BANK-FUND

Facing the Rising Challenges of Corruption

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Corruption—the abuse of entrusted power for private gain—was not on the agenda at the birth of the Bretton Woods institutions, nor at their 50th anniversary. Today, however, it is a prime concern for all official multilateral development and economic organizations.

The scale and impact of corruption not only remain major challenges to the successful implementation of the missions of the Bretton Woods institutions but represent increasing threats to security, the environment, and the world's most vulnerable peoples. The 75th anniversary of the founding conference in Bretton Woods needs to be recalled a generation from now as the time when the World Bank and International Monetary Fund (IMF) committed to far more effective actions to confront corruption across all of their member countries.

Quantifying the costs of corruption is at best a matter of informed guesswork: the IMF estimates that it could be between US$1.5 trillion and US$2 trillion annually, or around 2 percent of global GDP.[1] Approximately two-thirds of the 180 nations surveyed for the 2018 Transparency International Corruption Perceptions Index (CPI)[2] were seen as having high to very high levels of corruption.

Still, the statistics and general surveys fail to reflect adequately the extent of the damage done by corruption. Corruption, to use the IMF's jargon, is a major macro-prudential concern. Put more bluntly, government-promoted corruption in scores of countries is distorting economic progress, misallocating budgets, rendering public procurement inefficient, entrenching poverty, threatening financial crises, and adding to environmental destruction.

The extraordinary economic difficulties faced by such countries as Nigeria, Pakistan, Ukraine, Venezuela, and many others are largely the result of high levels of kleptocracy—theft of government financial resources by senior public officials. In each of these cases, and many more, the World Bank and the IMF have critical roles in acting to reduce graft and strengthen public transparency in all aspects of government activity.

ACCEPTING THE CORRUPTION PRIORITY

It is useful to recall that the core reason for the meeting at the Brookings Institution in January 1982, which was to lead to the establishment of the Bretton Woods Committee, was an international development assistance (IDA) funding crisis. The development assistance needs of the poorest nations were formidable and, truth be told, one of the reasons was the extensive mismanagement and misuse of fiscal resources in these countries. While the World Bank did not use the word *corruption* at the time, securing efficient use of financial resources was a key component of the Bank's then new sub-Saharan African adjustment programs.

It was at that conference that then World Bank President A.W. Clausen[3] called on leaders of the private sector to come together to actively support the missions and goals of the Bretton Woods institutions. He not only stressed the core humanitarian challenges that IDA grants aimed to meet, but he argued that it was in the self-interest of the more prosperous nations of the world, together with the Bank's private-sector

1 See International Monetary Fund, "Corruption: Costs and Mitigating Strategies" (IMF Staff Discussion Note 16/05, International Monetary Fund, Washington, DC, May 2016); and Christine Lagarde, "Addressing Corruption with Clarity" (Address by IMF Managing Director Christine Lagarde, Brookings Institution, Washington, DC, September 18, 2017).

2 Data from Transparency International, Corruption Perceptions Index 2018, February 2019, https://www.transparency.org/cpi2018. The CPI is a poll of polls that calculates scores for the public perception of corruption in countries. A score of 100 indicates zero corruption; 122 out of 180 countries included in the report had a score of 49 or lower.

3 Comments made by A.W. Clausen at the Brookings Institution in early 1982 reflected his address to the World Bank's board of governors in Washington, DC, on September 29, 1981.

partners, that the poorer nations attain sustained economic success.

In 1988, when Barber Conable was the Bank's president, an important World Bank report on poverty in Africa explicitly noted the challenges that corruption posed to economic development. It stated, for example, that conditions in a number of African states were characterized by "a high level of corruption, misuse of funds, side payments to political allies, deportation of opponents, or a high level of coercion."[4]

Interestingly, former World Bank President Robert S. McNamara traveled from Washington to Berlin in May 1993 to attend the launch conference of Transparency International, the first global anticorruption nongovernmental organization. He stressed publicly at that time that one of his greatest regrets was not having made fighting corruption a major Bank priority when he served as president.

