

## “Combating Corruption in the Multilateral Development Banks”

“Criminal Debt” – Written statement by Dr. Jeffrey A. Winters,  
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Senator Lugar, Chairman

Chairman Lugar, Senator Biden, distinguished Senators:

I am grateful for this opportunity to present the results of nearly 15 years of research on the MDBs, the matter of corruption, and particularly how the problem is manifested in the region of Southeast Asia, my geographical area of specialization. Together with my co-editor, Jonathan Pincus from the University of London, we have recently published a book entitled *Reinventing the World Bank*. The book contains two chapters devoted to the problem of corruption and the World Bank.

Since its founding, the World Bank has participated mostly passively in the corruption of roughly \$100 billion of its loan funds intended for development. If we include the corruption of loan funds from the other Multilateral Development Banks (MDBs) over the same period, the figure roughly doubles to \$200 billion.

In our book I refer to these lost funds as “Criminal Debt.”<sup>1</sup> The debt is criminal in two senses – first because it was a crime to allow the development funds to be stolen, and second because it is an injustice to expect poor populations around the world that never received these funds to bear the heavy burden of repayment. On average, the poor have received about 70 cents on the dollar in loan funds from MDBs. And yet they are obligated to repay 100% of the loans plus interest.

I would like to begin by making a few key points, followed by additional explanation:

1. The World Bank and other MDBs have paid more attention to the problem of corruption since the late 1990s. But the impact of this attention has been minimal in

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<sup>1</sup> Jeffrey A. Winters, “Criminal Debt,” in *Reinventing the World Bank*, Jonathan R. Pincus and Jeffrey A. Winters, eds. (Ithaca, N.Y. and London: Cornell University Press, 2002), pp. 101-130. Criminal debt is distinct from “odious debt,” which refers to loans that help an oppressive government further oppress its citizens. Criminal debt refers more narrowly to only that portion of loan funds that are stolen by officials before they can be used for development.

stopping most of the theft of loan funds because the Bank's approach is inappropriate to the problem.

2. The MDBs must do a much better job supervising and auditing projects and loans. But the only effective way to protect against corruption of development funds is to establish an international auditing body that is independent of the MDBs and of private sector auditing firms (nearly all of which have deep conflicts of interest). This Multilateral Auditing Agency should be empowered to spot-audit all MDB operations, loans, and projects. Career advancement within the MAA must be linked to success in detecting fraud and theft of development funds.

3. All the incentives built into MDB operations facilitate rather than retard the criminal debt problem. The "pressure to lend" creates a bias in favor of quantitative rather than qualitative results, and corrupt elements in client governments know this. No matter how much money is stolen, the MDBs currently bear no financial burden for the losses.

4. Under international law, the Articles of Agreement explicitly require the World Bank to make arrangements to ensure that the funds it lends or guarantees are used for their intended purpose. For decades it did not do this, despite extensive knowledge that loan funds were being systematically stolen. Recent efforts to stem corruption have had minimal effects. And current immunities for the MDBs block aggrieved populations from pursuing legal relief from having to repay funds they never received. It is the people who repay debt, not governments. But the people have no advocate and no legal standing to seek debt relief. Also, no one is protecting the money of taxpayers in the lender countries from falling into the hands of kleptocrats in borrower states.

5. The more fundamental question behind the corruption problem is: what are institutions like the World Bank supposed to be and do? Our position is that the Bank's core competence is in being a public sector lender. The MDBs have evolved over the decades into unwieldy bodies, the components of which function poorly. The World Bank is not an effective "knowledge bank," nor do its thousands of economists produce cutting edge research. The World Bank is not an effective environmental agency, nor a development agency, nor anti-poverty crusader, nor is it an NGO well suited to advance gender relations or "participation." The World Bank will work best if it is scaled back to its core function as a public sector lender. As such, it can devote more resources to ensuring that its loan portfolio is well protected against systematic theft. The other elements of the MDBs should be spun off, unpacked, or closed.

