

5-1-1997

Corruption-A General Review With an Emphasis on the Role of the World Bank

Ibrahim F.I. Shihata

Follow this and additional works at: <http://elibrary.law.psu.edu/psilr>



Part of the [Criminal Law Commons](#), and the [International Law Commons](#)

Recommended Citation

Shihata, Ibrahim F.I. (1997) "Corruption-A General Review With an Emphasis on the Role of the World Bank," *Penn State International Law Review*: Vol. 15: No. 3, Article 2.

Available at: <http://elibrary.law.psu.edu/psilr/vol15/iss3/2>

This Article is brought to you for free and open access by Penn State Law eLibrary. It has been accepted for inclusion in Penn State International Law Review by an authorized administrator of Penn State Law eLibrary. For more information, please contact ram6023@psu.edu.

ARTICLES

Corruption - A General Review With an Emphasis on the Role of the World Bank

Ibrahim F.I. Shihata*

Table of Contents

I. Different Perspectives on Corruption	453
II. Corruption as I See It	458
III. Efforts to Combat Corruption	462
A. Economic Reform	463
B. Legal and Judicial Reform	464
C. Administrative (Civil Service) Reform	465
D. Other Institutional Reforms	467
E. Moral Reform	468
F. International Measures	469
IV. The World Bank's Efforts	474
A. The Bank's Growing Concern with Corruption Issues	474

* Based on a keynote address by Ibrahim F.I. Shihata at Jesus College, Cambridge, England, September 9, 1996. Senior Vice President and General Counsel, World Bank; Secretary-General, International Centre for Settlement of Investment Disputes. The views in this article are the personal views of the writer and should not be attributed to the institutions he works for. This article is based on a paper submitted to the Fourteenth International Symposium on Economic Crime at the Jesus College in Cambridge, England, held September 8-13, 1996. It was prepared with the assistance of Ms. Sabine Schlemmer-Schulte.

B. Ensuring a Corruption-Free Institution	478
C. Curbing Corruption Under Bank-Financed Loans .	479
D. Assisting Borrowing Members in Curbing Corruption	481
1. Policy Lending	482
2. Technical Assistance and Sectoral Investment Loans	483
3. Bank Grants	483
4. Seminars by the Economic Development Institute (EDI)	483
5. Bank Research	483
V. Conclusion	484

I. Different Perspectives on Corruption

Societies may differ in their views as to what constitutes corruption, although the concept finds universal manifestations. Experts have different perspectives on the meaning, causes, and effects of this universal phenomenon. While a few take an interdisciplinary approach, positions are more often influenced by the respective discipline. The literature on the subject is vast and diversified. Any attempt to summarize it here would not do it justice. It may be useful, however, to begin this paper by sharing with the reader some of the main findings based on that literature.

Some economic writings tend to define corruption as a situation where the benefit (to a corrupt agent) of acting against the expectation of a principal outweighs the cost, or where a public good, service or office is sold for personal gain.¹ Others describe it in terms of the exploitation of economic rents which arise from the monopoly position of public officials.² In either sense, to quote one economist, corruption "provides a market price where a market is not allowed."³ Economists find the causes of corruption embedded in the country's economic and administrative structures.⁴ They note its prevalence where government intervention exceeds its ability to intervene efficiently and where discretion in the allocation of public goods, services or subsidies is great, the risk of punishment is low and the pay-offs are sufficiently attractive. A broader view takes into account government policies (e.g. the level of civil service wages or import tariffs) and may further look into the honesty and integrity of both public officials and private individuals. Holding these factors constant, however, this view determines the incidence and size of corruption by the level of benefits available, the riskiness of corrupt deals and the relative bargaining power of its source and beneficiary.⁵ Economists are

1. See R. KLITGAARD, CONTROLLING CORRUPTION 22 (1988); A. Shleifer & R. Vishny, *Corruption*, 108 Q.J. OF ECON. 599 (1993); M. Naim, *The Corruption Eruption*, II BROWN J.W. AFF. 245, 248 (1995).

2. See M. BEENSTOCK, ECONOMICS OF CORRUPTION (1977).

3. R. Klitgaard, *Bribes, Tribes and Markets that Fail: Rethinking the Economics of Underdevelopment*, 11 DEVELOPMENT SOUTHERN AFRICA 481 (1994).

4. R. KLITGAARD, *supra* note 1, at 38-47; see E. Mason, *Corruption and Development* 17-30 (Harvard Institute for International Development Discussion Paper No. 50, 1978).

5. See S. Rose-Ackerman, THE POLITICAL ECONOMY OF CORRUPTION - CAUSES AND CONSEQUENCES (WORLD BANK, VIEWPOINT NOTE NO. 74, 1996) (hereinafter THE POLITICAL ECONOMY OF CORRUPTION), S. ROSE-ACKERMAN,

also concerned about the effect of corruption on growth and development. They see bribery, when freely offered and accepted, as serving the immediate interest of the parties to it. As for the interests of the society, some writers have found corruption an important source of capital formation, which could promote flexibility and efficiency in the market and advance entrepreneurship.⁶ Others have concluded, on the basis of questionnaires and interviews with businessmen, that a lack of political credibility (faith in the stability of government policies) was much more harmful than corruption, which they viewed "more as a variable cost than as uncertainty factor."⁷ Other economists distinguish between "efficient" and "inefficient" bribes depending on the underlying regulation, arguing that a bribe to avoid regulations which restrict competition increases efficiency.⁸ Beyond this efficiency argument, and in spite of the dearth of empirical research, an emerging consensus in modern economic writings seems to suggest that the *long term* effects of corruption on competition in the market, the investment climate and the people's welfare are disruptive and inequitable and that such negative effects tend to increase with the degree of monopoly in the provision of goods and services.⁹ The vested interests established through corrupt practices tend to weaken public institutions and

CORRUPTION 9 (1978) (hereinafter CORRUPTION).

6. See J. Nye, *Corruption and Political Development: A Cost-Benefit Analysis*, 61 AM. POL. SCI. REV. 421-22 (1967). Professor Nye, a political scientist, who approaches the subject from an economist's point of view, is one of the most quoted sources for the argument that corruption can be useful for a country's economy.

7. S. BORNER, ET AL., POLITICAL CREDIBILITY AND ECONOMIC DEVELOPMENT 58-61 (1995) (distinguishing between different forms of corruption and suggesting that some forms while having potentially serious distributional effects, may not be too damaging to economic activity as a whole).

8. See, e.g., N. Leff, *Economic Development through Bureaucratic Corruption*, in BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA: TOWARD A SEARCH FOR CAUSES AND CONSEQUENCES 325 (M. Epko ed., 1979) (hereinafter BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA).

9. See CORRUPTION, *supra* note 5, at 88; A. Shleifer & R. Vishny, *Corruption*, 108 Q.J. OF ECON. 599, 600 (1993); P. Mauro, *Corruption and Growth*, 110 Q.J. OF ECON. 681 (1995) (representing one of the few empirical studies finding a correlation between corruption and economic growth in the sense that the less corruption there is, the higher the GDP growth rate); P. WARD, CORRUPTION, DEVELOPMENT AND INEQUALITY 170 (1989) (emphasizing the negative effect of corruption on the income distribution in developing countries).

delay attempts to reform the system, thus inhibiting the development of new activities and reducing economic growth.¹⁰

Political science speaks of corruption as a symptom of more deeply rooted problems in the society's structure related in particular to the means of attaining and maintaining power and the weak or non-existent safeguards against its abuse. Accordingly, they address this phenomenon in different patterns of the exercise of power and of outsiders' political influence on public offices. For many political scientists, the main causes of corruption are to be found in political structures. Some attribute it to those structures which are characterized by the lack of democratic rule.¹¹ They are aware that widespread corruption can be found under democratic governments, but find assurance in the checks and balances inherent in a democratic system.¹² They also seek to develop ways to reduce the opportunities for political corruption, including collusion between legislators and bureaucrats, and to increase the awareness and participation of voters in the democratic process especially through the efforts of civil society.¹³ Political scientists differ on the effects of corruption, with some distinguishing between "integrative" (positive) and "disintegrative" (negative) forms of corruption.¹⁴ However, a growing consensus is also emerging among political scientists on the adverse impact of corruption on political and bureaucratic stability and efficiency. To quote one of them, "[corruption] privatizes valuable aspects of public life, bypassing processes of representation, debate and choice."¹⁵

Legal literature generally treats corruption in the context of the deviation (for private gains) from binding rules, the arbitrary exercise of discretionary powers and the illegitimate use of public

10. See S. Knack & Ph. Keefer, *Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures*, 7 *ECON. & POL.* 207, 227 (no. 3 1995).