Finally, in 1996, corruption entered the lexicon of the Bretton Woods institutions. In his first year as World Bank president, James D. Wolfensohn concluded that the efficient uses of development assistance grants and credits demanded recognition of corruption risks and actions to mitigate those risks.[5] In 1997, under then IMF Managing Director Michel Camdessus, the Fund announced its commitment to anticorruption goals, and this was swiftly seen as an important part of fund conditionality in programs to countries embroiled in the 1997/98 Asian financial crisis. Under Wolfensohn's leadership, major diplomatic efforts in the latter part of the 1990s elevated anticorruption policies from oblivion to center stage on the agendas of all of the major multilateral development banks, including the regional institutions for Africa, Asia, and Latin America, as well as an increasing number of bilateral aid agencies.

MANDATE FOR ACTION

Within both the World Bank and the IMF, there has been a broad recognition in recent years of shortcomings in institutional anticorruption practices. For example, recognizing severe World Bank practical difficulties in investigating corruption in procurement contracting, the leadership of the Bank asked Paul A. Volcker to head a review committee.[6] Volcker had earlier headed investigations into corruption at the United Nations and drew on that experience to advocate tough new measures at the World Bank. His committee's findings were to contribute,

4 World Bank Economic Development Institute, "The Political Economy of Sub-Saharan Africa" (World Bank, Washington, DC, August 1988).

5 James D. Wolfensohn, "People and Development" (Annual Meetings Address, World Bank, Washington, DC, October 1, 1996).

6 Paul A. Volcker, Gustavo Gaviria, John Githongo, Ben W. Heineman Jr., Walter Van Gerven, and John Vereker, "Independent Panel Review of the World Bank Group Department of Institutional Integrity" (World Bank, Washington, DC, September 2007).

over time, to significant successes in the Bank's Integrity Vice Presidency unit and to the setting of standards for investigations and corporate suspensions that have become the model for the major regional development banks: the African Development Bank, Asian Development Bank, Asian Infrastructure Investment Bank, European Bank for Reconstruction and Development, and Inter-American Development Bank.

Managing Director Christine Lagarde launched a comprehensive review of the IMF's anticorruption framework, which concluded, in 2018, that the case is compelling for the IMF to deepen its work in this area considerably.[7] This comes at a time when both the IMF and the World Bank are bound to adhere to the UN's Sustainable Development Goals (SDGs), which came into force in 2016 and include, in SDG 16, the explicit call for all governments to "substantially reduce corruption and bribery in all their forms."

Meetings of global leaders at their annual G20 summit conferences in recent years have repeatedly endorsed the importance of multilateral institutions' pursuing anticorruption strategies. Unquestionably, the Bretton Woods institutions have a gold-plated mandate, but will effective action follow fine rhetoric?

The record of their performance in recent years has been mixed. Both institutions need to find ways to ensure that their approaches are more comprehensive and robust—in terms of implementation, monitoring, and enforcement.

ILLICIT FINANCE

Illicit financial flows across national borders, including proceeds from tax evasion, organized crime (notably narcotics), and government corruption, now amount to hundreds of billions of dollars. The US Treasury estimates that the United States alone probably receives an annual inflow of US$300 billion in laundered cash.[8] Excluding the proceeds of tax evasion, Global Financial Integrity estimates the annual volume of illicit cross-border financial flows at around US$1 trillion.[9] These funds add to poverty by robbing national treasuries of crucial resources to support domestic development, undermine sound regulation of the international financial system and weaken its institutions, and distort investment markets.

7 International Monetary Fund, "Review of 1997 Guidance Note on Governance—A Proposed Framework for Enhanced Fund Engagement" (IMF Policy Paper, International Monetary Fund, Washington, DC, March 2018), https://www.imf.org/~/media/Files/Publications/PP/2018/pp030918govpaper.ashx.