6. Whether on corruption or other MDB matters, it is unrealistic to expect an institution that has grown to unmanageable proportions on the basis of internally driven change to manage its own reform program. The World Bank cannot be reformed and certainly cannot reform itself. It must be reinvented. It is the responsibility of the major shareholding countries to undertake this task. Anything else will be patchwork on a broken system.

## **Criminal Debt**

The vast majority of criminal debt arises in the relationship between the MDBs and borrowing governments. And yet this is the nexus where the least effort has been made to stem losses from theft. While it is admirable that the World Bank now investigates its own employees (and has caught a few red-handed), corruption among these individuals is minimal. Similarly, the blacklisting of international firms engaged in corrupt practices is a positive move. But the scale of losses through corrupt firms is also minimal.

The lion's share of the theft of development funds occurs in the implementation of projects and the use of loan funds by client governments.

Not everyone at the MDBs is to blame for allowing so much of their loan funds to be systematically stolen. Many individual task managers, who deal with projects at a more micro level, have long complained that too much theft was going on and that projects and the broader developmental effort were being compromised.

But for decades, the top management at the MDBs averted their eyes from the abundant evidence of systematic corruption in almost every country where they were operating – as did the major shareholder governments such as the U.S. Institutions like the World Bank had a global “don't ask, don't tell” policy regarding criminal debt. Why? Because the only people with an incentive to speak up – the world's poor and indebted – were not being listened to, and they lacked the power to restrain greedy and powerful elites.

From the end of WWII until the mid-1990s, the MDBs themselves had no incentive even to speak or write the word “corruption” regarding their own loans, and indeed they did not. No matter how much was stolen, the MDBs were confident they would not have to shoulder any of the financial burdens. And moving up in the Bank hierarchy is a function of successful lending, defined almost entirely by the impressive size of one's lending portfolio, not how much of the money was actually used for its intended purpose.

For an ambitious Bank employee, there are still no career rewards today for focusing on corruption at any stage in the lending process. And a key problem is that there never will be.

The case of Dennis DeTray, the top World Bank official in Jakarta in the 1990s, is illuminating. When an individual running a Bank-funded project in Indonesia came to Mr. DeTray to ask the Bank to do something about the blatant theft of project funds, he was told, “Wrong address, call the police.”

When I blew the whistle in 1997 on the fact that a third of all World Bank loan funds to Indonesia had been stolen, a senior vice-president at Bank headquarters in Washington issued a press release denying the allegations and labeling me an irresponsible scholar. Within a year, two secret documents from inside the Bank would leak fully supporting the allegations.

## Corruption and Governance – The Banks’ Mistaken Approach

It is fashionable in MDB circles to cast the criminal debt problem as a broader “governance” matter. Corruption at the societal level does indeed reflect a national governance failure, just as corruption at the global level reflects an international governance failure.

But corruption in World Bank lending operations reflects a World Bank supervisory and auditing failure. Before the MDBs attempt to solve the daunting problem of reducing corruption across entire societies, it would be far more useful to do a competent job of reducing the theft of funds within the Banks’ own lending and project portfolios.

The World Bank’s misguided answer to the corruption problem is driven primarily by an institutional compulsion to respond in ways that generate additional lending and require the provision of expensive technical expertise.

Power relations and impunity lie at the heart of corruption. It is the absence of effective detection, constraint, and punishment that makes corruption possible and probable. At the national level, these are absent because power is concentrated in ways that block effective checks and balances in politics.

Corruption ranges in scale from petty to grand, in scope from personal to systemic, and in impact from negligible to ruinous. But it is rarely caused by a lack of education or training (everyone knows what corruption is) and can rarely be addressed significantly by writing better laws, reorganizing institutions, or upgrading personnel through “integrity” workshops.