11. See, e.g., G. MYRDAL, CORRUPTION - ITS CAUSES AND EFFECTS, IN *ASIAN DRAMA: AN ENQUIRY INTO THE POVERTY OF NATIONS* 951, 952 (vol. II, 1968) (a professor of economics writing this article from a political perspective); C. FRIEDRICH, *THE PATHOLOGY OF POLITICS: VIOLENCE, BETRAYAL, CORRUPTION, SECRECY AND PROPAGANDA* 127, 128 (1972).

12. See M. Johnston, Public Officials, Private Interests, and Sustainable Democracy: *When Politics and Corruption Meet*, in *CORRUPTION AND THE GLOBAL ECONOMY* 83, 67 (K.A. Elliott ed., 1997).

13. *Id.* at 24-27; ROSE-ACKERMAN, *CORRUPTION*, *supra* note 5, at 12.

14. See M. Johnston, *The Political Consequences of Corruption: A Reassessment*, 18 *COMP. POL.* 459, 464 (1986).

15. D. Thompson, *Mediated Corruption - The Case of the Keating Five*, 87 *AM. POL. SCI. REV.* 369 (1993).

resources.¹⁶ Lawyers address it in the implementation of economic, administrative and criminal law and in the performance of fiduciary duties in particular, noting its spread when law enforcement is weak and the probability of detection and punishment is low.¹⁷ They agree on its devastating effect on the rule of law which, through corruption, is substituted for by the rule of whoever has the influence or the ability and willingness to pay.¹⁸ They are particularly concerned when corruption reaches the ranks of the judiciary and distorts the system of justice.¹⁹ And they are increasingly aware of the need for rules to address situations of conflict of interests and for the protection of state assets from corrupt and fraudulent practices.

Sociology finds corruption a "social relationship" represented in the violation of socially accepted norms of duty and welfare.²⁰ Social scientists speak of it at times in patron-client terms. Some describe it as a form of "patrimonialism" which is strongest in societies where communities are small and interactive relationships are highly personal, and the need to accumulate "social capital" is great.²¹ Others consider it an indicator of a dysfunctional society. They generally attribute it to historical and socio-cultural factors resulting from conflicts between different groups and varied values within the society.²² It thrives, they say, in the conflict of values.

16. See, e.g., BLACK'S LAW DICTIONARY 345 (6th ed. 1990) (defining corruption as "[t]he act of an official or fiduciary person who unlawfully and wrongfully uses his station or character to procure some benefit for himself or for another person, contrary to duty and the rights of others").

17. See, e.g., R. Ogren, *The Ineffectiveness of the Criminal Sanction in Fraud and Corruption Cases: Losing the Battle against White-Collar Crime*, 11 AM. CRIM. L. REV. 959, 987 (1973); A. Morice, *Corruption, loi et société: quelques propositions*, 36 TIERS MONDE 41 (1995).

18. See, e.g., ROSE-ACKERMAN, CORRUPTION, *supra* note 5, at 81-83; A. Block, *American Corruption and the Decline of the Progressive Ethos*, 23 J.L. & SOC'Y 18 (1996) (noting that "there is a loss of faith in the United States of America today in public institutions because of the sense that they do not work as intended, for they . . . have been corrupted . . .").

19. See, e.g., M. Zalman, *Can We Cure Judicial Corruption*, 66 MICH. B.J. 365 (1987); J. Ramsyer, *The Puzzling (In)Dependence of Courts: A Comparative Approach*, 23 J. LEGAL STUD. 721 (1994).

20. See, e.g., M. Defleur, *Corruption, Law and Justice*, 23 J. CRIM. JUST. 243 (1995) (defining corruption as a "colonization of social relations in which two or more actors undertake an exchange relation by way of a successful transfer of the steering media of money or power, thereby sidestepping the legally prescribed procedure to regulate the relation.").

21. See V. Tanzi, *Corruption, Governmental Activities and Markets* (International Monetary Fund 1994).

22. See, e.g., J. Scott, *The Analysis of Corruption in Developing Nations*, in BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA, *supra* note 8, at 29, 31;

While they also recognize negative and positive effects of corruption, their more recent studies emphasize such negative aspects as adverse effects on development and on national integration.²³

Public administration specialists are concerned with bureaucratic corruption, even though they realize that this is but one form of a more complex phenomenon. They see corruption in the abuse of public resources and the use of public offices for private gains contrary to prescribed norms.²⁴ They say that it undermines the implementation (and sometimes the making) of public policy. They attribute it mainly to poor pay of public officials, monopoly of public services, wide personal discretion, weak financial control systems, excessive regulation and procedures, and the failure to build a strong internal culture of public service and ethics.²⁵ They also agree on its overall negative impact where the allocation of public goods and services becomes the privilege of who pays first or most.²⁶ They are particularly alarmed by the intrusion of political corruption into the bureaucracy and the possible collusion between politicians and senior bureaucrats against public interest.

Business organizations treat corruption mostly as a trade and investment policy issue. While they are concerned about its impact on the volume and cost of transactions, their major worry is the uncertainty it brings to business dealings and their inability to predict the outcome of competition when corruption is wide-

R. Braibanti, *Reflections on Bureaucratic Corruption*, in BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA, *supra* note 8, at 11.

23. See, e.g., *Introduction to Part III*, in BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA, *supra* note 7, at 307-09; W. Easterley & R. Levine, *Africa's Growth Tragedy: Policies and Ethnic Divisions 2* (World Bank Draft Working Paper, 1996).

24. See, e.g., G. Caiden & N. Caiden, *Administrative Corruption*, 37 PUB. ADMIN. REV. 301, 302 (1977).

25. See, e.g., A. BENT, *THE POLITICS OF LAW ENFORCEMENT: CONFLICT AND POWER IN URBAN COMMUNITIES* 3-6 (1974) (particularly discussing the cause of too broad discretionary powers of public officials); B. Schaffer, *Access: A Theory of Corruption and Bureaucracy*, 6 PUB. ADMIN. & DEV. 357 (1986).

26. See, e.g., *Introduction to Part III*, in BUREAUCRATIC CORRUPTION IN SUB-SAHARAN AFRICA, *supra* note 8, at 308.

spread.²⁷ Some, especially in developed countries, worry about its impact on company values and financial controls.

Practically *all people who publicly address corruption* condemn it, even though it would not exist at a wide scale without the participation of many. In the poor countries, most people take it as a fact of life, an unalterable part of the rules of the game which they have no choice but to accept. Their perception of its scope may even exceed its real dimensions.

Most people recognize corruption as an additional cost, which some consider necessary to get things done (and by doing so, contribute to making it necessary). Some see corruption broadly as a violation of human rights and, at the extreme, as a "crime against humanity."²⁸

All agree it may increase the wealth of those practicing it but almost certainly reduces the revenue of the state and the welfare of society as a whole.

Yet corruption in one form or another exists in varying degrees in all human societies. Like other immoral practices, its egregious manifestations have been recognized and condemned since old times in practically all cultures; it continues nonetheless to be widely practiced at all social levels.

II. Corruption As I See It

I use the word "corruption" here in a broad sense encompassing different forms of behavior. This behavior usually results from two types of situations. The first is where, in the allocation of benefits or even the mere allowance of opportunities, the temptation to realize private gains prevails over the duty to serve other interests which are usually common interests. And the second is where, in the application of rules, the opportunity to grant special

27. In its 1977 and 1996 Rules of Conduct, the International Chamber of Commerce (ICC), an international non-governmental organization having 7,000 member companies and business associations in more than 130 countries, condemns corrupt practices by member enterprises in connection with international commercial transactions because of their negative impact on international trade and international competition. See F. Heimann, *Combating International Corruption: The Role of the Business Community* in CORRUPTION AND THE GLOBAL ECONOMY 147 (K.A. Elliott ed., 1997). In 1995, under the auspices of the World Economic Forum in Davos, Switzerland, a "Davos Group" was formed to work on an agenda to catalyze the adoption of international standards for business ethics and regulation.

