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# CORRUPTION

..... AND .....

## GOVERNMENT EFFECTIVENESS

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### The influence of transnational organized crime

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PER CONCORDIAM ILLUSTRATION

Corruption is a global security issue. It has been a problem for a very long time and has finally been recognized as a first-tier international security challenge. Many view corruption as a “victimless” crime and bribery only as a different way of doing business, but today there is wide acknowledgement that corruption infringes on the fundamental human right to equal treatment. Major corruption cases are making news around the world. Current studies yield important insights on the nexus of transnational organized crime (TOC) and corruption as major threats to political stability, human security, democracy and economic development. United States Secretary of State John F. Kerry, in a speech to the World Economic Forum in Davos, Switzerland, called the negative consequences of corruption a social danger, a radicalizer and an opportunity destroyer.

Corruption takes many forms and shapes. Bribery, embezzlement, fraud, extortion, nepotism, cronyism and monopoly are among its manifestations. Examples of corruption include a multinational company, with suspected ties to criminal organizations, paying bribes to win a public contract; a politician redirecting public investment to his clients; a public official embezzling funds allocated for a new school to build his private mansion or pay a kickback to a questionable construction firm; a manager recruiting an ill-suited friend for an executive position; political parties hiding the sources of electoral financing; or a local policeman demanding bribes from ordinary citizens.

There is no single universally accepted definition of corruption, but there is wide agreement with the international, nongovernmental organization Transparency International’s definition of “the abuse of entrusted power for private benefits.” Other definitions capture multiple perspectives of disciplines such as law and criminology, sociology, economics or international development. The term itself is broad. Corruption can be incidental, systematic or endemic. There are two main groups: grand corruption, involving the highest levels of government, and petty corruption, the exchange of small amounts of money for minor favors.

Economist Robert Klitgaard explains that corruption usually occurs in certain contexts in which a monopoly of power is combined with discretion and absence of accountability. First, someone has to have some sort of discretionary power over the allocation of resources, both public and private. Second, there are economic rents associated with this power, in which higher incentives result in higher rents. Third,

for corruption to flourish, the value of derived income must be sufficient to offset the penalties associated with such acts. At the end of the day, corruption is a crime of opportunity that individuals and criminal organizations are eager to exploit. The incidence of corruption depends upon opportunities available and the effectiveness of measures designed to deter malfeasance.

Theories suggest that high levels of corruption and the absence of accountability and transparency are primarily consequences of governance failures and weak rule of law. In the globalized world, bad governance becomes a liability. Areas with poor governance create vacuums of power that are easily exploited by traffickers, criminals, insurgents and terrorists.

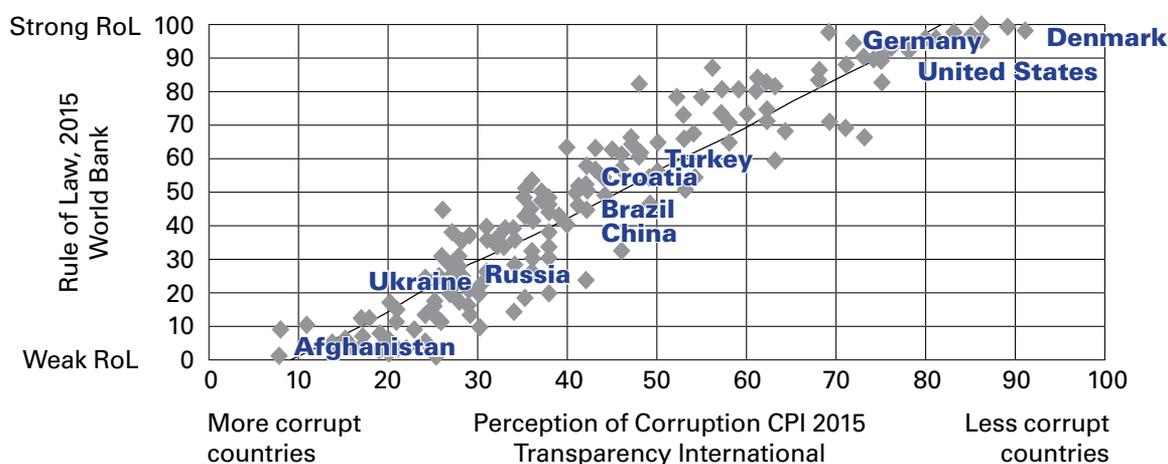
Corruption is mainly a rule of law and governance issue (see figures 1 and 2). Indices tracking corruption on one hand, such as Transparency International’s Corruption Perception Index 2015, and rule of law and government effectiveness on the other hand, measured by the World Bank’s Worldwide Governance Indicators such as the Rule of Law index and the Government Effectiveness index, reveal a visible correlation: Countries with severe corruption suffer weak rule of law and poor government effectiveness.

