

POLICIES THAT INCREASE VULNERABILITY TO CORRUPTION

By Dwight Ink

My comments on donor policies that increase vulnerability to corruption grow out of experience of directing programs of the Agency for International Development in the Western Hemisphere, as well as assessing USAID missions in Africa, the Near East, and Asia. Following this work, I headed a non-profit organization, the Institute of Public Administration, which has been heavily involved in the transition of countries in Europe and Asia from dictatorships to market economies and democratic societies. I should point out, however, that my background is in management, not banking or economics.

Despite my criticisms of certain foreign assistance programs, I would stress at the outset that I am a vigorous supporter of both bilateral and multilateral foreign assistance. The United States Congress should be providing much more funding for that purpose. Unfortunately, the American people do not have a clear understanding of the value of foreign assistance to world stability and other long-term foreign policy objectives.

One of the reasons is that an image of inefficiency and corruption among recipients in host countries has undermined the support foreign assistance deserves. Although the extent of corruption and waste is often exaggerated, it nonetheless constitutes a significant problem to which we have not given nearly enough attention. My comments today are focused on one dimension of this problem that has been given little notice, namely ways in which well-intentioned donor policies have inadvertently increased vulnerability to corruption in programs these donors have funded. Several examples will illustrate this view:

- **Role of Privatization.** I share the view that in earlier years some of the largest donors relied too heavily on host country governments as the principal vehicle through which economic reform could be achieved. Private enterprise was regarded as useful at the micro-enterprise level, but donors were wary of

supporting measures that addressed problems of larger businesses because they so often exploited the poor and corrupted society. We all remember the hopes the donors pinned on government entities organized as public enterprises as a way to utilize the entrepreneurship of private enterprise in the course of serving public policies. Unfortunately, this well-intentioned policy turned out to spawn bloated bureaucracies that were wasteful and corrupt, certainly not what donors intended.

In time donors grew to better appreciate the value of private enterprise as “the engine of economic growth”. But even so, for years little effort was directed toward helping to develop a broad-based private sector that could provide economic growth for society as a whole. Consequently, programs designed to encourage trade and the earning of much needed foreign exchange often helped a relatively small portion of the private sector, the largest and most powerful who used that power to press governmental policies and appointments that were oppressive to the poor and failed to foster a middle class. At times bilateral funds propped up regimes that were very corrupt in the interest of pursuing strategic objectives thought to be of overriding importance.

During the 1980s we developed reasonably good approaches to assistance programs that encouraged economic growth in which the private sector played a key role, but did not sacrifice social needs or democratic initiatives.

Then, in my view, roughly ten years ago we went to an extreme policy in which we became preoccupied with privatization, at least in those countries that had been struggling with the transition from communism to democratic societies with market economies. Although the fine print said otherwise, the headlines the recipient countries saw in donor offers of assistance asserted that government at the national level was the problem and donors were not going to waste money on national government reform except in a very few areas. The name of the game became privatization as rapidly as possible coupled with fiscal reform. Donors

did not want their resources diluted by meeting other needs. This overemphasis on the private sector led to problems.

My quarrel is not with advancing the concept of privatization, but with how we rushed into it in much of the former Soviet bloc with very little planning of how to avoid unintended negative consequences that were not too hard to predict. First of all, there was almost no private sector on which to build. There had been no entrepreneurial experience or training under the communist systems. The communication systems and other elements of infrastructure required for a vibrant private enterprise were rudimentary. Credit and banking systems did not exist. The basic legal framework was largely missing. There was no rule of law covering banking, bankruptcy, property and contracts. In this environment we somehow expected strong, competitive private sectors to quickly spring to life with minimum technical and managerial assistance.

I was dismayed, for example, at the conversion of public corporations into private enterprises with little of the planning or training that was required for success. Without host country experience or much donor guidance, a number of government enterprises were transformed overnight into unregulated private monopolies, thereby exchanging government corruption for private corruption.

There was no competition and no regulatory system such as the US and other developed countries have in place to prevent exploitation and abuse. Not understanding how to privatize, boards of directors of these new enterprises contained relatives and business associates of the government officials responsible for the privatization, creating serious conflicts of interest. Conflicts of interest were also common in contracting, bidding, and the auctioning of shares. Funds were channeled into these enterprises, which had no systems of accountability or transparency, and before they had competent management in place. Good accounting and auditing systems were almost non-existent. Few laws

and procedures were in place to investigate or punish the cases of bribery and kickbacks that were widespread.

When we were working in Poland the newspapers were full of corruption stories spawned by privatization. People were asking us, "What's so good about democratic governments and market economies if they simply exchange communist corruption for business corruption?" Corruption triggered by hasty privatization also weakened support for valid donor policies and programs. It undercut the credibility of reform governments and contributed to the proliferation of political parties in Poland and a concomitant lack of governmental stability. This was a friendly environment for corruption.

This corruption environment is more dramatic in Russia and has continued longer. The chances of ultimate success still appear to be in question.

