U4 Helpdesk Answer 2018:26

Impact of structural adjustment programmes on corruption

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The implementation and outcomes of structural adjustment programmes (SAPs), promoted by the International Monetary Fund and the World Bank to help countries all around the world overcome their economic crises, have generated significant controversy. The SAPs' impact on the economic development and levels of corruption of those countries are of special concern. Regarding corruption, the literature presents two main positions: one, the anti-corruption discourse legitimises and justifies the need for SAPs. Two, SAPs do not actually reduce corruption but they exacerbate it. Contextual conditions and interactions of SAPs with other policies make it difficult to establish a direct causal relationship between SAPs and levels of corruption, but studies show that aspects associated with those economic reforms have exacerbated corruption risks.

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Query

I would like to understand the scope of any research linking the implementation of structural adjustment or rapid privatisation programmes led by international finance institutions to the growth of corruption and economic crime.

Contents

Main points

- SAPs can potentially increase corruption at the same time that they can be legitimised by anti-corruption discourses.
- The phase of implementation of SAPs is especially vulnerable to corruption.
- The level of corruption in a country can also influence the success of SAPs.

The link between SAPs and corruption

Since the 1980s several countries in Africa, Latin America, Asia and Eastern Europe have adopted structural adjustment programmes (SAPs) – loans given by the World Bank (WB) and the International Monetary Fund (IMF) – to overcome their economic and debt crisis. SAPs loans came with the condition of implementing certain policies to reduce financial imbalances and to set the foundation for long-term economic growth. The implementation of SAPs involved moving in the direction of opening economies, freeing up prices and reducing the role of the state in regulating and managing the economic sector (Summers and Pritchett 1993). In more concrete terms, they implied measures such as liberalising external and internal trade and commodity prices, cutting back government expenditure, reducing subsidies on food and fuel, privatisation of parastatal enterprises, raising prices of basic services, such as education and health, lowering wages and removing measures to protect employment (Williams 1994).

The literature presents two main positions on how SAPs and corruption relate to each other, which reflect how the requirements of international financial institutions' provision of assistance has evolved over time. If in the 1980s and 1990s the concerns were privatisation, taxation and trade, at the end of the 1990s and 2000s good governance and corruption became a main focus (IMF 2018; Wesberry 1997).

One position states that the existence of corruption in developing countries justifies in part the need for SAPs and their economic liberal approach. In the late 1990s, corruption and good governance became part of the IMF and WB's language. In their view, corruption was an economic problem with significant impact in economic growth and development. Weak institutions and corruption explained in part the economic crisis in debtor countries, and SAPs were presented as the solution to the problem. This position responded to an emerging neoliberal turn away from social democracy. The importance given to corruption progressively increased, becoming a pre-condition for receiving international aid.

This understanding of corruption as the obstacle and SAPs as the solution would justify and legitimise economic liberalisation and the agenda of transnational actors (Doshi and Ranganathan 2018). For instance, it played an important role in justifying liberalisation in India (Jenkins 2014). And in the post-Cold War era, the promotion of the fight against corruption in Africa, Latin America, Asia and the former Soviet Union and Eastern Bloc was associated with making those countries ready for foreign investment (Wedel 2015).

The other position contends that SAPs not only do not help to reduce corruption but they exacerbate it. According to Joseph Stiglitz, the privatisation promoted by the WB facilitated grand corruption by elites. Stiglitz said that, when some politicians sell state companies they do not object but rather "you could see their eyes widen at the possibility of commissions for shaving a few billion off the sale price" (Palast 2001). For instance, "the US-backed oligarchs stripped Russia's industrial assets, with the effect that national output was cut nearly in half" (Palast 2001).

Nevertheless, to establish a clear direct causal relationship between SAPs and levels of corruption is difficult. The composition of the programmes and aid vary greatly, which makes it difficult to generalise about the causality between SAPs and corruption. In addition, the effects of SAPs differ from country to country due to the interaction of different policies.

