



THE FLETCHER SCHOOL
TUFTS UNIVERSITY

**The Nexus:
Corruption, Conflict & Peacebuilding Colloquium**

Thought Piece: How does corruption happen?

Fighting corruption has become an increasingly important topic for governments of the industrialized donor nations and the institutions whose membership they dominate. The World Bank and US government are at the forefront of this agenda, though most of the European nations have subsequently added it to their foreign aid policies in recent years.

Despite the increasing attention placed on this issue by the international community, very little exchange occurs between those working on conflict/peacebuilding and those engaged in fighting corruption. The de-facto pillars operate simultaneously and often in overlapping sectors yet without co-ordination or purposeful mitigation of possible consequences (positive or negative) each may have on the other.

The Institute for Human Security within the Fletcher School at Tufts University hosted a select group of thinkers and policy makers to discuss the critical questions related to the nexus of conflict, corruption and peacebuilding on April 13, 2007. The *purpose* of the event was threefold:

- 1.) Finalize a map of existing research and activity related to the nexus;
- 2.) Exchange views and ascertain thinking about gaps and emerging questions; and
- 3.) Determine the questions of significance for a research agenda and attendant activities moving forward

In preparation for the colloquium, each participant was asked to draft a short *Thought Piece* on a specific aspect of the agenda in order to fuel the discussion. These pieces were intended to be ‘food for thought’ and not academic, formal publications;¹ nor were they intended to be made public. However after much discussion regarding the paucity of existing literature it was felt, where authors permitted, that there was value in making them available.

For further information on the Colloquium, contact Professor Cheyanne Church at Cheyanne.church@tufts.edu or see <http://fletcher.tufts.edu/corruptionconf/index.html>

¹ Further information on the agenda and the parameters provided on the Thought Pieces may be found on the Colloquium website.

THE NEXUS: CONFLICT, CORRUPTION & PEACEBUILDING THOUGHT PIECE

A Political Economy Perspective of How Corruption Happens in Conflict and Peacebuilding

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Preliminaries

- This commentary adopts a critical political economy perspective and therefore contests the liberal order that divorces the political from the economic. Orthodox ‘economy building’ operations adopt unreflective assumptions about economic laws and treat economic reform as a technical, a-political, value-free issue. Nor does the critical perspective offered here endorse the liberal project’s assumption that physical and structural violence can be artificially divorced. This piece contends that distributive injustice and structural violence continue when physical violence stops.
- A broad definition of corruption is used here in order to capture phenomena that are excluded by a narrow emphasis on abuse of public office or ‘entrusted power’, i.e. mere political corruption.² A critical theory perspective warrants a broad definition because:
 - (a) there is usually limited and contested public office in conflict zones, let alone much ‘entrusting’;
 - (b) the restricted definition creates silence over ‘non-political corruption’, such as corporate corruption (at which advanced capitalist societies excel).
- The commentary makes particular reference to Bosnia and Hercegovina (BiH) and indicates how corruption occurs, who is involved and why it persists. A provocative finale follows.

The How

- Legacies of pre-conflict corruption include crony economic development; avoidance of regulation and command planning; and fraudulent accounting to meet targets.
- Sanctions, where applied, provide a considerable boost to corruption because of the incentives to evade that may result in new means to control trade, as happened in BiH, Macedonia and Serbia for example.³

* The author apologises for the absence of diacritics in proper names. This is not his preference and no discourtesy is intended. US web software appears to default to a mode which mismanages accents and diacritics, and so the author has removed them in this version.

² *Transparency International's Global Corruption Report* for 2004 focused on political corruption, defined as: ‘the abuse of entrusted power for private gain’ (p.11), which omitted company fraud and those *not* entrusted with power (though ‘power’ like ‘private’ is not defined). It is a contention of critical international relations that the public and private spheres are difficult to distinguish in advanced modernity.

³ Peter Andreas, ‘Criminalizing Consequences of Sanctions: Embargo Busting and Its Legacy’, *International Studies Quarterly*, vol.49, no.2, June 2005, pp.335–360.

- Conflict creates new incentive structures for primitive capital accumulation (i.e. the acquisition of surplus value as a process delimited by Marx in which capital is acquired and markets expand). It can be interpreted as continuous and not just bound historically and involves plunder and violence as well as profits made from exchange. These conflict incentives include:

- (a) change in the pattern of diminishing marginal returns because of shortages (i.e. the high value of goods for which there is no regular supply creates profit windfalls);
- (b) displacement of 'legal' options;
- (c) enhanced discrimination against 'others';
- (d) predation and looting;
- (e) resource exploitation;
- (f) new borders that create obstructions and incentives for engaging in risky exchange;
- (g) borderlands grow in significance and gain extra-territorial linkages as central authority weakens.

- The conflict endgame (the military, political, economic and social relations that coalesce around developing a peace) can create opportunities for corruption. Dayton created multiple layers of authority that proliferated such opportunities, notably in the Federation.

- Violence and intimidation is used to protect new empires, though it has largely been superseded by divisions of spoils or the isolation of rivals.