28. Corruption in Government 24 (United Nations 1990), TCD/Sem. 90/2, INT-89-R56 (Report of an Interregional Seminar held in the Hague, the Netherlands on Dec. 11-15, 1989).

favors undermines the general obligation to apply public rules without discrimination. In situations where rules are being circumvented, are applied with unwarranted differentiation, or are simply non-existent, a corrupt agent, acting on his own or at the behest of others, typically chooses to give preference to special interests over the broader interests he is legally required to serve. The resources put at his disposal or the office he holds are being used, or rather abused, in ways different from those set out by his principal. The principal varies according to the situation. It may be the agent's supervisors, the institution for which he works, the owners of such an institution or the public at large.

In this broad sense, corruption occurs when a function, whether public or private, requires the allocation of benefits or the provision of a good or service. The agent may have the opportunity to perform this function in the absence of any or adequate prior rules, substantive or procedural, and may thus have great discretion and a vast opportunity to make personal choices. He may also be acting when pre-established rules exist but chooses to violate them to achieve private profit for himself and his bribers. Alternatively, he may apply the rules as written but selectively, to benefit himself, his family, friends or whoever pays him for the favor. In all cases, a position of trust is being exploited to realize private gains beyond what the position holder is entitled to. Attempts to influence the position holder, through the payment of bribes or an exchange of benefits or favors, in order to receive in return a special gain or treatment not available to others is also a form of corruption, even if the gain involved is not illicit under applicable law. The absence of rules facilitates the process as much as the presence of cumbersome or excessive rules does.

Corruption in this sense is not confined to the public sector and, in that sector, is not confined to administrative bureaucracies. It is not limited to the payment and receipt of bribes. It takes various forms and is practiced under all forms of government, including well established democracies. It can be found in the legislative, judicial and executive branches of government as well as in all forms of private sector activities. It is not exclusively associated with any ethnic, racial or religious group. However, its level, scope and impact vary greatly from one country to another and may also vary, at least for a while, within the same country from one place to another. While corruption of some form or another may inhere in every human community, the system of governance has a great impact on its level and scope of practice.

Systems can corrupt people as much as, if not more than, people are capable of corrupting systems.

Some cultures seem to be more tolerant than others when it comes to certain forms of corruption, particularly favoritism and petty bribes. In some societies, favoritism is so pervasive in human behavior that those who, in the performance of their public functions, decline to favor friends and relatives are generally criticized as being unhelpful or unkind. Petty bribes are also seen in many countries as a charity, an advance incentive or expression of gratitude, or an acceptable substitute for the low pay of public officials - not the extortion it is recognized to be in other countries. Such cultural variations, though real, should not be taken as acceptable excuses for what is basically a corrupt behavior.

Corruption may be petty or grand, sporadic or systemic, casual or entrenched but the widespread practice of any of its forms has devastating effects in all societies:

- *In the application of law*, it creates a different law in practice from the one in the books. It transforms public rules and procedures based on democratic or meritocratic principles into ad hoc practices based on the willingness and ability to pay or on personal connections and reciprocated favors.
- *In the practice of government*, corruption turns the rule of law to a rule of individuals pursuing their private interests. It gives special interests priority over the public interest represented by majority rule. Its spread undermines public confidence in government and the government's ability to implement policies, leading to the weakening and possible disruption of democratic systems and in the extreme to the collapse of the public order. Collusion between political corruption and bureaucratic corruption is bound to accelerate this process. While this tends to destabilize political structures, spreading the benefits of corruption has often been used, however, as a stabilizing tool, especially under non-democratic governments.²⁹
- *In the working of most economies*, the impact of corruption is not less harmful, whether we look at market or non-market economies. While the phenomenon is complex and the cost may fall on other areas and in future times, corruption can endanger the use of economic choices, increase the costs of transactions, reduce state revenue, increase public

29. See Rose-Ackerman, CORRUPTION, *supra* note 5, at 80-1.

expenditures, penalize law abiders and produce adverse distributional effects. It is likely to tax the system in its entirety, although it works in particular against the poor and the underprivileged. Its prevalence could over time threaten macro-economic stability, raise the rate of inflation and push business into the informal sector. The scope and adverse impact of corruption, or at least the eruption of cases of corruption,³⁰ tend to increase in the periods of transition from non-market to a market system, and from a totalitarian to an open political system.

- *In the application of environmental rules and procedures*, corruption may enable those addressed by them, both in the public as well as the private sectors, to violate applicable standards, turning ideal environment laws and regulations into meaningless gestures for those who have the money or the influence.
- *In all cases*, and however you look at it, corruption deepens inequities. In doing so, it sows the seeds for social and political tensions, threatens the very fabric of society and undermines the effectiveness of the state and the political legitimacy of government.³¹

Once corruption finds its way in a certain place or sector, like a virus, it tends to spread out to other areas and sectors. It does not stop at political boundaries and it grows faster in environments of under-regulation or over-regulation. Corrupt and corrupting individuals have a vested interest in spreading the perception that corruption is dominant and prevalent. Through them, it becomes self-perpetuating. Foreign business, especially in developing countries, often contributes to the spread of corruption by assuming that pay-offs and connections are inevitable facts of doing business - an attitude which often turns out to be a self-fulfilling prophecy.³² If unchecked, corruption eventually distorts the values of the society, except for the few who manage to insulate themselves through strong moral shields, often based on strict religious and ethical values. Its effect on the society and on individuals in that society is thus as destructive as it is far reaching. Any short-term

30. See M. Naim, *The Corruption Eruption*, *supra* note 1, at 246 (1995) (arguing that the greater disclosure of corruption in recent years is a sign that democracy and markets are working).

31. See Rose-Ackerman, *THE POLITICAL ECONOMY OF CORRUPTION*, *supra* note 5.

32. Naim, *supra* note 1, at 255.

benefits it may bring (such as practically deregulating a heavily regulated economy or "greasing the wheels" of business transactions) will most likely be outweighed by the collective damage corruption is bound to bring about beyond the specific transaction at hand. Even at the transactional level, corruption often increases inefficiency in government projects and may raise the cost of public and private procurement alike. Quite often, large illicit payments, far from being invested in the country, are transferred abroad or diverted into other illegal business. Corruption may also increase the public debt of the country as a result of the higher cost of externally funded contracts secured through corrupt or fraudulent practices.

In short, corruption, in spite of some returns for its beneficiaries, retards the overall development of societies and their systems of governance. Historically, it declined with the rise of civilizations and increased with their fall. Its level and pace of growth may thus have an inverse relationship with the degree of development.

III. Efforts to Combat Corruption

Attempts to combat corruption may have a greater chance of success if they recognize from the outset the complexity of this phenomenon and the impossibility of eliminating it altogether. Those who are determined to fight corruption must realize that it results from forces which have accumulated over a long period of time and that it takes strong commitments as well as laborious and lengthy efforts to overcome such formidable forces. They are best advised to avoid simplistic solutions and the narrow approaches typically advocated in different social disciplines. A comprehensive approach encompassing the experiences of different disciplines and countries will inevitably consist of short-term and long-term measures which may have both domestic and international dimensions. It should address the economic, political, social, legal, administrative and moral aspects of the phenomenon and recognize the close linkages among these aspects. It must recognize that different types of corruption may need to be addressed by different strategies and methods. It cannot ignore that the prevalence of corruption is often based on deeply rooted causes related to the values with which people grow up and the system which governs their relationships, both among themselves and with their government. For this reason, a successful approach must also take into account the educational and mass communications' processes which influence such values and system of governance. The synergistic

effects of all the measures included in this approach are likely to produce positive results over time. However, curbing corruption requires continued commitment by an adequate number of people as well as an *a priori* acceptance of possible frustration and failure.

A comparative survey of the literature, including different attempts by governments to combat corruption, leads to placing the emphasis on certain areas of reform which may have particular relevance in this respect. Although these relate mainly to government action, there is also a need for complementary efforts by business groups such as the adoption of international and domestic codes of conduct and internal systems for compliance with applicable law and codes against extortion and bribery.³³ Nor should the measures stated below obscure the fact that efforts to combat corruption have a much greater chance of success when they are not confined to the high ranks of government but become the responsibility of the largest possible numbers of individuals, acting individually and collectively through non-governmental organizations.