Thus, the economic liberalisation promoted by SAPs and corruption are multi-dimensional phenomena, and they present paradoxes and complexities in the way they affect each other. Econometric studies have often shown a negative relationship between corruption and economic freedom (Chafuen and Guzman 2000; Paldam 2002). However, there is the question of in what degree and pace economic liberalisation influences corruption, and if some aspects of economic liberalisation have more influence than others.

In trying to address this question, Graeff and Mehlkop (2003) investigated the impact of various components of economic freedom (understood as the absence of regulation) on corruption. The authors state that, while some state regulations on economic freedom might increase corruption, other types reduce it, and that influence also depends on the level of development of the country. In particular, they find that restrictions of capital and financial markets have the biggest impact on corruption. Particularly in poor countries, freedom to move capital across borders and be hidden abroad benefits corrupt individuals to launder money from corrupt or criminal actions.

Keeping illegal income in overseas accounts has been common practice among some oligarchs (Blackburn and Forgues-Puccio 2010). For example, Mobutu Sese Seko, president of the Republic Democratic of Congo from 1965 to 1997, stored part of US$4 million personal fortune in places like Switzerland (Drozdiak 1997).

Switzerland, Luxemburg, UK and the US were also destinations for the outflow of resources embezzled by the former military ruler of Nigeria, General Sani Abacha, with an estimated fortune of US$3 billion (Nsehe 2011). Similar examples can be found in other countries in Africa, Latin America and Eastern Europe.

In Russia, the economic liberalisation in early 1990s was followed by a huge capital flight, storing abroad US$68 billion from which 33% is estimated to come from illegal sources and 37% from semi-legal origins (Abalkin and Whalley 1999). In this case, economic freedom supported corruption. On the other hand, when regulations increase the transaction costs of illegal bargains, corrupt actions are less likely (Graeff and Mehlkop 2003).

Studies also indicate how the level of corruption might affect the positive or negative impact of economic liberalisation. Rivera-Batiz (2001) shows that the stimulation of capital flight by financial liberalisation depends on the existent level of corruption. When the level of corruption is high enough, the removal of barriers to international financial transactions generates capital flight. When the level of corruption is sufficiently low, financial liberalisation will attract capital to the economy. Blackburn and Forgues-Puccio (2010) also find that the presence of corruption in the government has a negative impact on the benefits of financial liberalisation for the economy. In non-corrupt countries, opening the economy to cross border financial transactions raises capital accumulation and promotes economic growth. On the contrary, opening a corrupt economy to international capital flows leads to higher corruption and reduces capital accumulation.

Stephenson (2014) points to a double paradox between liberalisation and corruption. On one hand, established democracies (liberalised political systems) seem to have lower levels of corruption, whereas countries in democratic transition, or in the process of liberalising the political system, tend to have higher corruption. On the other hand, liberal economies (characterised by more market competition, fewer state-owned enterprises and less central economic planning) have less corruption than countries in the process of economic liberalisation. Stephenson's analysis suggests that the difference in the impact of corruption is the distinction between being in the process of implementing adjustment programmes and when they have already been implemented. Later, in the final section, we identify some of the risks for corruption attached to the implementation of SAPs.

How anti-corruption legitimises SAPs

In the late 1980s, NGOs and institutions such as UNDP and Unicef criticised SAPs for their negative effect on development and led the IMF and the WB to shift the blame to debtor countries on account of their governments being corrupt, interventionist, inefficient, bloated bureaucracies with oversized public sectors, red tape and protectionism (Polzer 2001; Simon 2013). According to Polzer (2001), Breton Woods institutions adopted the anti-corruption and good governance discourses as a defensive strategy to respond to criticism of their liberal economic approach.