Most countries where corruption is endemic have reasonably good laws on the books. The problem is implementation and enforcement. This leads to an immediate question: What should be the primary focus of the MDBs’ response to the challenge of corruption? To answer, it is important first to distinguish clearly between efforts directed at reducing corruption on a *micro level*, in projects and programs financed by the Banks, at a *middle level*, within and across whole societies, and at a *macro level*, in the relations and transactions among countries globally.

**Recommendation:** The MDBs currently focus most of their efforts at the middle level (corruption across whole societies), when they should instead focus on the micro and macro levels (that is, on supervision and auditing of their own lending, and on strengthening international coordination and safeguards).

It is precisely in the nexus between the Banks and their borrowers that the Banks have both the leverage and the legal justification to act forcefully and consistently against corrupt practices. As multilateral bodies, they also can play an effective coordinating and legitimating role to strengthen international institutions, norms, and sanctions linked to corruption.

The Banks are at their weakest, most ineffective, and most politically vulnerable in the middle zone – in the battle against systemic corruption across whole governments. The Banks will have a muted impact at this level while encountering the greatest disruptions in their relations with borrower countries, the Banks' Boards of Directors, and the international community.

Moreover, it is not the World Bank's job to solve a society's corruption problem. It is the proper task of *groups and actors in each society* where corruption is rampant to challenge the power relations that make the abuses possible. The MDBs are ill-equipped to put checks and balances in place – except in their own projects and activities, and in the international environment.

And yet, it is precisely in this middle range of the corruption problem that the MDBs have decided to focus their efforts. “The main thrust of the Bank's support for countries' anticorruption efforts,” declares a key World Bank document on the subject, “will be in helping to design and implement government programs.”

The MDBs cannot lend their way out of the criminal debt problem.

The benefits for the Bank of focusing its efforts at the micro and macro levels and avoiding a mezzo approach are several. First, because the Bank can control through internal decisions how its loans are used, it can respond rapidly and credibly to the chorus of critics charging that Bank funds are being stolen on a massive scale (which damages the reputation of the Bank and exposes the institution to legal challenges).

Second, it quite properly removes responsibility from the Bank's shoulders for any lack of progress in reducing corruption at the broader *societal* level. The Bank's own studies recognize that systemic corruption is complex and cannot be addressed quickly. Reducing corruption across the country should not be the centerpiece of the Bank's response to kleptocracy.

And third, by using tighter fiscal supervision built into its own projects as a “best practices” model, the Bank can more credibly position itself as a leader in the international effort to combat corruption in bilateral and multilateral lending.

### **The Articles of Agreement – Failure on the Ground**

The Articles of Agreement represent the founding charter of the World Bank, setting forth the Bank's purpose, membership, operations, rights, limitations, and responsibilities. It is a binding Constitution subject to all the rules and norms of international law. For purposes of the present discussion of corruption and accountability, the most relevant part of the charter is Article III, Section 5, Paragraph (c), which states: “The 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.”

This is an unambiguous statement against allowing Bank funds to be corrupted. It places a clear burden and responsibility on the Bank to make arrangements that ensure its funds are not stolen or misallocated, and it admonishes the Bank to carry out this function in a manner that is economical, efficient, and unbiased politically.

Does the World Bank make effective arrangements to safeguard the loan process and project implementation? Is supervision taken seriously? My research and interviews with Bank officials and task managers suggest it is not.

“We look more than anything else at what the project achieves,” explained Katharine Marshall, a senior official with the Bank, “not really the money. We look, for instance, at whether schools get built, not how the money was spent to build them.”

Julian Schweitzer, another senior official at the Bank, went even further in our joint interview, making direct reference to the estimate that a third of the Bank’s funds loaned to Indonesia had been stolen and became criminal debt. “If you take the amount of 30 percent loss,” Schweitzer stated, “it means 70 cents [on the dollar] got used for development after all. That’s a lot better than some places with only 10 cents on the dollar.”<sup>2</sup> He was referring to certain Bank clients in Africa where nearly all of the loan funds are misallocated, diverted, unaccounted for, or simply stolen.