While these simple correlations are alarming, the graphics do not reveal the cause-effect relationship. Does more corruption cause weak rule of law and poor governance effectiveness or vice versa? Highly corrupt countries run the risk of getting trapped in a vicious downward spiral that leads to the institutionalization and acceptance of corruption. By corroding the public trust, undermining the rule of law and delegitimizing the state, corruption creates a deficit of trust in interpersonal relations. Longstanding acceptance of corruption, fatalism and resistance to change become a “justification game,” which perpetuates bottlenecks in institutions, stalling reform. When people notice that corrupt behavior is not sanctioned, it becomes morally acceptable, creating a crisis of values among society and institutions.

Fighting corruption is not easy. One of the biggest challenges is that corruption is seen only as a symptom, a sign of failure of governing systems. Instead, in places where corruption is endemic, it is the system. In such cases, governments have been repurposed to enrich the ruling elites and serve their personal objectives at the risk of the population.

Corruption costs everyone, but is taking a much heavier toll in poorer countries. According to the World Bank, corruption costs the global economy more than \$1 trillion a year. Other international institutions estimate even higher financial costs, although

**Figure 1. Corruption and Rule of Law (RoL)**



actual costs are hard to measure because of the illicit nature of the crime. However, rampant corruption in some parts of the world is robbing the poorest people of up to three-quarters of their economic potential while benefiting the privileged — thus the moniker the “Robin Hood-in-reverse tax.”

Today, corruption is viewed as being responsible for political instability, economic deprivation, low efficiency and poor governance around the world. It destroys economic value, thwarts development, victimizes ethical people and businesses, perverts policies and undermines democracy. Scholars and policymakers are increasingly finding corruption to be entangled with other security challenges, from organized crime to violent extremism and terrorism. It is important to examine the multivector consequences of corruption — democratic, economic and geopolitical.

Although most corruption in developing countries is local, it is exacerbated by international purveyors of corruption. The unprecedented speed of globalization has both exposed and accelerated large-scale corruption and diminished the authority of governments through the expansion of free trade, open borders, free movement and new technologies. The push for globalization and liberalization at the beginning of the 1990s opened a new mechanism for bureaucrats in former communist countries to exploit regulations and gain illicitly from the privatization process. Additionally, the rapid expansion of offshore financial centers within the global banking system, as shown by the recent “Panama Papers” scandal, has made it easier to move money internationally and made the fight against corruption very difficult. These secrecy jurisdictions, or tax havens, refer to financial and fiscal domains that are subject to little or no effective jurisdiction or transparency. According to a 2010 report by Global Financial