This defensive strategy evolved to build a specific understanding of corruption supportive of the IMF and WB economic arguments and practices. Polzer (2001) identifies five ideas that structure WB's conception of corruption:

- The idea of corruption is constructed as external to the WB, to debt, to the international economy or to other historical events such as colonialism or colonisation. What justifies an intervention regarding corruption is not the problem of corruption as such but an increasing external demand to which the WB is responding.

- The WB understands corruption as an economic problem only, excluding the political character of the phenomenon. This results in weakening and delegitimising governments, as well as ignoring how the WB's interventions affect power structures in the states and how politicians make decisions. Thus, the de-politicization of corruption through the work of the WB leads, according to some authors, to the emergence of a new type of 'governance-state' that has to reduce its steering activities to the minimum and allow free market reforms (Katzarova 2019).

- There is an unproblematised separation of the private and the public, with clear ideas of what kind of behaviour is expected in each of those realms: in the private sector actors are expected to seek personal profit, and in the public are expected to fulfil a duty to a greater good. However, this distinction corresponds to Western parameters and not so much to other experiences like in Africa, where, since the colonial times, the public sector was concerned with seeking profit. In addition, the WB abstracts administrative activities from their possible political significance, which does not correspond to the reality in Africa, for instance, where the civil service plays an important role in the consolidation of elites, appeasing opposition factions and managing conflicts over state resources.
- The WB focuses on institutional structures rather than in individual actors, and considers corrupt behaviour based on rational decisions, ignoring their moral component. This approach avoids challenging the power status quo and the individuals in power.
- Policy formulation in the WB has not considered the challenges to the implementation of its policies. The separation between who designs the policies (the WB) and who implements them (national governments) also conflicts with the amount of ownership needed for a successful programme.

The way in which international financial institutions give meaning to the idea of corruption legitimises their interventions and the lack of them, for example, by improving the quality of institutions. Moreover, they might indirectly incentivise corruption. For instance, the effect of excluding the government from economic decisions may delegitimise the state in the eyes of the population. Following Polzer (2001), this was especially relevant in new independent countries in Africa where the expectation is that the government has a say in economics. Thus, this separation of the economic from the political may reduce the trust of the population in the government and, as a consequence, increase tolerance to corruption (Polzer 2001).

How SAPs can exacerbate corruption

The implementation of SAPs involves the liberalisation of the economy through devaluation of the currency, deregulation and privatisation. The implementation of these measures involves corruption risks associated with the reduction of public spending, implementing economic reforms in states with weak institutional frameworks and oversight systems, and with the instability and public mistrust generated when implementing unpopular economic reforms (Breen and Gillanders 2013).

Liberalisation of the economy implies a reformulation of the role of the state in the economy, the introduction of new economic players by increasing the private sector, and a redefinition of the relationship between governments and firms. These changes in the economic landscape might create new spaces for corrupt behaviour as well as alternative forms of corruption.

According to Harriss-White (1996), changes in ownership might complicate lines of accountability and dilute enforcement capacity. In addition, the transition to a liberalised economy might imply having quasi-state organisations over which the state has some control. This might create opportunities for harmful rent-seeking (Zúñiga 2017) and bribery by some businesses to maintain access to resources or exemptions, and by other businesses to enforce deregulation (Harriss-White 1996).

Deregulation increases public servants' discretion over policy decision, making them vulnerable to bribes. Moreover, Decoeur (2018) highlights how deregulation of the banking sector has created new financing opportunities for illicit activities, has facilitated fraud, embezzlement, and money laundering, and created new opportunities for rent-seeking. Off-shore banking, tax-evasion schemes, unequal terms of trade, credit-export agencies and illicit capital flow are other drivers of corruption related to SAPs.

In transition economies with an uncontrolled distribution of state assets, corrupt relationships might take the form of attempts to capture the state and influence law-making processes. Hellman et al. (2000) show how some transition economies in Eastern Europe and the former Soviet Union are captured by certain firms, shaping and affecting the formulation of the rules of the game through private payments to public officials and politicians. In some of those countries, large incumbent firms with close ties to the government tend to inherit influence from the past and enjoy more secure property and contractual rights. To compete with those firms, new companies try to capture the state to compensate for weaknesses in the legal framework, buy secure property rights and remove obstacles that might damage their performance (Hellman et al. 2000).