8 US Treasury, "National Strategy for Combating Terrorist and Other Illicit Financing" (US Treasury, Washington, DC, December 2018), https://home.treasury.gov/system/files/136/nationalstrategyforcombatingterroristandotherillicitfinancing.pdf.

9 Global Financial Integrity, "Illicit Financial Flows to and from 148 Developing Countries: 2006–2015" (Global Financial Integrity, Washington, DC, January 2019).

The IMF has played an important role in recent years in providing technical assistance to central banks to guard against money laundering.[10] Given the scale of the problem, however, the IMF should expand its work in this area and enhance its cooperation with other institutions, such as the Financial Action Task Force of the Organisation for Economic Co-operation and Development (OECD). The challenge will be all the more complex in coming years as cryptocurrencies play a rising role in illicit finance.

Far more extensive cooperation between the world's leading banks and the IMF on the stage of illicit finance is also warranted. While the banks have introduced increasingly sophisticated compliance systems to guard against suspicious transactions, the latest evidence, according to the US Treasury,[11] suggests that substantial sums of money continue to be laundered through the banking system. The IMF might well take the lead in bringing together the central banks and the commercial banks to forge better safeguards against all forms of illicit finance.

A number of major global banks have settled money-laundering cases brought by US and European authorities, paying record-level fines. More such cases are now being pursued, for example, with regard to Danske Bank, Deutsche Bank, and ING. Research by the G30 shows deficits at many major banks when it comes to ensuring that culture and conduct assign the highest priority to integrity.[12] The IMF needs to join with leading central banks by adding its voice to encourage leading banks to make greater commitments to anti–money laundering efforts and by stressing the dangers to the international financial system if this does not happen.

Importantly, IMF officials privately concede that they need to do more by explicitly raising issues of illicit finance with the governments of major Western developed economies, whose capital markets provide safe investment havens for so much of the illicit cash. Laws, and their enforcement, to reveal the true beneficial ownership of vast numbers of holding companies registered in offshore havens remain weak. Insufficient effective action is seen in the United States, the UK, and numerous other countries to require real estate brokers to pursue meaningful know-your-customer due diligence on their clients. The IMF should use its Article IV consultations as the mechanism to raise such issues with its leading shareholder member countries.

Curbing money laundering is—and this needs to be underscored—*an issue of international security.* Illicit cash funds

10 "The IMF and the Fight Against Money Laundering and the Financing of Terrorism" (International Monetary Fund Factsheet, International Monetary Fund, Washington, DC, March 2018).

11 "The IMF and the Fight Against Money Laundering."

12 The Group of Thirty, "Banking Conduct and Culture: A Permanent Mindset Change" (G30, Washington, DC, 2018); The Group of Thirty, "Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform" (G30, Washington, DC, 2015).

terrorism and the illegal export of weapons and weapons systems. Bribery and dirty cash are the enabling mechanisms for narcotics trade, ivory smuggling, vast product counterfeiting, and human trafficking that today enslaves a record of more than 26 million people. The imperative for the IMF, in particular, to work with many other players to find solutions and counter transborder illicit financial flows, needs to be a central priority in coming years.

LAW ENFORCEMENT

Laundered cash, of course, is the product of crime, including governmental corruption, and therefore the World Bank and IMF will need to push far harder and use their leverage to influence changes to public policy and public accountability in many of their member countries. For the Bank, the challenge starts with law enforcement. It has worked constructively over the years to help governments improve their court systems, establish anticorruption commissions, and take other supportive measures. But surveys in many of the world's poorest countries show that police extortion of small bribes from the poorest citizens is seen as the single greatest area of petty corruption. Why is this?