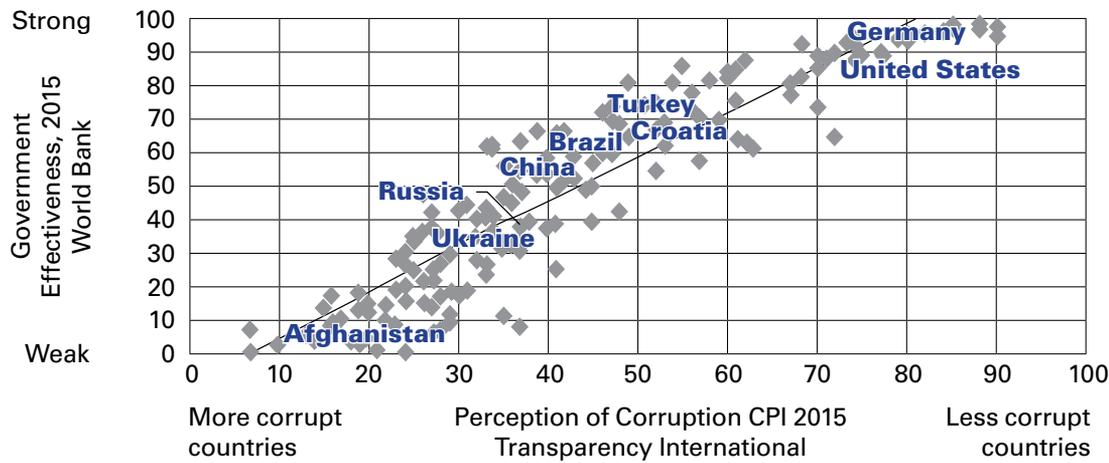
Integrity, a U.S.-based nonprofit working to counter illicit financial flows, the total amount of offshore deposits was nearly \$10 trillion.

The objectives of corruption are wealth and power, whereby corrupt governments seek to capture a country’s revenue streams for the personal profit of corrupt elites. Identifying and assessing such revenue streams is crucial in a comprehensive fight against corruption. The streams of illicit profits vary from country to country, depending on geography, history, natural resources, regional context, political systems, and economic and social development. Natural resources present one of the most common revenue streams, which is referred to in economic literature as the “resource curse.” This mainly describes countries rich in natural resources that are misused and exploited by the few kleptocrats, hindering present and future development. Some African countries, rich in natural resources, are perfect examples of places where corrupt elites fight over political and economic control of resources.

TOC enterprises such as narcotics, human smuggling, and trafficking in arms or wildlife products, are revenue sources for corrupt elites. These activities are prevalent in drug producing countries such as Afghanistan or Colombia. Geography also plays a critical role, especially for transit countries such as those in West Africa, Latin America, Central Asia or the Balkans. External financial assistance is another revenue stream that has been monopolized by corrupt networks. Petty bribery can also represent a significant revenue stream. In Afghanistan, the annual sum of daily shake-downs was estimated at \$4 billion in 2014.

Previously, international discussions about corruption focused on the more visible petty or bureaucratic corruption. “Petty” is a misnomer because of the large economic and human costs, but it is also a symptom

**Figure 2. Corruption and Government Effectiveness**



of a larger disease: grand corruption or kleptocracy. Lawrence Cockcroft, in his book *Global Corruption: Money, Power, Ethics in the Modern World*, explains that the drivers of petty corruption vary from survival — compelled by low official salaries and lack of opportunities — to greed, which may emerge from the efficacy of survival corruption. Corruption can also be orchestrated from above or traced to sociological factors and systems of social reciprocity, where public officials do favors for family members or others with strong personal ties.

Grand corruption is pervasive political corruption and generally refers to the exploitation of power by political elites to direct and distort economic policies. By turning the institutions of public service into tools for public exploitation, this type of corruption causes large economic and social tolls. It undermines financial accountability, discourages investment and stifles economic performance. It feeds instability by eroding trust between people and government, and destroys the social fabric. This type of corruption drove protesters into the streets to upend the political order in Tunisia, Egypt, Ukraine, Moldova and elsewhere.

Among the drivers of grand corruption, the most problematic is illicit funding of political parties. It raises money to sustain regimes in power or invests in politics as a way of securing business objectives for politicians, criminal organizations and their clans.

Multinational companies have been another driver of corruption, with some seeing foreign bribery as a normal part of market development. This perception was challenged for the first time in 1977 by the U.S. Foreign Corrupt Practices Act (FCPA), which criminalized the payment of bribes by U.S. companies to foreign government officials. Until the early 2000s, the FCPA was rarely enforced, but this has changed, accompanied by the adoption of other important international conventions.

Transfer pricing and illegally traded products are also considered drivers of corruption since more than half of global commerce is accounted for by sales between subsidiaries within the same corporation.

### The Corruption and Organized Crime Nexus

Research shows a very strong nexus between corruption and organized crime. This situation is common in post-communist and post-conflict countries where power vacuums and weak rule of law have created opportunities for criminal organizations. Any comprehensive analysis of the growing threat of TOC must consider the role of corruption in its role as an enabler for these activities. The relationship between organized crime and corruption creates a nexus that, once established, is very difficult to break.

