-programmed computer diskettes that can be submitted for Bank supervision on a quarterly, or semi-annual basis. In this way, borrower staff will develop better financial management skills as entries will, of necessity, have to be made at the

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<sup>30/</sup> This is not presently the case, where project accounts are poorly kept, physical inventories are not verified, and audits are submitted so late as to render them useless.

<sup>31/</sup> This would primarily entail more intensive and more frequent spot checking of account entries and related documentation, in addition to periodic physical verification of goods and services procured.

<sup>32/</sup> It is not uncommon for ledger entries to be entered in pencil, frequently erased and re-entered, kept on separate pieces of paper and not entered, entered under different dates, and written in other ways not compatible with good bookkeeping practices.



time of transaction and with greater attention to accuracy. Borrower staff will also be aware that the accounts may be subject to a more complete review by Bank staff, who will have the time and the option to review them more thoroughly at headquarters, rather than conducting superficial reviews during supervision missions. This procedure would help to impose greater transparency in project accounting, and should not be confused with the present trend of financing more complex Management Information Systems (MIS) in institutional development components of lending operations.

- c. Institutional Thresholds. One of the major problems in assessing institutional implementation capacity, is how to determine management integrity and the point at which the institution will, or will not, be able to effectively manage donor inputs. This requires the establishment of minimum criteria and/or thresholds that must be met if an institution is to qualify for assistance.<sup>33/</sup> In this way, borrowers will be obliged to achieve at least minimum standards of institutional integrity if they wish to receive assistance, while the Bank will be able to assess more accurately, the chances for project success and sustainability.
- d. Audits. In addition to frequently being of poor quality and/or incomplete, annual audits are often submitted so late as to be useless as a management tool.<sup>34/</sup> Thus, by the time audits are received, evaluated, and responses are transmitted back to the borrowers, it is too late to take any effective action to correct financial management problems. In addition, management letters are frequently not submitted, or if they are, are frequently ignored. As a result of these auditing

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<sup>33/</sup> For example; an institution would have to account for at least 90% of its resources in order to qualify for assistance. Thus, if more than 10% of its employees could not be identified, or located, it would be below the threshold. If more than 10% of its revenue was unaccounted for, it would be below the threshold. As another example; if more than 20% of its procurement was found to be above competitive market prices, it would be below the threshold. These kinds of assessments can be done in an equitable manner so as not to exclude any reasonably viable institutions, and are relatively easy to conduct, when carried out by experienced staff.

<sup>34/</sup> A review of audit submissions on Bank funded projects for FY93 indicates that only 24% had complied with audit submission dates, with some being two or three years late.



failures, the auditing process is almost totally ineffective on most lending operations. In this regard, corrective action by the Bank should be integrated with stricter financial management supervision and computerized accounting as noted above. In this way, project accounting ledgers can be closed on time at the end of each fiscal year, and submitted on diskette to the auditors and the Bank simultaneously. The audit reports would then be submitted simultaneously to the borrower and the Bank for further action.

- e. Supplier Verification. As noted in paragraph (5) above, there are numerous instances (especially with regard to local procurement and where unknown international firms are involved) where shell companies are established primarily for the purpose of defrauding public institutions. By conducting periodic follow-up and spot checks of vendors and suppliers, the Bank would be in a better position to verify the integrity of project procurement. This requires more than a casual review of procurement documents and involves actual field visits to supplier locations when and where circumstances warrant. <sup>35/</sup> This subject might also be used as institutional threshold criteria as noted in paragraph (20.c) above whereby a certain percentage of dealings with such suppliers would be a threshold factor.
- f. Contract Management. As noted in paragraph (4) above, contract management requires more stringent guidelines in order to preclude abuse. While contracts are more strictly monitored under international competitive bidding (ICB) procedures, local contracts (and especially those financed by counterpart funds) tend to be poorly supervised. Standardized guidelines for mobilization fees would be effective in this regard, and as noted in paragraph (20.e) above, periodic follow-up and spot checks should be made of contractor facilities, equipment, staffing, and contract outputs when and where circumstances warrant. This subject might also be used as institutional threshold criteria.