In part, the answer rests on the exceptionally low level of pay to police officers, which encourages them to supplement their incomes through extortion.[13] In part, the answer relates to systems in numerous countries that institutionalize police corruption. For example, reports from one country show that police units pay their senior officers high amounts on a regular basis for duty at airports, where they can engage with wealthy people; somewhat lesser amounts to be on duty on major highways, where they can "inspect" middle-income travelers and truckers; and in comparison, low amounts for assignments to poorer locations. And these senior officers, in turn, pay top criminal justice officials for these positions.

These entrenched systems prevail in part because public prosecutors and judges turn a blind eye—they are appointed to do so and are part of the corrupt systems. Ultimately, the World Bank, among others, faces not a technical but a political challenge when seeking to introduce integrity into law enforcement in many countries. When top officials and lowly police officers all know that they will not be prosecuted for corruption, then they indulge.

When James Wolfensohn decided that the World Bank must confront "the cancer of corruption," he challenged the Bank's lawyers, who argued that this was a political matter and thus in contradiction to the Bank's articles of agreement. Wolfensohn prevailed, and as we look ahead, the Bank's leaders

13 Transparency International and Afrobarometer, "People and Corruption: Africa Survey" (Global Corruption Barometer 2015/16/17, Transparency International, Berlin 2015). The survey covered 28 countries in depth.

need to assess how best to engage with national authorities on the complex political issues that are key to building systems of law enforcement that are honest, win respect, and serve as meaningful counters to both grand and petty corruption.

RECONSTRUCTION

The International Bank for Reconstruction and Development (to use the World Bank's formal title) started its work over 70 years ago by supporting post–World War II reconstruction. This mission continues to be important, as underscored by conditions in, for example, Afghanistan and Iraq, and the likely prospect in due course of massive reconstruction needs, to take further examples, in South Sudan, Syria, and Yemen. These countries at war have seen the breakdown of law enforcement and the emergence of extraordinary levels of corruption. The Bank and its multilateral and bilateral aid partners will be tested as they develop programs to secure the institutional capacity necessary to reestablish justice and effective anticorruption enforcement.

In each of these country situations, not only do the Bretton Woods institutions have direct roles to play as lenders, but they are central to convening international long-term undertakings. They have, indeed, opportunities to ensure that all creditors—multilateral, bilateral, and private-sector—place anticorruption activities at the core of reconstruction and development projects. Lessons from reconstruction and development programs in Afghanistan underscore that support for building institutions to ensure law enforcement is of paramount importance in reconstruction strategies. Reports by the US Special Inspector General for Afghanistan Reconstruction on both multilateral trust fund programs led by the World Bank as well as the bilateral programs of the United States—which have involved outlays of over US$10 billion and US$125 billion, respectively—stress that inadequate safeguards in this area can result in foreign aid inflows' increasing, not reducing, corruption.[14]

NATURAL RESOURCES

Corruption at the highest levels of government and in partnership with organized crime and multinational corporations is doing enormous damage in many resource-rich countries, from Angola to Malaysia. The humanitarian consequences are severe, as is evident, for example, in the rising numbers of refugees from resource-rich countries—Venezuela is an outstanding and tragic case. The country's once enormous

14 See quarterly reports of the US Special Inspector General for Afghanistan Reconstruction, particularly "Afghanistan Reconstruction Trust Fund: The World Bank Needs to Improve How It Monitors Implementation, Shares Information, and Determines the Impact of Donor Contributions" (SIGAR 18-42 Audit Report Afghanistan Reconstruction Trust Fund, Special Inspector General for Afghanistan Reconstruction, Washington, DC, April 2018).

oil-related income has failed to lift living standards; quite the contrary, the failures of government have created an extraordinary humanitarian crisis. Leadership in addressing such crises and their underlying causes needs to become a higher priority in the World Bank.

Research by the Natural Resources Governance Institute[15] shows that about 80 percent of the resource-rich countries that it surveyed were weak, poor, or failing in their governance of extractive industries. Programs that powerfully promote anticorruption actions provide clear paths out of abject poverty for most of the 1.8 billion people who live in these countries—nations that have, in many cases, been borrowers from the World Bank over several decades.