A. *Economic Reform*

Although macro- and micro-economic reforms may not necessarily target corruption as a specific objective, they do have a major positive effect on the situations which give rise to it.³⁴ On the general level, the adoption of sound development strategies creates an environment of hope in the future in the economy as a whole. The loss of such a hope contributes to the shift towards corrupt practices for many of those who see in them the only chance for the betterment of their own conditions. Liberalization of markets, demonopolization of services, and deregulation (i.e. reducing regulations to the level needed to protect competition and ensure transparency and accountability) certainly decrease the opportunities for arbitrary and corrupt practices on the part of public officials. The positive effects of these measures, especially in areas such as foreign trade (imports and exports licenses),

33. See examples in "Corporate Anti-Corruption Programs - A Survey of Best Practices" prepared by the US Chapter of Transparency International in June 1996.

34. See, e.g., World Development Report - From Plan to Market 95-6 (World Bank 1996) (listing economic measures such as transparent privatization, liberalization, demonopolization of the economy, and deregulation as measures which, according to Bank experience, have produced the scope for corruption and are supposed to also have this effect, if applied, in transition economies).

taxation (tax structures and administration, including customs), and entry and exit barriers for investment have been proven in many countries. Such effects are clearest when these measures are coupled with the development or strengthening of institutions which supervise the proper implementation of remaining regulations and ensure their effectiveness. In the absence of strong and effective institutions, economic liberalization may become counter-productive. It may increase the chances for corruption and create a vacuum for organized crime to fill. Even privatization authorities and regulatory institutions can themselves be subject to corruption.

In addition to general economic reform measures, specific anti-corruption actions enhance the chances of success. These may include the imposition of user fees for government services (with a simultaneous increase in the salaries of public employees, practically replacing illicit bribes), or reducing the discretionary distribution of benefits (especially subsidized food and public housing allocations which can be delivered at market prices, with cash payments to the needy) as well as similar measures which, to the extent possible, replace administrative approvals with market mechanisms, thus obviating the need for influencing the officials in charge and reducing the scope for rent seeking. Governments must be careful however as all these measures may easily be exploited in the absence of efficient regulatory regimes and strong supervisory institutions.

B. Legal and Judicial Reform

Clarifying and streamlining the necessary laws and eliminating the unnecessary ones, strengthening the law enforcement capacity in the country while putting in place measures to ensure an efficient and just judicial process are not only general steps required for the creation of a sound investment climate;³⁵ they are also necessary for reducing the incidence of corruption.³⁶ Specific laws may also be issued to introduce a greater measure of transpa-

35. On the role of legal and judicial reform for private sector development, see I. SHIHATA, *THE WORLD BANK IN A CHANGING WORLD*, Vol. II, 127-82 (1995), Chapter Three (Legal Framework for Development and the Role of the World Bank in Legal Technical Assistance) and Chapter Four (Judicial Reform in Developing Countries and the Role of the World Bank).

36. See generally ROSE-ACKERMAN, *CORRUPTION*, *supra* note 5, Part II on bureaucratic corruption. See also World Development Report - From Plan to Market 95 (World Bank 1996) (identifying uncertain rules and heavy regulation in many economy-related areas as causes of corruption and calling for legal order to reduce corruption).

rency in government actions, to regulate procurement of goods and services for the government on a competitive basis and impose deterrent procedures on corrupting bidders, to create investigative, monitoring and evaluating authorities, to prohibit bribery of both local and foreign officials, and to impose severe punishment on both the giver and recipient of bribes, to end tax deductibility of bribes, to impose strict corporate auditing, accounting and disclosure rules, to forfeit corruptly gained assets and contracts, to protect witnesses and informers, and to reverse the burden of proof in cases of unjustified enrichment in order to facilitate the often elusive attempts to capture corrupt officials. Legislative action may also address political corruption by criminalizing bribery (and other advantages) of members of and candidates for law-making bodies and officials of public parties.

Such legislative anti-corruption measures may not be effective, however, in the absence of honest and efficient investigative and judicial bodies. Increasing the remuneration and training of clerks, prosecutors and judges and enhancing their career development opportunities as well as protecting their independence contribute greatly to the fight against corruption. The establishment of an anti-corruption commission, an ombudsman's office and the like may also be helpful, although experience has been mixed in this respect. Corruption is rampant in some countries with several such offices, filled with low-paid and ill-trained staff at all levels. Worse still, these offices have been actively used in some instances by incumbent governments against their political enemies.

C. *Administrative (Civil Service) Reform*

As in the cases of economic and legal/judicial reforms, general administrative reform (especially in the revenue-collecting departments) can significantly reduce corruption.³⁷ Reform of the civil service may also include specific measures which directly address this phenomenon. Obviously, the issue here is not merely the reduction of the size of the civil service, necessary as this may be.

37. See generally ROSE-ACKERMAN, CORRUPTION, *supra* note 5, Part II on bureaucratic corruption, and World Development Report - From Plan to Market 95-6 (World Bank 1996) (listing some administrative reform measures such as the strengthening of oversight and appeal mechanisms, as well as the increase in public officials salaries, etc. as efficient anti-corruption efforts). See also Corruption in Government 12-17 (United Nations 1990), TCD/Sem. 90/2, INT-89-R56 (Report of an Interregional Seminar held in the Hague, the Netherlands on Dec. 11-15, 1989).

The required general reform includes as well all the measures needed to ensure *efficiency* and *honesty* of the civil service. Of particular relevance are:

- the restructuring of the civil service to make it responsive to actual needs;
- the streamlining of administrative rules and procedures, especially by eliminating meaningless approvals and programs riddled with corruption;
- the introduction of competition between government agencies and the private sector in the delivery of public services and the supply of goods;
- the professionalization of the service through adequate remuneration (especially for officials with discretionary powers over distribution of benefits), continuous training, skilled management, objective systems of recruitment and promotion based on qualification and performance and improved definition of tasks and work standards;
- the promotion of ethics in the civil service through the enactment and enforcement of clear rules governing conflicts of interest, elaboration on expected behavior, obligatory disclosure of assets and investments above a certain threshold (including those of dependents) and meaningful sanctions in cases of violation;
- paying special attention to the selection of managers, both from the professional and ethical viewpoints, and applying to them an effective system of incentives and sanctions;
- increasing the public's awareness of their rights to government services and the channels available to them for submission of complaints, while strengthening the capacity of these channels and access to administrative and judicial remedies;
- introducing an effective system of financial management, including serious and timely record keeping, auditing and supervision of performance, especially in the procurement of goods and services and the execution of public works;
- adoption of clear legislation and regulations on public procurement generally based on the principle of competitive bidding;
- adequate regulation, staffing and equipment in the agencies in charge of combating tax evasion and money laundering, including rewards and punishments needed to ensure effective compliance and implementation; and

- creation of oversight bodies and offices of client advocates to receive complaints from the public, as checks and balances throughout the bureaucracy.

Such general administrative reforms may also be complemented by specific anti-corruption techniques, such as creating several offices to provide the same function (e.g., to issue driving licenses or passports), in order to reduce the monopoly rents of a single outlet and allow the public to opt out of the corrupt ones. They may also include anti-corruption measures, such as anti-bribery laws which impose penalties representing a multiple of the marginal benefits of the pay-offs, not just the amounts paid or received, in addition to mandatory dismissal of corrupt officials, and the disqualification (from bidding for government contracts or services) of corrupt firms or individuals and regulating the payment of commissions for public contracts with a view to limiting them to appropriate remuneration for legitimate services, if not eliminating them altogether.

D. Other Institutional Reforms

The above reforms may not produce their desired effect in the absence of a system of government endowed with adequate checks and balances to prevent collusion between the separate branches of government and the emergence of *de facto* centers of power which act above the law. Depending on the circumstances of each country, the introduction of such a system may require a massive effort of political reform, along with broad access to information and a free press. This, of course, may not always be feasible and cannot at any rate be sustained if it is merely imposed from the outside. However, political reform may gradually develop from within the society, through the elimination of illiteracy, the strengthening of the education system, the development of civil society, the liberalization of economy, the building up of the citizens' confidence in their state's political and economic system, and the adoption of measures of legal and judicial reform to establish the rule of law, especially with emphasis on the due process of law.

Nothing in the above suggests that democratic governments are immune from corruption; it simply indicates that the more checks and balances exist within a society, and the more strong institutions are in place to protect such checks and balances, in an overall environment of liberalization, the fewer opportunities there may be for corrupt practices which remain unchecked or unpunished.

Electoral laws can also be used to curb political corruption. They should regulate political contributions and provide for their disclosure. Immunity of members of Parliament should not be invoked in cases of alleged bribes or extortion to them or by them.