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<sup>35/</sup> As an example; if twenty purchase orders, invoices and payments were made between supervision missions, or between accounting periods, then several suppliers would be selected for site visits, review of goods delivered, pricing, and inventory control. As these inspections confirm the integrity of procurement, the number of visits can be reduced accordingly, although spot checks should still be made from time to time.



- g. Financial Management and Procurement Skills. While supervision of financial management, accounting and procurement is reasonably straightforward, the skills, focus, and interest that most Bank staff bring to the task, is considerably less than that required to do the job effectively.<sup>36/</sup> In this regard, if the Bank is serious about building institutional capacity, strengthening management of the public sector, achieving transparency, improving disbursements, and otherwise making more effective use of its funds, then it must drastically increase the number of operationally deployed staff with accounting, auditing and procurement skills. The present ratio of Bank staff with these skills in the Africa region is totally untenable, and needs to be increased perhaps as much as five fold <sup>37/</sup> if there are to be any genuine improvements (as opposed to improvements in ratings) in the Bank's present portfolio.

21. While there may also be policy options that the Bank might wish borrowers to pursue in dealing with corruption, it is fairly evident that most governments have more or less adequate systems in place to deal with the problem, but lack sufficient commitment to adhere to them. If there is any policy option to be pursued, it should be a policy of the Bank to place greater emphasis upon more accurate and transparent institutional assessments, BEFORE approving specific lending operations. When institutions fall below certain established thresholds of viability, and where corruption precludes even minimum levels of management effectiveness, then lending should not proceed. In the meantime, the above options, in most cases, can be implemented within the framework of existing institutional regulations and safeguards, provided that staff time and skills are properly deployed to deal with this issue.

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<sup>36/</sup> This is also confirmed in the Financial Reporting and Auditing Task Force Report by ACTCO dated August 8, 1994.

<sup>37/</sup> This would bring the level to around 50 to 60 persons which, when translated to project operations, would allow one person to cover roughly 10 to 15 projects. Stated another way, this would translate to one accounting, auditing, or procurement specialist for each \$250.0m of the Bank's undisbursed funds in the region. While it is recognized that various professional groups within the Bank's workforce all clamor for additional staff (ie; sociologists, anthropologists, technical specialists, etc.) none can be more critical to the financial integrity of the Bank's lending operations than those in the financial management cluster. Thus, the above is not an unreasonable assessment when coupled with the workload of future lending operations, and is not recommended as an addition to present staffing levels, but rather as a true shifting of the skills mix in the region.



## CONCLUSIONS

22. While it is acknowledged that the issue of corruption is complex, contentious, and extremely difficult to resolve, there are nevertheless numerous ways in which it can be minimized, provided there is sufficient commitment to do so. While corruption is not merely an African phenomenon, it is clear that the people of Africa suffer more than any other region from the loss of national resources as a result of this cancer in the public sector. It is also clear, that there are two facets of the African management culture which contradict each other. The public sector culture is rapacious in its efforts to divert public resources for private gain, yet the private sector culture shows another side of the African manager that is efficient and effective in an extremely difficult environment.<sup>38/</sup>

23. In this regard, it is evident that the African manager is capable of effective management, provided that the institutional culture will permit such behavior. In order to change this culture, it is necessary for the borrowers and the donor community both, to make a much more concerted effort to address this issue. For it is only through local commitment combined with, and supported by, better control and supervision from the funding sources, that attitudes about corruption can begin to change. And it is only through more open discussion, that the truly damaging impact corruption has on the continent will be appreciated by all parties. If all the resources that have been diverted from the public sector over the past two decades had been used for economic development, instead of personal gain, it is clear that the decline of Africa would have been much less, and perhaps could have even resulted in some degree of positive growth. This did not happen however, and it is safe to conclude that if the issue of corruption in the public sector is not addressed with greater intensity, Africa's economic decline will continue, with or without improvements in other economic indicators.

Steve Berkman, AFTCB  
April 3, 1995

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<sup>38/</sup> In this, it is clear that in business dealings within the private sector (that is, between two private parties), African managers will not pay kick-backs on contracts, will not pay above market prices for goods and services, will not hire "ghost" workers, and will not do any of the other corrupt practices that are so common in the public sector. This supports the conclusion that African managers can conduct business with probity, when the environment is conducive to such behavior.



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