A study in 2013 by the African Progress Panel,[16] then chaired by former UN Secretary-General Kofi Annan, provided compelling details on the degree to which massive poverty in some 20 natural resources–rich sub-Saharan African countries is the major cause of extraordinary income inequality, with hundreds of millions of people trapped in humanitarian conditions that are among the world's worst. Public housing, schools, sanitary systems, and clinics are not being built because the revenues from extractive activities that should be used for these purposes are being plundered by top government officials and their cronies, and invested in the world's leading capital markets instead.

The failure to counter corruption in these countries contributes to environmental destruction, insecurity, and destitution, which leads to a rising tide of migration as global refugee numbers reach record levels. The destabilization of these economies, to a considerable degree due to corruption, has led to the rise of terrorist organizations, such as Boko Haram and al-Shabaab, and contributed to the massive violence in, for example, the Democratic Republic of the Congo and South Sudan.[17]

And with respect to the environment, consider illicit logging and its massive destruction of many rain forests, as well as the concomitant damage to indigenous peoples through organized crime syndicates that bribe government officials. This activity may well account today for as much as 30 percent of total global sales of wood products, with annual revenues

15 Natural Resources Governance Institute, "Resource Governance Index 2017" (Natural Resources Governance Institute, New York, 2017).

16 Africa Progress Panel, "Equity in Extractives" (Africa Progress Panel, Geneva, Switzerland, 2013).

17 For example, see "Jihad's Next Battleground: The Fight Against Islamic State Is Moving to Africa," *The Economist*, July 14, 2018; research by Sarah Chayes at the Carnegie Endowment for International Peace; and Tom Burgis, *The Looting Machine: Warlords, Oligarchs, Corporations, Smugglers, and the Theft of Africa's Wealth* (New York: Public Affairs, 2015).

equal to those of the international narcotics trade.[18]

In sum, the plunder of royalties, license fees, and profits from the extraction of oil, gas, and minerals in many countries directly results in extraordinary avoidable poverty, and the World Bank is better equipped than any other institution to launch a major multiyear campaign to address what is now an extraordinary crisis. The Bank has extensive data on the prevailing conditions and the threats. Its leaders are likely to be judged in coming years by how effectively they address these issues. Without a far more effective set of tools and a much sharper focus, the Bank will fail to meet its own goal, and that of the SDGs, to see the eradication of absolute poverty by 2030.

INFRASTRUCTURE DEVELOPMENT AND FINANCE

Such a failure to meet goals is also the inevitable conclusion if the World Bank and other multilateral development banks, including the new Asian Infrastructure and Investment Bank, fail to monitor and enforce anticorruption approaches in all aspects of their infrastructure lending. Infrastructure accounts for the largest share of approximately US$9.5 trillion of worldwide annual public contracting. According to the Open Contracting Partnership, "57 percent of foreign bribery cases prosecuted under the OECD Anti-bribery Convention involved bribes to obtain public contracts. According to a 2013 Eurobarometer survey, more than 30 percent of companies participating in EU public procurement say corruption prevented them from winning a contract."[19]

The World Bank and other multilateral and bilateral lenders have accepted opacity in some governments when it comes to public contracting and subcontracting. In some countries, military establishments have wielded exceptional influence, controlling large parts of national budgets and blocking the public transparency of many projects on the grounds of national security. Neither the Bank nor the IMF has publicly and explicitly challenged military establishments in its member countries over their extensive engagement in public contracting.

18 According to Professor Ray Fisman and Miriam A. Golden, "Interpol estimates that illegal logging—logging in violation of laws or regulations in the country of origin—contributes nearly a third of the wood on the global market, and somewhat between 50 percent and 90 percent of the volume of wood leaving the world's main producer countries in the Amazon basin, central Africa and Southeast Asia. The value of the illegal timber exports is comparable to the production value of the global drug trade." Fisman and Golden, *Corruption: What Everyone Needs to Know* (Oxford, UK: Oxford University Press, 2016). See also Interpol, "Uncovering the Risks of Corruption in the Forestry Sector" (International Criminal Police Organization, Lyon, France, 2016).