E. Moral Reform

Underlying all reforms is the commitment of the reformers, the pressure from the civil society that sustains this commitment, and the ability of the leadership to influence the public. This usually requires high moral standards at the leadership level. Such standards normally reflect the common aspiration of the society and are often embedded in the teachings of its predominant religion and ethics. It is not uncommon, however, to note a wide gap between such teachings and peoples' day-to-day behavior. Rather than attempting to narrow this gap through a combination of reinterpreting the teachings and reforming the behavior, most societies are content to live with it and to see it widening further over time. The effect on the level of corruption is then inevitable.

If corruption becomes rampant, combating it would require a major change in moral behavior. The issue here is hardly the lack of an agreed set of moral values, but rather the prevalent hypocrisy which confines these values to public postures, with little impact on daily behavior. While a new moral movement, with or without religious underpinnings, may emerge from time to time, it cannot be always relied upon as a practical remedy. The attitude of the elite in power can have demonstrable effects, however. The behavior of parents at home, teachers at school, and political leaders in and outside government inevitably influence the behavior of a new generation. An ideology of austerity may be useful in a poor society, but not if it is required only from the poor. Religious teachings may also have little effect if the public has little faith in the degree of their observance by those who are more privileged in the society or by the religious establishment itself.

F. International Measures

While domestic measures of reform such as those already mentioned may help in checking corruption, certain corrupt practices defy remedies by domestic measures alone. International collaboration is particularly needed with respect to activities which by their very nature are transboundary, such as corruption in international business transactions and money laundering (especially in connection with illicit narcotics trafficking). It is required in

particular to enhance the capacity of states which need assistance in combating corruption and to strengthen mechanisms for exchange of information and for mutual assistance in the investigation.

It should be noted, however, that international measures addressing corruption are still in their infancy. Apart from the international measures for the criminalization of money laundering which started with the 1988 *UN Convention Against Drug Trafficking*,³⁸ other international measures are the product of more recent years (with the exception of the abortive attempt of the UN Commission on Multilateral Corporations referred to later on). Mostly regional in character, these measures have, for the most part, taken so far the form of draft agreements or non-binding recommendations.

At a universal level, the UN Commission on *Transnational Corporations* completed in 1978 a draft *International Agreement on Illicit Payments*. Covering both active and passive corruption, this draft requires the criminalization of corruption in international commercial transactions and establishes the jurisdictional basis for the prosecution of this offense. It requires the parties to provide for the obligation of transnational corporations to keep accurate records of payments related to their international transactions. It also requires civil sanctions for corrupt practices and mutual assistance among the states parties to it. Late in 1995, the UN resolved to reconvene work on this draft agreement. In December 1996, the General Assembly of the United Nations has also adopted a *Declaration Against Corruption and Bribery in International Commercial Transactions* by which states pledged to criminalize bribery of foreign public officials and to deny the tax

38. Reference is to the UN Convention Against Illicit Traffic in Narcotic Drugs and Psychotropic Substances which was open for signature on Dec. 20, 1988 and entered into force on Nov. 11, 1990. This convention establishes that illicit trafficking in drugs and laundering of the proceeds from such trafficking shall be criminal offenses in the state parties. The Convention also requires parties to it to render mutual legal assistance with respect to the prosecution of the just mentioned offenses and particularly with respect to search and seizures. International measures against money laundering include, in addition to the above-mentioned UN Convention, the 1988 Statement on Prevention of Criminal Use of the Banking System for the Purposes of Money-Laundering issued by the Basle Committee on Banking Regulations and Supervisory Practices, the 1990 Council of Europe Convention of the Proceeds from Crime (in force), the 1991 EC Directive on Prevention of the Use of the Financial System for the Purpose of Money Laundering (in force), and the 1990 Forty Recommendations of the Financial Action Task Force (FATF) (created by the G-7 Summit in 1989) on Money Laundering. The Forty FATF Recommendations were revised in 1996.

deductibility of bribes paid by any private or public corporation or individual of a UN member state to any public official or elected representative of another country.

Recently, a Government Procurement Agreement covering the purchase of goods and services including public works and public utilities was prepared by the World Trade Organization (WTO) to ensure that the international procurement process was open and transparent. Only 24 WTO members are parties to this 1994 agreement which entered into force in January 1996. In the meantime, participants at the WTO ministerial meeting in December 1996 have agreed to negotiate an interim procurement arrangement on transparency, openness and due process in government procurement until such time as the 1994 agreement is more widely accepted. A Working Group on Transparency in Government Procurement has been established to facilitate the negotiation of this interim agreement.

At the OECD level, two recommendations to governments have been adopted. The 1994 Recommendation is directed against "bribery of foreign public officials in connection with international business transactions." Recommending the extra-territorial application of bribery law, the Recommendation suggests the criminalization of bribery and making its acts illegal in terms of civil, commercial and administrative laws and regulations, along with eliminating the indirect favoring of bribery in tax laws and introducing company and business accounting requirements and banking regulations to facilitate inspection and investigation as well as the denial of public subsidies, licenses, and other public advantages in cases of bribery. The 1994 Recommendation also provides for cross boundary cooperation and consultation among the relevant authorities, regular reviews, and international legal assistance. By contrast to this broad recommendation, the 1996 OECD Recommendation is confined to the prohibition of tax deductibility of bribes to foreign officials - a practice which seems to have been tolerated earlier outside the United States.³⁹ In May 1987, the members of the OECD agreed to draft a treaty by the

39. It is interesting to note in this respect that the new Trans-Atlantic Agenda (TA), a product of the 1995 United States-European Union Summit, urged EU members to combat illicit payments by implementing the 1994 OECD Recommendation. The private sector counterpart to the TA, the Trans-Atlantic Business Dialogue, later formed a separate issues group to deal exclusively with bribery and called on governments "to implement promptly the 1994 and 1996 OECD recommendations."

end of this year which would make it illegal for firms from member countries to bribe foreign officials.

At the regional level, several multilateral attempts to curb corruption have taken place. Among these is the one multilateral anti-corruption agreement which has been signed by 23 countries and has actually entered into force, the 1996 *Inter-American Convention Against Corruption* prepared under the auspices of the Organization of American States (OAS). This regional convention is open for accession by non-OAS members. It requires the states parties to take action against defined corrupt practices both within their territories and, subject to their respective constitutions, those committed by nationals and residents abroad. As defined in the convention, the actions to be outlawed cover corruption both in its active form (the offering or granting of any article of monetary value or other benefit to a government official in exchange for any act or omission in the performance of a public function) and passive form (the solicitation or the acceptance by a government official of such article or benefit for the same purpose). It also covers the fraudulent use or concealment of property derived from the afore-mentioned acts, the participation, in any manner, in their commission or attempted commission, and other acts of corruption which the states parties agree to include under the Convention. Subject to the constitutional law of each member, the Convention equally covers the offense of "illicit enrichment," that is any unexplained significant increase (in relation to lawful earnings) in the assets of a government official. (The U.S. delay in signing the Convention has been justified by the possible inconsistency of this latter requirement with the constitutional protection in the US against self-incrimination.) In addition to requiring that such acts of corruption be established as criminal offenses, and providing the jurisdictional basis for such state actions (including the possible extra-territorial application of bribery laws), the Convention also provides for mutual assistance among the agencies of the states parties in the investigation and prosecution of acts of corruption and in the tracing and seizure of their proceeds. It prohibits states parties from invoking bank secrecy as a basis for refusal to provide such assistance.⁴⁰

40. In June 1996, the Council of Securities Regulations of the Americas adopted a resolution on efforts to combat bribery of government officials by publicly held companies and to develop and promote laws that address such illicit payments, to strengthen auditing, assist in enforcing securities laws and improve access by securities regulators to investigatory information.

The charter of the *North American Development Bank*, established under NAFTA, requires companies seeking loans from that Bank to certify that they have not engaged in bribery and to state that they have not been convicted of bribery within the past five years.

A number of *European draft conventions* are also worth mentioning. These include the two 1996 draft conventions which the Multidisciplinary Group on Corruption of the *Council of Europe* has still to finalize. The first of those is the draft *Framework Convention on Corruption* which focuses on the criminal law aspects of this phenomenon, requires the parties to outlaw corruption (and the laundering of its proceeds) "at home and abroad," and prohibits the granting of tax deductions for bribes or other economic advantages linked to corruption "whether benefited at home or abroad." It also requires parties to adopt "appropriate legislation" for the procurement of public goods and services and for the restructuring of administrative procedures as well as codes of conduct for elected representatives, freedom of the press, auditing of businesses and the establishment of appropriate civil law remedies for victims of corruption.

