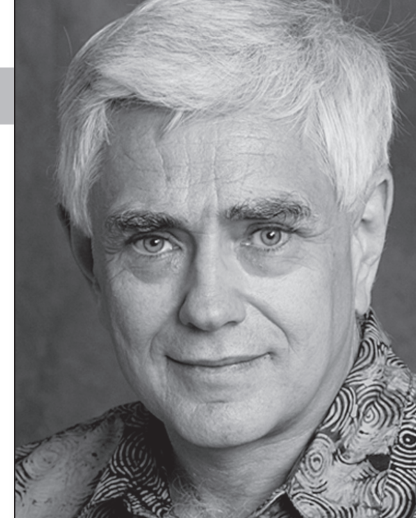
Does Chronic Leakage Undermine International Environmental Aid?



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When I first came to Washington in the 1980s, I heard references to *leakage* from contacts in the World Bank. I wondered how it could be that a well-funded institution like the bank would not maintain its plumbing — wasn't it time to fix the leaky toilets and faucets immediately and reduce the water bills? Of course leakage was the widely used euphemism even then for corruption. Over the decades leakage has grown, despite greater awareness and intermittent reforms in the transparency of the bank and other aid agencies. The initial institutional response often remains denial, and the cold light of continuing research reveals that reforms have often had little effect.

In February, the chief economist of the World Bank, Yale professor Penelope Goldberg, resigned after only 15 months on the job. Goldberg's departure, according to the *Economist* and *Financial Times,* appeared to be connected to frustration with the alleged suppression by bank management of a report documenting substantial increases of capital flight to tax havens directly following disbursements of bank loans and other foreign aid.

The bank subsequently did publish the paper ("Elite Capture of Foreign Aid: Evidence From Offshore Bank Accounts"), and its findings are troubling. It examined disbursements to 22 borrowing nations with a high dependence on foreign aid, and increases in financial flows from the same countries into offshore financial tax havens, finding an "implied leakage rate [of] around 7.5 percent for the sample." Leakage increases to over 15 percent for the most aid-dependent nations, where foreign assistance accounts for more than 3 percent of GDP.

According to the paper, "The results are consistent with aid capture by ruling elites; diversion to secret accounts either directly or through kickbacks from private-sector cronies can explain the sharp increase in money held in foreign banking centers specializing in concealment and laundering." The authors, affiliated with universities in Norway and Denmark, state that their analysis is "consistent with the view that very high levels of aid" may actually "foster corruption and institutional erosion."

These findings are of great relevance for the increasing flows of bilateral and multilateral aid for environmental purposes. For one thing, a significant part of environmental aid to conserve biodiversity goes to poorer countries with threatened ecosystems — for example tropical forests in the Democratic Republic of the Congo, Madagascar, or Papua New Guinea. Substantial aid has gone for climate finance where there have been well-publicized problems of environmental integrity — is the aid financing real net environmental benefits? — and corruption. The Kyoto Protocol Clean Development Mechanism, the U.N./World Bank Reduced Emissions for Forest Destruction and Degradation (REDD+) programs, and the UN Green Climate Fund are among the climate finance instruments where concerns over environmental integrity and leakage have arisen.

> **The cold light of research reveals that reforms have often had little effect**

In 2005, the Senate Foreign Relations Committee found that as much as 30 percent of multilateral development bank lending may be leaked — stolen by borrowing country national elites and their collaborators and facilitators often based in rich countries. The bank established a Department of Institutional Integrity to investigate corruption in bank projects in 2001, but from the beginning even this modest initiative encountered resistance from major borrowers whose governments complained of an infringement on sovereignty.

In 2007, the bank's executive board commissioned former U.S. Federal Reserve head Paul Volcker to lead an independent evaluation of the integrity department. After submitting his report, Volcker told the *Financial Times* that there was "ambivalence in the bank as to whether they really want an effective anti-corruption program or not." Many on the board as well as in the operational staff feared that "a strong anti-corruption effort would be anti-development." Volcker concluded that "the bank does not lack for units reviewing and evaluating its varied operations," but, he added, "a strong focus on managerial and institutional accountability is lacking." The circumstances surrounding Goldberg's departure indicate that Volcker's concerns are still at least partly valid.

The new bank leakage report observes that a decade of OECD-driven reforms have enhanced financial transparency in rich country tax havens, but nevertheless its sample data for 22 nations produced "no clear signs" of reduction in the leakage and theft of aid.

The World Bank is hardly the worst example of leakage. In fact, because of its increasing transparency and the degree of outside scrutiny it attracts, the bank probably ranks among the best-managed international institutions — which is both the proverbial good news and bad news.