Today, TOC networks are much more sophisticated and challenging to fight. New TOC groups are constantly diversifying their methods and structures, and, enabled by the forces of globalization such as technology and innovation, have increased their impact on society. By adapting new technologies and methodologies, organized criminal networks have dramatically increased their reach into the lives and affairs of ordinary people, governments and private companies. The internet — as a key facilitator of electronic communication — and the rise of international transfer firms have played crucial roles in assisting the growth of the worldwide illicit economy through money laundering tools and facilitating new types of criminal activity such as cyber crime.

To better understand TOC, it is important to look at the TOC enterprise theory. Jay Albanese, a criminology expert, argues that a TOC network is “a continuing criminal enterprise that rationally works to profit from illicit activities that are often in great public demand.

Its continued existence is maintained through the use of force, threats, monopoly control and/or the corruption of public officials.” Based on this theory, organized crime groups exist because legitimate markets leave many customers unsatisfied. Criminal groups could be considered to be as rational as multinational companies, seeking economic profit through the evaluation of risks, benefits and market analysis for a particular country.

With global expansion, the international dimension is key to understanding cooperation among different organized crime groups transcending national, ethnic and business differences. It is striking that TOC groups are not involved exclusively in illicit activities, but venture into legitimate businesses and the regular economy, creating blurred boundaries between legal and illegal and making them less visible and harder to target.

The proceeds of illicit trade, largely rooted in organized crime — whether it is human trafficking, drugs, arms trafficking, illegal wildlife, counterfeiting or money laundering — fuel the black-market economy. These activities proliferate in regions where there is lack of governance and high levels of corruption. The World Economic Forum’s Global Agenda Council on Illicit Trade estimates the illicit “shadow economy” to be as much as \$2 trillion a year. The ties between TOC groups and grand corruption are rising as a security threat. Louise Shelley, author of *Dirty Entanglements: Corruption, Crime and Terrorism*, has documented the scale of the organized crime-corruption threat.

Push and pull factors are stressed in analyzing the spread of criminal enterprises. Pull factors represent opportunities offered by unregulated markets, the absence of a well-functioning state, weak rule of law, lack of judicial and enforcement tools and widespread corruption, leading to an environment conducive to successful criminal activities. Existing vacuums in regulation and enforcement can be easily filled by TOC, undermining the legitimacy of the state. Other more immediate challenges such as poverty, unemployment, corruption, political instability, weak governance and interethnic disputes create the perfect environment for exploitation by TOCs.

Weak governance, corruption and poverty create a vicious cycle that destroys opportunities and development. Institutional weaknesses and fragmentation, socio-economic inequalities, uneven development and openness to corruption encourage organized crime to flourish. Organized crime has a real impact on institutional and judicial corruption in some countries because bribes and kickbacks are significantly higher than public administration salaries, within the framework of a highly politicized and unprofessional civil service.

These problems are reflected in many countries, from Asia to Africa, to the Black Sea, the Balkans and

Latin America. Significant long-term power vacuums were created in post-dictatorial, post-colonial and post-communist countries, caused by revolutions, wars, ethnic disputes, extremism and major political changes. In addition, the strategic geographic location of some of these countries created unique opportunities for illicit profiteering, which helped develop complex patterns of interdependent organized crime and corruption.

Decreased incomes and increased unemployment, caused by the recent economic recession, made individuals and organizations in the private and public sectors more vulnerable, consequently presenting greater opportunities for criminal activities and making the fight against organized crime more challenging. Increased social tolerance toward criminal activities could be the highest risk for society.