The second draft convention of the Council of Europe is the draft *Convention on Corruption*. Unlike the previous one, this draft convention provides a detailed definition of the forms of corruption covered by this term. Those include both active and passive bribery as well as the trading in influence over the decision-making of public officials and money laundering. It is not limited in scope to public officials. Also covered are private, including foreign, entities, and senior officials of international organizations, elected representatives of international bodies and judges and officials of international courts. The latter draft convention also provides for cooperation and assistance between the parties in the investigation of corrupt acts and in the confiscation of their proceeds and the provision of additional remedies for their victims.

Other European initiatives include first a *Protocol on Corruption to the EC Convention on the Protection of the Communities' Financial Interests* which was signed by the EU-Member States in September 1996 and which criminalizes corruption in which community and national officials are involved damaging or likely to damage the European Communities' financial interests. Another *Convention on the Fight Against Corruption Involving Officials of the European Communities as Officials of Member States of the European Union* has recently been signed by the Member States. This Convention required EU Member States to make active and

passive corruption involving community officials or officials of the Member States a criminal offense. Corruption, committed by or against government ministries, elected members of national parliaments, members of the highest court or the court of auditors, members of the Commission of the European Communities, the European Parliament, the Court of Justice and the Court of Auditors of the European Communities has equally to be criminalize according to the Convention. The Convention also includes a provision requiring Member States to hold heads of businesses for the corrupt acts of persons under their authority criminally liable.

At a less formal level, the *International Chamber of Commerce* issued in 1996 a revised version of its 1977 *ICC Rules of Conduct* as a set of legally non-binding rules of ethical business conduct. While these Rules appeal to public international organizations, such as the World Bank, to take measures to combat corruption, they basically address the behavior of member corporations.⁴¹ They prohibit corruption in a broad sense which includes extortion, bribery, kick-backs, payments to agents which represent more than the appropriate remuneration for legitimate services and contributions to political parties or committees or to individual politicians if undisclosed and made in violation of applicable law. The Rules also require proper financial recording and auditing by the enterprises and introduce control and review procedures within each enterprise to ensure compliance and sanctions against the responsible director or employee contravening the Rules. They also speak of the need for a code of conduct for each individual company (with examples provided) and of coordination between the ICC headquarters and its national committees in this field as well as for the promotion of the Rules themselves on the domestic and international levels.

Similarly, the International Bar Association issued in 1996 a declaration recommending to governments the adoption of several anti-corruption measures for international economic transactions and calling on international financial institutions to take up the matter in its activities.⁴²

41. See Heimann, *supra* note 27.

42. Similar, recent unofficial international declarations were issued by the Council of Securities Regulations in the Americas (1996) and by the TransAtlantic Business Dialogue in 1994 and 1996.

IV. The World Bank's Efforts

A. *The Bank's Growing Concern with Corruption Issues*

The World Bank is required by its Articles of Agreement to ensure that the proceeds of its loans will be used only for the purposes for which they are granted and to disburse its loans only as expenditures on the projects it finances are actually incurred.⁴³ It is also required by these Articles to finance such expenditures with due attention to considerations of "economy and efficiency," and without regard to political or other non-economic influences or considerations.⁴⁴ The Articles of Agreement do not specifically include curbing corruption among the Bank's purposes or functions. They generally prohibit the Bank from taking non-economic considerations into account in its decisions and from interfering in the political affairs of its members.⁴⁵ For this reason, the Bank has traditionally been active and explicit in ensuring that procurement under its own loans is done in a transparent manner and on a competitive basis but has avoided, until very recently, any full-fledged attempt to adopt an anti-corruption strategy. Since the early 1990s, the Bank has, however, identified corruption as an issue to be taken into account in its work on governance and, in a few cases, begun to raise it in the country dialogue. It has also sought to assist its borrowing countries in introducing economic, administrative, legal and judicial reforms through a series of

43. See Article III, Section 5 (c), 2d sentence of the IBRD Articles of Agreement (providing, *inter alia*, that "in the case of loans made by the Bank, it shall open an account in the name of the borrower and the amount of the loan shall be credited to this account in the currency or currencies in which the loan is made. The borrower shall be permitted by the Bank to draw on this account only to meet expenses in connection with the project as they are actually incurred"). See also Article V, Section 1(h) of the IDA Articles of Agreement (providing that "[f]unds to be provided under any financing operation shall be made available to the recipient only to meet expenses in connection with the project as they are actually incurred").

44. See Article III, Section 5(b) of the IBRD Articles of Agreement (providing that "[t]he Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations"). See also Article V, Section 1(g) of the IDA Articles of Agreement to the same effect.

45. See Article IV, Section 10 of the IBRD Articles of Agreement (stating that "[t]he 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"). See also Article V, Section 10 of the IDA Articles of Agreement to the same effect.

structural and sectoral adjustment loans, technical assistance loans and grants and sectoral investment loans. While the Bank was not in this way directly involved in fighting corruption, it was aware that these reforms have a direct positive effect not only on the growth prospects of the borrowing countries but also on the level of corruption.

The Bank's explicit concern with corruption as a general development issue came with the assumption of James D. Wolfensohn of its Presidency in mid-1995. Soon thereafter, he highlighted the issue in his first speech before the Annual Meeting of the Board of Governors (in September 1995). He then asked this writer, as the Bank's General Counsel, to review all proposals and consider initiatives for possible actions by the Bank. Detailed discussion of such proposals and initiatives at the senior management level led to specific action which has been approved by the President and, as needed, by the Board of Executive Directors. Such action covers a number of different fronts, all related to measures deemed to be within the Bank's competence which will be detailed below. In the meantime, a comprehensive strategy to address corruption, both as an issue of the Bank's own effectiveness and more generally as a development policy issue, is being prepared for consideration by the Bank's Board in the near future.

Before addressing in the remaining part of this lecture past and current actions of the Bank in combating corruption, it may be useful to explain the reasons which prompt it, at this particular stage, to take a leading role in this area.

The Bank's involvement in addressing corruption issues beyond the projects it finances has not been free from controversy. On the one hand, it can validly be argued that the Bank is not a world government for the borrowing countries; its mandate is defined by its Articles of Agreement. Being subject to a weighted voting system and limited in its operations to the borrowing countries, its role as a world reformer beyond its defined purposes would inevitably carry the marks of rule by the rich countries of the poorer ones. In any event, the Bank should only be concerned, under this argument, with the functions provided for in its Articles of Agreement, the main among which is to help finance specific projects for productive purposes.⁴⁶ It should, in particular, avoid

46. See Article III, Section 4(vii) of the IBRD Articles of Agreement which reads: "Loans made or guaranteed by the Bank shall, except under special circumstances, be for the purpose of specific projects of reconstruction or development." See also Article V, Section 1(b) of the IDA Articles of Agreement

involvement in a subject matter which has obvious domestic political connotations and could otherwise entangle the Bank in complex political considerations which it is explicitly prohibited from taking into account under its Articles.

It should nonetheless be stated that as the world's major development finance institution and the coordinator of foreign aid to many of its members, the Bank cannot realistically ignore issues which significantly influence the effective flow and appropriate use of external resources in its borrowing countries. It has already been able to deal with a large number of governance and institutional issues which have direct relevance to its development mandate, without entanglement in partisan domestic politics. Its concern with public sector management in its borrowing countries has been an important factor in its operational and research work through the years. Any intervention by the Bank would, at any rate, take the form either of a financial instrument to which the country involved would be a contracting party, as a borrower or guarantor, or advice which must be related to the Bank's development mandate. In neither case can the Bank take a coercive stance or impose a particular direction on a borrowing member. It can only play a facilitating role, the effectiveness of which would depend largely on the borrower's full cooperation.