- **Central Government Reform Ignored.** Also contributing heavily to vulnerability to corruption in Central Europe and the former Soviet Union was the failure of donors to provide either leadership or funds for central government executive branch reforms so badly needed for successful transitions from the communist systems. At the time a few of us were pleading the case for government reform as a prerequisite for developing a sound private sector, a theme roundly rejected by nearly all the major donors.

Attached is a memorandum I circulated to a small group I convened for lunch in late 1990 in which I tried to alert leaders to the critical need for government reform in Poland. One of the key points in the memo was the need for heading off patronage and corruption at the outset of Poland's emerging democracy.

During the ensuing months Polish, Czech, and Slovakian governments, and later those from the former Soviet Union, continued to beg for help on virtually every aspect of governance. They knew that drastic change was essential as they

emerged from a totalitarian state, but they had no idea just what changes were needed. Words such as “democracy,” “management,” “accountability,” and “decentralization” were used constantly in discussions with donors, but the communist experience had provided no opportunity to understand either their meaning or how to attain them.

I recall meeting with a minister in charge of cabinet operations complaining, “nothing happens. The cabinet meets, the prime minister exhorts the ministers to move forward, but there is no movement. They just mill around.” I looked at their last agenda. It was a series of vague descriptions of hopes and concerns, but no recommendations or action items to discuss. The so-called minutes of the meeting mentioned subjects that had been discussed, but no agreements on policies or assignment of actions were listed. I found exactly the same pattern in the meetings of their national security leaders. Communism left not even the most fundamental understanding or skills as building blocks for public management.

As the private sector began to develop in Poland, the prime minister asked for technical help in contract management because their early contracts had been plagued with allegations of corruption, many of which he knew to be true. Except for an OECD workshop that dealt only with contract concepts, no help was forthcoming as the ministries struggled to find their way through an unfamiliar process. The Institute of Public Administration in New York, unable to find donor funding but alarmed at the continuing vulnerability to graft and abuse, provided some help pro bono. But Poland needed more assistance and needed it fast. Donors were disinterested as Poland struggled.

These countries in transition also had an urgent need to completely overhaul their administration of justice systems. Police must perform very differently in a democratic society than in a totalitarian state. The basis on which people are arrested and incarcerated is very different. Timely scheduling of court cases now

becomes important. Concepts for deciding cases and determining punishment are different. Graft that permeated the old system has to be rooted out. The whole system of courts and law enforcement agencies has to be transformed from top to bottom. Yet for too long these governments were without outside assistance in learning what the administrative practices are in a democratic society and how to put them in place. Consequently, many of the old totalitarian abuses continued. Corruption rapidly took new forms while the systems for administration of justice that were needed to attack these abuses were slow to change.

The most basic elements of government management and organization had to be developed from the ground up in these countries, and the longer donors ignored their plight, the longer their vulnerability to corruption and waste continued. One of the Solidarity leaders pointed out that their union was a great place for generating a freedom movement, but it was not able to train people to govern.

The response from the United States, and to a large extent from the IMF, World Bank, and most foundations was very disappointing. We did provide some useful assistance with respect to the conduct of elections, and there were a number of good local government projects funded by USAID and several private foundations. But to a large extent we turned a deaf ear to the pleas for helping the national governments design and execute reforms so badly needed to establish democratic institutions and foster a broad based private sector.

Donors were saying that they did not want to waste their limited resources on lost causes such as government reform. Some in the public administration community contributed to donor disdain for government reform by focusing on sophisticated public administration systems that were too expensive for developing countries and required an established merit system nonexistent in most countries. They had the appearance of the dysfunctional bureaucratic red tape that characterized the communist governments. Even more important, they failed to provide a

recognizable linkage between the administrative reforms and the success of the economic policies sought by donors.

I do not believe that any of the major donors had any idea of the extent to which their early policies of ignoring the need of national government reform contributed to waste, corruption, and political instability.

- **Pre-occupation With Economic Theory.** I believe that donors get too caught up in economic theory without understanding the social and political realities with which the host country governments are faced. As a result, we have seen too many instances of donor imposed economic reforms so unrealistic they bred contempt for the reforms and provided strong incentives for such things as black markets, smuggling of contraband, and worse. Further, they often did not work.

I could never understand, for example, why our Treasury Department and the IMF, with the World Bank and USAID often supporting, would insist on economic and fiscal reforms far more drastic than the political leaders of the United States and other developed countries could tolerate. Yet the recipient governments had less political stability than that enjoyed by the United States, and the draconian measures insisted upon by donors frequently eroded their limited stability further.

No economic theory works in a vacuum, yet some of our conditions were very rigid, leaving little room for changing conditions that are inevitable in the life of a grant or loan program. . When the specified reforms failed, as they often did, it was doubly difficult to persuade hard-pressed government leaders to try again.

Some donor led programs were also too complicated, making their rigidity even more unrealistic. I recall one such AID assistance program in Honduras in which the conditionalities were embedded in an algebraic formula. Imagine the task of a Finance Minister trying to explain the workings of such an international

agreement to a legislative body that had to approve the program. Imagine further that Finance Minister going back to the legislative body to request approval of an amendment to the agreement with AID because of unforeseen developments a few months later.