19 Open Contracting Partnership, "Why Open Contracting," accessed May 2018, https://www.open-contracting.org/why-open-contracting/. The Open Contracting Partnership is an advocacy and consulting enterprise.

Many of the largest cases brought against multinational corporations under the OECD Anti-bribery Convention and the US Foreign Corrupt Practices Act have involved kickbacks to foreign government officials in return for large-scale infrastructure contracts. For example, joint US and Brazilian investigations of Odebrecht, the largest construction company in Latin America, concluded that the firm paid bribes to government officials in possibly as many as a dozen countries in the region.

Many of the largest infrastructure projects involve significant financing from banks, and here, too, there is scope not only for opaque transactions but also for the banks and project contractors to evade environmental norms and standards. The World Bank has diverse partnership channels with private finance, from its cofinancing operations to the expanding portfolio of investments under the International Finance Corporation. The Bank needs to provide bolder leadership in its diverse ventures with private finance to emphasize transparency and ensure sound monitoring and enforcement of anticorruption standards.

Adding yet another level of complexity in public contracting is the fact that some of the largest corruption scandals, from Brazil to South Africa, have involved major state-owned enterprises (SOEs) that are large-scale infrastructure developers. Neither the World Bank nor the IMF has assigned noteworthy priority to monitoring for corruption in SOEs.

Recent internal research by the IMF on corruption and fiscal policy highlights this area, noting that top government officials' allocation of funds to SOEs may at times prove to be effective mechanisms for the officials' own enrichment, and also that SOEs play an important role in providing employment for corrupt associates of top politicians and officials. Finally, as the Petrobras scandal, for example, has revealed, SOEs are frequently used as prime sources of political party financing.

IMF research into fiscal affairs highlights corruption in both revenue collection (we have seen all too clearly in many countries, following one debt crisis after another, that governments have too often failed to collect tax revenues efficiently, with bribes to tax collectors being part of the problem) and the disbursement of tax revenues. Decisions by top officials to allocate resources in one area rather than another may be due to kickbacks and graft in general, just as decisions to allocate public contracts to one vendor rather than another may have similar causes and lead to overpaying for inefficient services.

FUTURE COLLABORATION

Thus, many of the particular aspects of corruption that emerge as areas of central importance to the World Bank and the IMF come together to force the conclusion that the coming years will test these institutions. As Managing Director Lagarde recognized, anticorruption approaches need to be mainstreamed into the work of the IMF. The World Bank needs to do the same—it cannot view good governance as just one of many areas of interest: it is integral to virtually all of the Bank's activities.

The Bank and the Fund will need to forge effective mechanisms for joint anticorruption structural adjustment programs. Partial reforms simply will not be adequate. To address one area of anticorruption work and ignore others would be counterproductive. Moreover, as the institutions move more explicitly to the heart of national governance issues in the interests of the overwhelming majority of the citizens of their member countries, they need to engage with citizens more directly.

In recent times, the IMF has sought to do just that in Ukraine, where it recognized that it needed to work with many stakeholders outside government to convince the government to put essential law enforcement reforms in place. During its work in Ukraine, the Fund has understood that overcoming political opposition demanded that it work in close partnership with a range of governmental and nongovernmental organizations in a continuing effort. The Fund is learning lessons from this experience that need to inform much of its future work in many countries and in cooperation with the World Bank.

The IMF's Christine Lagarde and the World Bank's new president, David Malpass, will be challenged in coming years to mobilize the skills and resources of their respective institutions to formidably strengthen anticorruption programs. They have no choice; corruption is a rising threat to issues that are at the core of the mission of the Bretton Woods twins: the soundness of the global financial system and the development of the human condition.