As a practical matter, the World Bank can hardly insulate itself from major issues of international development policy. Corruption has become such an issue. Its prevalence in a given country increasingly influences the flow of public and private funds for investment in that country. The Bank's lending programs and in particular its adjustment lending take into account factors which determine the size and pace of such flows. From a legal viewpoint, what matters is that the Bank's involvement must always be consistent with its Articles of Agreement. The Bank can in my view take many actions to help the fight against corruption. It can conduct research on the causes and effects of this world-wide phenomenon. It can provide assistance, by mutual agreement, to enable its borrowing countries to curb corruption. It may take up the level of corruption as a subject of discussion in the dialogue with its borrowing members. And, if the level of corruption is high so as to have an adverse impact on the effectiveness of Bank assistance, according to factual and objective analysis, and the government is not taking serious measures to combat it, the Bank

to the same effect.

can take this as a factor in its lending strategy towards the country. The only legal barrier in this respect is that in doing so the Bank and its staff must be concerned only with the economic causes and effects and should refrain from intervening in the country's political affairs. While the task may be difficult in borderline cases, its limits have been prescribed in detail in legal opinions issued by this author and endorsed by the Bank's Board.⁴⁷

According to one such legal opinion ("Governance Issues and their Relevance to the Bank's Work" issued in December 1990), the concept of governance in the sense of the overall management of a country's resources cannot be irrelevant to an international financial institution which at present not only finances projects but also is deeply involved in the process of economic reform carried out by its borrowing members. Clearly, the concern here is not with the exercise of state powers in the broad sense but specifically with the appropriate management of the public sector and the creation of an enabling environment for the private sector. It is a concern for rules which are actually applied and institutions which ensure the appropriate application of these rules, to the extent that such rules and institutions are required for the economic development of the country and in particular for the sound management of its resources.⁴⁸

No doubt, the Bank has to address issues of corruption in this context with great caution, acting on the basis of established facts and only to the extent that the issues clearly affect the economic development of the country. It cannot, however, ignore such issues at a time when they have become a major concern, not only to the sources of international financial flows but also to business organizations and indeed to the governments and peoples of most of its member countries.

B. Ensuring a Corruption-Free Institution

For an institution like the World Bank to take a leading role in the international efforts to assist its members in curbing

47. See Issues of "Governance" in Borrowing Members - The Extent of Their Relevance Under the Bank's Articles of Agreement, Legal Memorandum of the General Counsel, dated Dec. 21, 1990 (SecM91-131, February 5, 1991), also published as Chapter Two in I.F.I. SHIHATA, *THE WORLD BANK IN A CHANGING WORLD*, Vol. I (1991), and Prohibition of Political Activities in the Bank's Work, Legal Opinion of the General Counsel, dated July 11, 1995 (SecM95-707, July 12, 1995).

48. For details see I. SHIHATA, *THE WORLD BANK IN A CHANGING WORLD*, Vol. 1, 53-96 (1991).

corruption, it must first introduce adequate safeguards against any corruption within its ranks. There is no evidence of any major instance of corruption in the more than 50 years of Bank's history; few incidents have been promptly dealt with, even harshly in some cases, according to the Bank's Administrative Tribunal.⁴⁹ The Bank's Staff Rules include detailed provisions on conflicts of interest and the expected behavior of staff in their dealings within and outside the Bank.⁵⁰ They require annual financial disclosures of all assets and financial transactions by senior staff⁵¹ and disclosure by all staff of "any financial or business interest of the staff member or of a member of his immediate family that might unfavorably reflect on or cause embarrassment to the Bank."⁵² An Outside Interests Committee, headed by a Deputy General Counsel, must approve any staff activity unrelated to the performance of Bank duties, other than a non-compensated position in a non-profit corporation or organization, to ensure that it is compatible with Bank Group work requirements and the principles of staff employment.⁵³ In addition, a statement on staff ethics, first issued in 1994, is now to be distributed annually under the President's signature.⁵⁴ As part of the recently approved measures, the Staff Rules will be amended to make termination of employment mandatory in any case of corrupt or fraudulent practice resulting in a misuse of Bank funds or other public funds. They will also clarify the duty of staff to report incidents of corruption and strengthen the reporting procedures in such cases. Focal points have been designated to receive corruption-related complaints and to investigate them or advise on how best they should be investigated. Programs for increasing staff awareness about corrupt practices will be launched. Periodic audits of internal

49. So far, three cases before the Bank's Administrative Tribunal have involved fraud committed by Bank staff. In all cases, the Bank had terminated the staff for defrauding the Bank by submitting exaggerated overtime claims. This sanction was found, however, to be disproportionate by the Administrative Tribunal. See *W. Carew v. IBRD*, Decision 142, WBAT Reports (1995); *A. Planthara v. IBRD*, Decision 143, WBAT Reports (1995); *Th. D. Smith v. IBRD*, Decision 158, WBAT Reports (1997).

50. See Staff Rule 3.01, Paras. 1.01, 4.01-4.06, 5.01-5.03, 6.01-6.03, (setting forth the rules governing conflicts of interest including public and private activities of Bank Staff). See also Principle 3 of the Staff Manual summarizing the general obligations and general behavior of Bank staff.

51. See Staff Rule 3.01, Paras. 8.01-8.02.

52. See Staff Rule 3.01, Para. 8.01.

53. See Staff Rule 3.01, Paras. 10.01-10.05.

54. See The World Bank Group Code of Professional Ethics.

activities will also take place over and above the normal auditing work of the Internal Audit Department, to establish whether any questionable practice has taken place.

C. *Curbing Corruption Under Bank-Financed Loans*

While the Bank has long been known for its stringent measures to insulate the projects financed by it from any possible corruption, such measures have recently been enhanced in a number of areas, some of which have broader objectives:

(i) *At the early stages of project design, preparation and appraisal*, the Bank now places emphasis on the participation of affected people and NGOs.⁵⁵ Such participation, while serving other purposes, indirectly improves the accountability of government agencies and allows the Bank to hear and verify possible complaints about corruption, such as the selection of the project location to accommodate some special interests. Also, during project appraisal, Bank staff are now required to place emphasis on confirming the adequacy of the project's accounting system and to make sure that loan agreements include adequate covenants on appropriate financial management.

(ii) *During project implementation*, the Bank now places a much greater emphasis on supervision, including the actual observance of auditing requirements. It reviews with borrowers the Bank's portfolio of on-going projects, both to identify problems and agree on solutions.⁵⁶ Through such close supervision and review, questions of corruption, if they arise at all, have a much greater opportunity to be addressed. The Bank's more open disclosure policy adopted in 1993 also allows concerned NGOs and the public at large to play a more effective role in monitoring Bank-financed projects.⁵⁷ The establishment, also in 1993, of the Bank's Inspection Panel gives affected parties access to an independent mechanism to review alleged deviations by the Bank from its policies and

55. Pursuant to Operational Directive (OD) 14.70, NGOs may become involved at all stages of a Bank-financed project. Other Operational Directives such as OD 4.00 on Environmental Policies or OD 4.30 on Involuntary Resettlement ensure the participation of people affected by Bank projects.

56. See Operational Policy Statement (OP) 10.02 which is discussed *infra*.

57. See Bank Procedure (BP) 17.50 on Disclosure of Operational Information and the Bank's Operational Policy Statement on Disclosure of Information (OP 17.50).

procedures with respect to the design, appraisal or implementation of projects financed or to be financed by it.⁵⁸

(iii) In the preparation of the periodic *Country Assistance Strategies* for each borrowing member and more generally in the on-going *dialogue* between Bank staff and government officials, Bank senior staff are authorized to raise governance issues relevant to the Bank's mandate. Should an issue related to alleged corruption under Bank-financed projects arise, it would no doubt figure prominently in such discussions and might influence the Bank's position if they are not adequately dealt with by the government.

(iv) A new *Operational Policy Statement and Procedure (OP/BP 10.02 - Financial Management)* has recently been prepared. It requires the strengthening of accounting and auditing procedures for the borrowers and the project implementing agencies with respect to Bank-financed projects and tightens the rules regarding the borrowers' compliance with an audit and other financial covenants in the loan agreements. This OP/BP includes specific procedures for the suspension of loan disbursement in cases of prolonged non-observance.