Some studies argue that privatisation, or transfer of state ownership of companies and assets to the private sector, might increase corruption because it weakens government bureaucracies by reducing personnel and funding (Reinsberg et al. 2018). Moreover, those affected by the privatisation of state enterprises may try to make up for their losses pressuring bureaucrats to get other advantages, generating thus other forms of corrupt behaviour (Reinsberg et al. 2018).

Privatisation measures associated with SAPs have further blurred the boundaries between the public and private sectors by encouraging nepotism, placing resources in the hands of the ruling elite and facilitating plundering of the economy (Decoeur 2018), as well as the emergence of corrupt patron-client networks.

The liberalisation of the economy also opened the doors for the intervention of international players in transition economies with poor governance and weak regulations, generating or perpetuating corrupt activities. A clear example is the activity of international investors attracted by natural resources in Africa, Asia and Latin America, which has resulted in the maintenance and/or increase of corruption in the land sector (Zúñiga 2018). Over the last decades, there has been a significant increase in large-scale land deals in developing countries with abundant natural resources, land suitable for cultivation, extractive activities, timber concessions and/or infrastructure projects (De Schutter 2016). Data provided by Land Matrix reveals that, between 2000 and August 2017, an estimated of 1,347 transnational deals have been concluded, covering more than 49 million hectares, with the largest share in Africa (557 documented deals), followed by South-East Asia (337 documented deals).

The land sector is also an example of how pre-existent conditions, such as the quality of governance and levels of corruption, affect the impact of the liberalisation of the economy on corruption. Contrary to what the specialised literature argues regarding the importance of the business climate to attract economic foreign interests, high levels of corruption and poor governance are characteristic of countries that attract land investors (Arezki et al. 2012). Weak governance and corruption can facilitate quick and cheap deals, maximise profit and minimise red tape; all reasons why investors might be attracted to those contexts.

Finally, SAPs have resulted in high social costs since they undermine access to quality and affordable public services due to government cuts in services like health and education, and they often involve the reduction of food subsidies and a decline in wages, affecting vulnerable populations in particular (Thomson et al. 2017; Watkins 1995). In Zimbabwe, the "lack of human face" of the adjustments changed led to the acronym for Enhanced Structural Adjustment Programme (ESAP) being known as Enhanced Suffering for African People (Watkins 1995).

Some studies show how the inequality resulting from the implementation of the SAPs may affect differently urban and rural population (Williams 1994, Heidhues and Obare 2011). According to Williams (1994), the costs of structural adjustment fall most heavily on urban wage and salary earners and on consumers of public services. Those self-employed are affected indirectly since on the one hand they can pass on the costs of rising prices to their customers and, on the other hand, they are confronted by declining markets and increasing competition (Williams 1994). However, according to Williams, rural producers are less affected by devaluation since they were the least likely to have access to imported or manufactured goods at official prices or fair access to basic services. Moreover, structural adjustment benefits rural produces, particular those with export crops, by rising local prices (Heidhues and Obare 2011, Williams 1994).

The inequalities and poverty derived from SAPs creates opportunities for corruption at least in two ways. First, service delivery is one of the sectors most vulnerable to corruption from the procurement stage to the access to the service, and it acquires different forms of corruption, such as clientelism, patronage and bribery (Albisu and Chêne 2017). Second, the development aid sent to those countries to alleviate the inequality and poverty derived from the adjustment involve corruption risks too (Martinez B. Kukutschka 2018; Lindner 2014). According to reports from donors, the misuse of aid funds is a common form of corruption, and procurement processes is one of the most vulnerable areas involving collusion in the bidding process, falsifying bid documentation or bribery in the award of contracts (Lindner 2014).

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