One World Bank task manager who struggled for years to get his employer to take the corruption issue seriously responded to the “glass is 70% full” perspective:

That’s the old argument, isn’t it? They’ve been saying that for years. [...] There are a couple fallacies there, and it is much too cavalier an attitude. That’s because, in fact, my experience has been – and it’s the experience of a lot of other people there [on the operations side of the Bank] – if they’re busy stealing 30 percent, they’re not paying any real attention to the other 70, even assuming 30 percent is all they’re taking. What you’re really doing is really ruining the whole effectiveness of the investment itself. I try to tell people [...] it’s like giving the money to buy a car but they’re stealing the money that would buy the gasoline. So what good is the car? It is a fact, I can demonstrate it, and I’ll stand by it. I’ll prove it anytime.

He offered the following example:

You cut corners and nobody cares. If you let out a contract for \$2 million, and you get the few civil servants at the top sharing \$600,000 or 30 percent, do they care if the contractor puts in concrete that is just sand and water? Do they care if the contractor doesn’t put reinforcing steel in the structures? They don’t care. So when Bank people say we’re at least getting 70 cents of good development on the dollar, no you don’t. Because the contractor either has to make back the money

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<sup>2</sup> See Winters, “Criminal Debt,” 2002, p. 111.

that he's kicked back, or he just figures, "hey, it's open season, I do what I want and no one is going to challenge me." And so you have this feeding frenzy, and the end result is you get very little development.

Putting aside who is fiscally responsible to repay the lost 30 percent, he questioned what genuine value a country or the poor really get from projects conducted in ways where such levels of theft are tolerated.

If you get only one dollar out of ten that goes to the poor, is that really worth it? And have you done anything to strengthen the economy for the long term? No. You've only nourished a corrupt government that has no intention of providing services. To me, those arguments are hollow.

### **Relief from Criminal Debt**

The primary concern of the Senate in these hearings is combating corruption in MDB operations. This is a forward-looking agenda, and it is to be commended. There are a range of likely motivations for engaging in this combat. U.S. representatives want to ensure that the development funds from U.S. taxpayers are not wasted or used to buy mansions or fund sectarian militias. They must also be motivated by a desire to make development spending effective in alleviating the poverty around the world, which carries too many benefits to list here.

In the spirit of being forward-looking, I have offered some specific ideas about what approaches or reforms can and should be adopted. But being forward-looking leaves an important part of the criminal debt problem untouched.

One problem with accumulated debt burdens is that they have this tendency to be mired in the past. Since it is unlikely that the debt slate is going to be wiped clean for borrowing countries, it is simply not possible to be exclusively forward-looking.

We will never have precise figures on levels of criminal debt accumulated since the MDBs began operations. My own research suggests that the figure of \$200 billion presented at the outset is, if anything, an under-estimate. When citizens groups and NGO in developing countries demand, as they have several times in demonstrations in Indonesia and elsewhere, that the criminal portion of their debt be written off, they are not acting irresponsibly or trying to repudiate their obligations.

They are simply pointing out that there is something very wrong about demanding repayment for funds the people never received. The money was delivered from the World Bank and other MDBs, but it was intercepted along the way and "privatized" illegally. It is easy to demonstrate that officials in the MDBs were aware of these practices for decades and, in violation of legal obligations under the Articles of Agreement, did nothing at all to stop the corruption. On the contrary, in almost every case, flows of funds from the MDBs increased as pressures to lend mounted.

This was a bonanza for those positioned to skim the riches. And the populations below could do little or nothing to constrain the behavior of the authoritarian leaders over them. The only powerful actors with the leverage to make arrangements to ensure that development funds were used for their intended purpose, the MDBs themselves, cooperated with the foxes raiding the chicken coop.

The indebted poor of the world are legally entitled to an immediate debt reduction of \$200 billion, not as an act of charity or generosity, but because the debt is criminal in every sense of the word.