(v) Perhaps more importantly in the context of curbing corruption, the Bank's *rules, applicable to the procurement of goods and services under its loans*, which are incorporated in its loan agreements, have been further tightened by virtue of new rules and procedures approved by the Bank's Board on July 23, 1996. According to these new rules and procedures:

a) The Bank can at any time cancel the financing of any contract under the loan, not only in cases of misprocurement as previously stated, but also whenever corrupt or fraudulent practices were engaged in by representatives of the borrower or a beneficiary of the loan during the procurement process or the execution of the contract, unless the borrower takes timely and appropriate action satisfactory to the Bank to remedy the situation. Both the General Conditions applicable to IBRD loans and IDA credits, and the Procurement Guidelines, have been amended to reflect this important change.

b) Any supplier/contractor/ consultant financed by a Bank loan which is found by the Bank, after appropriate investigation with adequate safeguards, to have engaged in a corrupt or fraudu-

58. See Resolution Establishing the World Bank Inspection Panel (Resolution No. 93-10; Resolution No. IDA93-6). See also I. SHIHATA, *THE WORLD BANK INSPECTION PANEL* (1994).

lent practice, will be declared by decision of the Bank's President, upon the recommendation of a high level committee, ineligible to bid for Bank-financed contracts, for a specific period of time or indefinitely, according to the gravity of the offense.

c) The Bank will also reject a proposal for the award of a contract by the borrower if it determines that the bidder recommended for this purpose by the borrower has engaged in corrupt or fraudulent activities in competing for that contract.

d) The Bank can now require its borrowers to include in the contracts financed by Bank loans a provision by virtue of which the Bank will have the right to inspect the accounts and records of the contractor/ supplier/ consultant concerned relating to the performance of the contract and to have them audited by auditors appointed by the Bank.

e) Bidders for Bank-financed contracts are now required to disclose in their bids any commissions or other payments paid to local or foreign agents in the context of the procurement or execution of such contracts.

(vi) In addition to the above, recently approved measures include additional, previously unannounced, audits of Bank operations in a specific country by outside firms, and regular post-review of procurements on a country basis. Three of the first type of audits have already started in large borrowing countries.

D. Assisting Borrowing Members in Curbing Corruption

The main vehicle for assisting its members in their fight against corruption as a general phenomenon is the Bank's policy lending instruments and its technical assistance loans. Other measures have also been used by the Bank, however, to good effect.

1. *Policy Lending.*—Although adjustment lending was initiated in 1980 to assist countries in improving their economic performance, many reform measures introduced under structural and sectoral adjustment loans (and other "rehabilitation" and "recovery" loans) have indirectly and at times specifically helped in stemming corruption.⁵⁹ These have included, in addition to

59. For details on the policy of adjustment lending as a response to macro-economic disturbances in the 1980s in most developing countries, see *The Social Impact of Adjustment Operations: An Overview* (World Bank Operations Evaluation Department, Report No. 14776, 1995) and *Structural and Sectoral Adjustment: World Bank Experience 1980-1992* (World Bank Operations Evaluation Department, Report No. 14691, 1995); see also *World Development*

general measures of deregulation, liberalization and privatization which aim at replacing administrative dictates with market mechanisms, such specific measures as the following:

a) The introduction of banking laws and regulations to ensure the health of the financial sector and also to strengthen controls over fraudulent and imprudent practices and money laundering;

b) The introduction of tax laws and regulations, not only to simplify tax structures and reduce tax rates but also to improve tax administration and collection;

c) The introduction or amendment of procurement laws, regulations and documents as well as measures of financial management, not only for development projects but more generally of the government budget, accounting and auditing systems;

d) Less specific measures of legal and judicial reform have also been introduced in the context of policy based lending, especially under sectoral adjustment loans in situations where agreement was reached with the borrower on the pressing need and the feasibility of short term actions;

e) Specific civil service reform measures have often been agreed under adjustment loans, especially for downsizing and pay increases.

2. *Technical Assistance and Sectoral Investment Loans.*—Both free standing loans and components of technical assistance and sectoral investment loans have covered Bank financing of legal and regulatory reform, civil service reform, judicial reform and public sector reform, all with potential direct or indirect effects on the opportunities for and level of corruption.⁶⁰ While relatively large free standing loans have been made in recent years for legal and/or judicial reform in countries as diverse as Venezuela, Bolivia, China, Russia and Ecuador, public sector reform and civil service reform loans started earlier and have covered a large number of countries. The recently agreed measures by the Bank's top management to assist in combating corruption include the broadening of activities in these fields as may be needed in the circumstances of each country.

3. *Bank Grants.*—Since the establishment by the Bank of its Institutional Development Fund (IDF) as a trust fund to provide

Report - Poverty 104-20 (World Bank 1990).

60. For a general overview of legal technical assistance by the Bank, see the World Bank and Legal Technical Assistance (World Bank Policy Research Working Paper No. 1414, 1995).

grants to borrowers for capacity building purposes (other than project preparation, which may be financed by other types of Bank grants), a number of grants have been made for purposes such as the preparation of new legislation, public procurement and associated training, or the carrying out of studies which diagnose the problems of the civil service or the judiciary. Some of these studies paved the way for technical assistance loans for these sectors. Among the recently agreed measures, IDF grants will also be made for capacity building in accounting and auditing in borrowing countries. Other grants have already financed a number of surveys to assess the level of delivery of public services in some borrowing countries.

4. *Seminars by the Economic Development Institute (EDI).*—EDI has pioneered a number of “Integrity Workshops” for specific countries to increase awareness of the causes and economic effects of corruption. These seminars are planned to cover more countries in the future. EDI has also provided training for economic journalists. Recently agreed measures for the Bank to assist in combating corruption include new procurement seminars to be provided by EDI for the training of specialists in borrowing countries.

5. *Bank Research.*—Corruption has been researched on a few occasions by Bank staff as a separate topic but has been more regularly addressed under more general reports. Examples include the two Bank reports on governance issues published in 1992 and 1994, private sector assessment reports carried out for most borrowing countries, service delivery surveys (financed mostly by IDF grants), surveys of manufacturing enterprises in transition economies, a few Country Assistance Strategy (CAS) reports and the 1996 World Development Report (WDR) on Transition. The 1997 WDR, which will deal with “The State in a Changing World,” will treat the issue of corruption in a broader and more detailed manner. In depth analysis of the causes of corruption, the empirical evidence of its impact on development, and how best to address it in Bank’s lending and non-lending operations, is now being considered as possible subjects to be specifically addressed by Bank research.

V. Conclusion

Although corruption can be seen in a much broader context, it has been addressed here mainly in terms of the use of public

office or trust for private gain, the abuse of a public or private position in favor of the position-holder, his family, friends or bribers and the selective or arbitrary application of public rules to benefit the official in charge and those who pay him for the favor. Its causes and effects, both on the parties to a corrupt deal and on the society at large, have been discussed from different angles. In spite of direct material benefits to the corrupting and corrupt parties and possible facilitating effect on business transactions, the long term effects of corruption are found to be negative on the society, its government, law, ethics and economy. Businessmen may be content to live with it as long as it is fairly predictable, and the poor may accept it as a fact of life, but its devastating distributional effects are increasingly recognized on a world-wide scale.

In practically all societies, corruption has been recognized as a social malaise, if not a religious sin. However, its manifestations continue to exist in varying degrees in all societies. Measures to combat it have also had different degrees of success but have generally been more effective when they followed a comprehensive approach and combined the efforts of governments with those of business groups and non-governmental organizations.

Both in theory and practice, many ways have been proposed to achieve the reduction of corruption. However, as the discussion in this paper demonstrates, these proposals may remain empty gestures in the absence of some basic requirements: (i) real commitment from national and local leadership at the political and administrative levels, (ii) a broad and sustained campaign by civil society to keep that commitment alive, (iii) institutional capacity to implement and enforce, (iv) public disclosure and a free flow of information, (v) a social enabling environment of norms and values supportive of anti-corruption measures, (vi) the adoption by multinational corporations and international agencies of standards and practices which address corruption with a view to fighting it in their work, and (vii) international cooperative efforts to deal with trans-boundary corrupt and fraudulent practices.

International conditions seem to be more conducive now than any time in the past to address corruption as an issue of global concern. With the greater liberalization of trade and investment, the gradual globalization of the market place and overwhelming advances in technology, corruption is becoming not only a common domestic problem but an international problem as well. It is being recognized as a development issue in view of its possible impact on the cost of transactions, the volume of external flows, the stability and predictability of the investment environment, and eventually

the rate of growth itself. Inevitably, it has become a concern for the world's premier development finance institution.

The World Bank has already played an extensive role in the fight against corruption, a role which goes beyond the confines of the activities of its staff and the projects it finances. As corruption becomes a major issue of development policy, with respect to aid, trade and investment, the Bank's role is bound to increase and take on new dimensions. Chances of success in this complex area are more limited, but the expected impact on development may well be worth the effort.