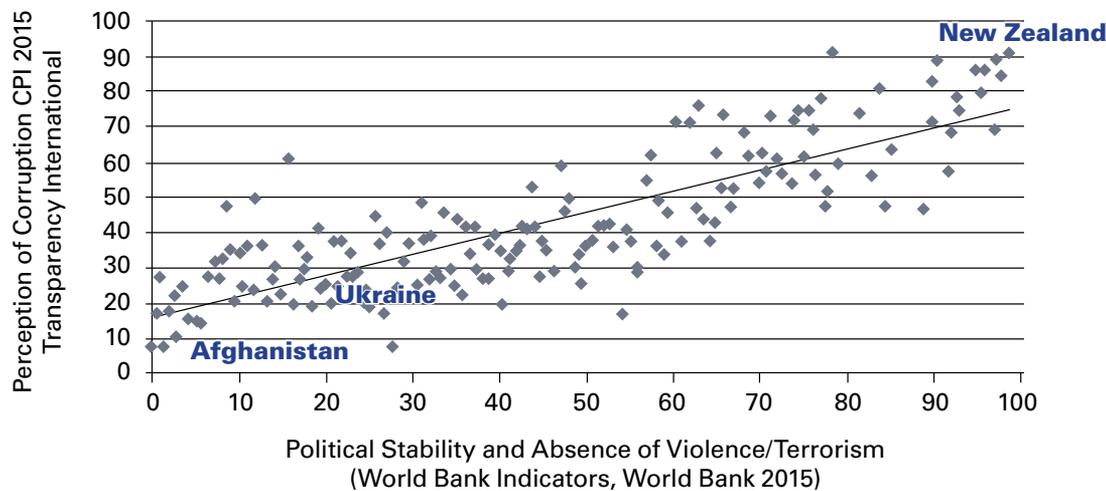
For example, according to sources such as Europol and the United Nations Office on Drugs and Crime, Southeastern Europe has seen the greatest organized crime expansion in the last decade, gaining a dominant position with an annual market value of \$20 billion and contributing to the formation of a Balkan axis for trafficking a wide variety of illicit commodities to the European Union. The Global Financial Integrity report states that dirty money from crime, corruption and tax evasion cost the Balkan countries an astounding \$111.6 billion over 10 years (2001-2010); Serbia ranked the worst with about \$5 billion annually. Previous conflicts and political instability have, over time, distracted Balkan governments from implementing real economic and political reforms, resulting in fragile democratic institutions and undermining effective law enforcement across the region.

### Corruption Hurts National and International Security

The impact of corruption on international security has been overlooked for a long time. Today, there is a heightened international focus on anti-corruption efforts. Of course, corruption happens anywhere, even in the most developed countries, but when a country is hampered by endemic corruption that pervades the political system and state institutions are captured for the interests of a few elites, it poses a significant threat not only to the security of that country, but it also poses a real risk to the international order. From this perspective, corruption is an international social danger and radicalizer that feeds organized crime, extremism and terrorism, and destroys people’s faith in legitimate authority.

A recent study by the Carnegie Endowment for International Peace found a visible correlation between indices of violence, instability and corruption, showing that countries characterized by rampant corruption tend to suffer conflict and state failure. In fact,

**Figure 3. Corruption and Political Stability**



12 of the 15 lowest ranked countries in Transparency International's Corruption Perception Index 2013 suffered from some sort of violent extremism, terrorism, insurgency or other similar threat to international security. Countries such as Libya, Syria, Afghanistan, Sudan, Iraq and Yemen fall into this category.

Pervasive levels of corruption create fragile states by limiting effective democratic governance. The rule of law is damaged when rules and regulations are circumvented by bribes, public management is undermined by illicit money, and free media is silenced through political control. A highly corrupt country runs the risk of getting trapped in a vicious downward spiral, leading to the "institutionalization" of corruption. Social and economic inequality cause a loss of confidence in public institutions, creating turmoil and increasing social instability.

These implications played out very clearly in North Africa and the Middle East, where popular outrage against kleptocratic regimes sparked the Arab Spring in 2011. The international community overlooked the endemic corruption that had plagued these African countries for many decades until it became the only reference for a system of governance. Today, the negative consequences are also felt inside the EU, which is facing the largest refugee and migrant crisis since World War II. More than 1.5 million irregular migrants crossed European borders in 2015 alone. While hundreds of thousands of people are fleeing war and terrorism, the large majority are escaping poverty, unemployment and lack of opportunities. This current migration crisis has also focused new attention on the migration-corruption nexus. Recent studies show that countries where corruption is perceived to be widespread are primarily countries of emigration, and countries where corruption is perceived to be a minor issue are recipients of immigration.