Further, the unrealistic and unnecessarily complex conditionalities imposed by donors meant that host country leaders felt no sense of ownership in the agreements and were quick to distance themselves from the onerous provisions when public opposition developed. Some of you may recall I did away with much of the AID conditionality approaches in Latin America and the Caribbean, although I understand some of them were later restored.. I did not believe the assistance agreements should be entered into unless the host country leaders had a sense of ownership in the provisions and felt a strong stake in success of the program.

In addition to these problems, too often donors have failed to support safety net arrangements needed to cushion the impact of drastic economic and political reforms, thereby fueling social discontent..

These criticisms have been made by others. But I do not believe we have appreciated the extent to which the short-term social tensions and political instabilities in which donors have played a part have contributed to vulnerability to waste and corruption. And I am not aware of studies that examine the extent to which this linkage has at times been significant. I think the logic is strong, however, and my own experience has convinced me that the problem is very real.

In striving to negotiate agreements that include provisions to address corruption, for example, I have never found success in doing so when dealing with a minister or chief of state who was worried sick about how to devalue his currency without triggering inflation and riots that would threaten his ability to remain in office. It also seemed to me that public contempt for an economic reform program

weakened respect for the government that was undertaking the reform and increased its vulnerability to corruption.

- **Economic Support Funds.** Large amounts of economic support funds, such as those the United States has provided to countries in which there has been a strong strategic interest, such as Central America not too long ago, provide new opportunities for waste and abuse in the absence of sound management. These opportunities are even greater when the assistance is accompanied by the generation of large amounts of local currency.

Although I came to oppose the imposition of most conditionalities in those formal agreements that required legislative approval, I did believe we needed to insist on better host country financial and contractual controls. These were often opposed as interference with internal affairs of the country, but I believed the taxpayers who were generating the funds were entitled to have those funds protected against diversion and abuse. Audit and accounting systems should have been required, not just suggested, and technical assistance made available whenever needed. Disbursement of funds should have been linked to progress in establishing these controls and credible testing of their reliability. It is my position that this failure of donors to place the fight against corruption high on the negotiating agenda resulted in cash supports unnecessarily expanding vulnerabilities to misuse of funds.

- **Loss of AID Independence.** Over the past decade, AID has gradually lost much of its independence as an agency, a development which I believe has increased the vulnerability of U.S. programs to waste and abuse, as well as handicapping the State Department in carrying out its mission. A foreign ministry in most countries is not the part of the government in which effective management has a high priority. It is not a major part of the training future diplomats receive, nor should it be.

An ambassador will want to muster all the embassy resources he or she can to meet current political issues with which the ambassador has to deal. There is not a great incentive to devote the amount of resources needed to provide adequate handling of contracts and grants. Host country audit and accounting controls are not high on the agenda of the ambassador or the DCM. Few of them realize the ease with which well-intentioned assistance projects can be abused.

One of the more frequent problems I faced in AID was that of keeping my mission directors from being too responsive to certain ambassadors who believed that winking at safeguards was necessary in the interest of good diplomatic relationships with host country leaders. Examples ranged from pressing AID missions to favor sons and daughters of important ministers in overseas training to special treatment in the award of contracts. Most U.S. ambassadors, however, were pleased with the degree of insulation from such pressures that the independence of AID provided.

I recall urgently cabling my mission director in Honduras in which I countermanded instructions he had just received from our ambassador to award a particular contract. I knew that the recipient worked very closely with the Contra forces opposing the Sandinistas, and that funds could very easily flow to the Contras in direct violation of the law. Ten days later, the whole Iran Contra scandal broke open, but my controller operation had successfully blocked any of our funds slipping into the wrong hands. Today, with AID having been placed within the State Department, no AID bureau director has sufficient operational autonomy to countermand a U.S. ambassador in this manner or to ensure the independent safeguards we were in a position to use to avoid politically induced scandal or illegal actions.

Summary. I suspect that there has been some progress in addressing many of the above problems since I left the field several years ago. Nevertheless, I hope that the foregoing examples illustrate my views about the unintentional consequences of foreign aid that

contribute to corruption vulnerability on occasion. One of my greatest concerns is that in some countries there may be a growing acceptance of the notion that corruption is nearly as inevitable in democratic governments and market economies as was experienced under communism.

Some argue that corruption is so deeply embedded in many of these countries that no amount of effort by donors will make a dent in the problem. I am not willing to concede this. But even if one were to agree that it is true in some circumstances, I suggest that very few donor decision makers are fully aware of the extent to which certain well-intentioned donor policies can increase opportunities for corruption in the absence of strong counter-measures. If they were, I should think anti-corruption measures would receive far more attention.

It may be that your International Anti-Corruption Forum has addressed most, if not all, of the problems I have outlined. If not, I hope you will. In closing I would like to say that I certainly wish your group had been in existence when I was a donor.

Attachment:

1990 Memo on Government Reform