The consequences of corruption also played out very clearly in Ukraine, where popular outrage against of the kleptocratic regime of President Viktor Yanukovich sparked the Maidan protests in 2013 and the Revolution of Dignity. Yanukovich's decision not to sign the Stabilization Association Agreement with the EU was the trigger of popular unrest, the tipping point of a crisis that stemmed from more than 20 years of weak governance, rampant corruption and a lopsided economy dominated by oligarchs. In 2013, Ukraine ranked 144 of 175 countries in the Transparency International Corruption Perception Index. At the beginning of the 1990s, Ukraine and Central European states such as Poland and the Czech Republic stood on similar economic footing, with similar incomes and standards of living. While the Central European states reformed quickly to free-market economies, Ukraine succumbed to slow economic development. Today, Ukraine is among the poorest countries in Europe, with less than \$4,000 per capita average income.

Through infiltration of the official economy and the political sphere, organized crime and corruption have profound economic and political consequences, in addition to the obvious social and psychological costs. These phenomena increase risk and uncertainty in the business sector, hindering the accumulation and distribution processes, hurting economic growth and negatively impacting the country's competitiveness.

### Countering Corruption Internationally

The fight against corruption has become a high priority worldwide, but there is no magic bullet. Any realistic anti-corruption effort should start with recognizing that both supply and demand need to be addressed. According to Vito Tanzi, former director of the International Monetary Fund Fiscal Affairs



Ukrainian Interior Ministry officers block activists demanding the resignation of law enforcement officials, whom they say were involved in corruption and other criminal violations, in Kyiv in April 2016. REUTERS

Department, four main issues need to be tackled to successfully counter corruption:

- Honest and visible commitment to fighting corruption by leadership;
- Policy changes that reduce the demand for corruption by scaling down bureaucratic regulations and increasing economic transparency;
- Reforms that reduce the supply of corruption by increasing public sector salaries, increasing incentives toward honest behavior, and instituting effective controls and penalties;
- Electoral reforms that increase transparency in the financing of political parties.

Addressing corruption requires a broad and bold approach. The gravity of the problem calls for radical measures, strong political will and a comprehensive response. Tackling corruption is also the first step in fighting transnational organized crime. Attempts to dislodge organized crime and eradicate corruption are unlikely to be successful unless the forces that create power vacuums in the most affected countries are addressed. Since corruption and organized crime create and are fed by poverty, underdevelopment and weak institutions, efforts should focus on economic development.

For successful strategies, a balance is needed between law enforcement responses to punish corrupt people and broader reforms to strengthen corruption prevention efforts by fostering economic and social development. There are three main scholarly approaches to fighting corruption: the lawyer, the economist and the businessman approaches.

The lawyer approach corresponds to tougher, more

effective laws to increase the risks and costs of engaging in corruption. Legislation is an essential instrument to combating corruption and organized crime; however, it frequently is reactive regulation, which often results in an unwise response to these types of crime. Strong regulations to curb corruption and organized crime often fail to address the roots of the criminality. There is a need for strong implementation of legislation and harmonized regulation regionally and internationally, rather than just increased national legislation. In countries affected by endemic corruption, there are huge gaps between formally adopted laws and the inability of institutions to enforce them. Strong criminal laws against corruption are a necessary condition, but insufficient alone. Regulations need to be accompanied by well-staffed and funded institutions able to implement these laws. Strong institutional capacities are therefore crucial to effectively address organized crime syndicates and their corrupt enablers. A society could deter crime by making illegitimate activities costlier, increasing the probability of crime detection and the severity of punishments.

The economist approach advocates increasing the level of economic competition so that reforms can generate a more open market economy and honest competition, thereby reducing opportunities for corruption. This approach includes streamlined and transparent government processes in the market economy to reduce opportunities for graft. Countries should invest in strengthening institutions, and increasing transparency and accountability with the aim of creating a favorable business environment to attract quality foreign investors that would benefit long-term, sustainable development and have positive spillover effects, improving the domestic economy and increasing competitiveness.

The businessman approach contends that the government should pay higher wages to civil servants to reduce their need to engage in corrupt activities. Pay reform is important, but insufficient alone. It needs to be combined with monitoring, transparency and accountability, and merit-based recruitment and promotion mechanisms.

A combination of these three approaches can be a recipe for success. Georgia provides an excellent example, showing that the vicious cycle of endemic corruption can be broken with appropriate and decisive reforms. Georgia took and applied the best experiences of other countries, such as Hong Kong and Singapore. In 2003, corruption permeated nearly every aspect of Georgian life. Since the Rose Revolution at the end of 2003, the government's "zero-tolerance" policy drastically reduced corruption in the public services. After instituting a number of economic reforms to liberalize its markets and improve efficiency, Georgia dramatically improved its position, not only in Transparency

International's Perception of Corruption Index, but also in the World Bank's Doing Business rankings. It moved from 112th in 2006, to 8th in 2014. Georgia's top-ten ranking enhanced its ability to attract large inflows of foreign direct investment (FDI), which became a driving factor for economic success. The total stock of FDI in Georgia increased more than sixfold, from \$423 per capita in 2004, to \$2,833 per capita in 2014. The FDI increase correlates with a threefold increase in Georgia's per capita income, which rose from \$1,135 in 2004 to \$3,699 in 2014.

The best way to fight corruption is through strong regulation and building effective institutions. Strong institutions are key. Fighting and preventing corruption requires the participation and commitment of all of society. Well-functioning public management systems, an independent judicial system and vigilant civil society are at the core of any anti-corruption strategy. These are objectives that cannot be achieved overnight. Increasing transparency must be the first serious step in this process. In fact, transparency is becoming an important tool in efforts to reduce corruption worldwide. If the work of the government is transparent to the public, citizens can hold officials accountable. The experience of Scandinavian countries shows that open and transparent societies are the best remedy against corruption.

Civil society, private businesses, and free and independent media can also play key roles in dispelling the black clouds of corruption and organized crime. Cooperation and effective partnerships with these institutions would provide sustainability in the long term, assisted by information and communication technology. Civil society and the media should play the role of watchdogs of public-sector integrity. Promoting public awareness, transparency, accountability and integrity in public institutions and civil society aids the fight against corruption. Fortunately, the 2011 Open Government Partnership initiative offers an enduring platform of these principles for reformers committed to making their governments more open, transparent and accountable to citizens. The initiative started with only six countries, but has grown to 69 countries where government, civil society and businesses are working together to develop important open-government reforms.

Fighting corruption internationally is not only central to the work of law enforcement agencies, it is also a new priority for diplomacy. In January 2016, in his speech at the World Economic Forum, John Kerry raised the fight against corruption to a new level by asking everyone to make it a national security priority.

Fighting public corruption on an international level started with the U.S. FCPA in 1977, the first



Brazilians demonstrate against former president Luiz Inacio Lula da Silva, who faced corruption allegations, in March 2016. Tolerance for official corruption is declining worldwide. REUTERS

legislation ever to outlaw a bribe paid in another country. Unfortunately, other developed countries did not embrace such measures and foreign graft from multinational companies continued to be tax deductible for another two decades. A big step was taken internationally in 1997 when The Organisation for Economic Co-operation and Development passed the Convention on Combatting Bribery of Foreign Public Officials in international business transactions. This legally binding anti-bribery convention was signed by 34 members and five nonmember countries and entered into force two years later. The 2003 United Nations Convention against Corruption, which came into force in 2005, is the lodestar of anticorruption initiatives. It includes very important acts which combat foreign bribery, facilitate the extradition of corrupt officials, encourage mutual legal assistance, and assist in the recovery and return of stolen assets.

Globally, institutions such as the EU, the Council of Europe, the Organization of American States, Transparency International, the World Bank and the G-20, the group of countries accounting for 85 percent of the world economy, have recognized corruption as a global problem and are engaging to produce solutions.

Global anti-corruption policies are only as strong as the political will to enforce them. The good news is that citizens worldwide are increasingly willing to hold their governments accountable. Technology, investigative journalism, social media and international efforts have played key roles in raising awareness about the scourge of corruption. Leaders worldwide can no longer afford to ignore the call for good governance. □