- Peacebuilding creates incentives for corruption because by definition corruption can only exist where efforts to establish rule of law are undertaken. An even more critical stance is that: 'These regulatory frameworks are evasive ones because rather than [the 'international community'] taking political responsibility for its regulatory policies it seeks to assert that its actions are merely facilitating the will of the governed, aimed at empowering and capacity building both states and their citizens.'⁴

- In BiH economic policies have meshed with corruption, especially through the sequestration and redistribution of assets (including public/social assets), asset stripping, privatisation, decentralisation, sub-contracting, lack of employment policies and the absence of policing/judicial system.

The Who

- Controllers of scarce goods. In combat economies strongmen engage in predation and exploitation at various levels. They may be warlords or pre-war security personnel and pre-war entrepreneurs. They may be intellectuals and self-styled 'patriots' (Karadzic). Often they are opportunists acquiring capital. In BiH, smuggling was often an opportunistic venture. Sometimes such control is associated with 'resource wars' but often with 'service provision'.

⁴ David Chandler, *Empire in Denial: the politics of statebuilding*, London: Pluto, p.143.

- Political and religious elites establishing and reinforcing clientalism, patrimonialism and control of constituencies. In BiH, political parties are perceived as the most corrupt institutions in BiH. Party leaders developed a symbiotic relationship with shadow economies.⁵
- Entrepreneurs with access to resources. BiH lacked an easily transported mineral wealth or an agricultural crop comparable to poppy cultivation in Afghanistan (where farmers can make gains). But it has forestry. In BiH the timber business was riddled with illegal logging, unlicensed saw mills and links to persons subsequently indicted for war crimes. One company based in Republika Srpska has a timber web, up to 50% owned by the SDS (Serbian Democratic Party, which supports Karadzic) and another 50% by the PDP (Party of Democratic Progress).⁶ It has links with a roads and construction firm in Serbia and firms in the Federation as well as RS logging companies.
- Mobility controllers are just as significant as resource controllers. Officials and others who control movement and access can charge premiums because mobility is interrupted by conflict. In BiH the political borders erected by Dayton also reinforced the profits to be made by crossing them. The costs of access and movement and those who control it charge premiums, including taxation of relief supplies. If the risks and costs associated with a particular route increase then it can often be displaced.⁷ It should be unsurprising that hotels serving as transit points became sites of money laundering and trafficking.
- Transport owners and conveyors are in high demand for their services. Although vulnerable to hijacking and taxation by route controllers, they can also smuggle using: petrol tankers (BiH), boats (Albania), mules (Kosovo), motorcycles (Sierra Leone), or camels (Afghanistan). Bus and truck drivers can rise in the hierarchy. In wartime Herceg Bosna a truck driver, Dinko Slezak Dika, dealt in gold, built up a Mostar construction company reportedly worth US\$250 million and became part of the Prlic group, the country's strongest economic and financial empire by 2001.⁸ Smuggling fuel and money during sanctions and war led, unsurprisingly, to garages and petrol stations becoming a significant channel for laundering money.
- Dealers who understand financial transactions have been significant in swindles such as setting up phantom companies, paying for goods that are not supplied and customs frauds. Thousands of deutschmarks entered the Bihac enclave with every vehicle during the war. Unsurprisingly, banks, both public and private became foci of corrupt activity, even though bank privatisation was considered by internationals as

⁵ Transparency International, *National Integrity System Study: Bosnia and Herzegovina, 2007*, Berlin 2006; Michael Pugh, 'Postwar Political Economy in Bosnia and Herzegovina: the Spoils of Peace', *Global Governance*, vol.8, no.4, 2002, pp.467–82; 'Rubbing salt into war wounds: shadow economies and peacebuilding in Bosnia and Kosovo', *Problems of Post-Communism*, vol.51, no.3, 2004, pp.53–60.

⁶ The PDP provided two RS Prime Ministers, both economists, Mladen Ivanic and Dragan Mikerevic. The latter was also embroiled in an oil refinery deal, but was a 'moderate' in calling on Karadzic to give himself up, Both ministers resigned office in protest at the OHR's centralisation policies. Mikerevic is now Chair of the Steering Board, Association of Accountants and Auditors of RS.

⁷ Francesco Strazzari, 'Between Ethnic Collusion and Mafia Collusion: The "Balkan Route" to State Making', in Dietrich Jung (ed.), *Shadow Globalization, Ethnic Conflicts and New Wars: A Political Economy of Intra-state War*, London: Routledge, 2003, pp.140–62.

⁸ Neven Katunaric and Marijan Puntaric, 'Prlic i partneri sada Peru Robu u Pistom Moru Makarske Rivijere', ['Prlic and his partners now launder money in the clean water of Makarska River'], *Slobodna Dalmacija* (Split), 24 Sept. 2001) [OHR trans.].

successful. The Hercegovacka banka network was a major channel of political-economy corruption that the OHR disbanded by force.⁹

Why Persistence?

- Corruption and fraud have been particular features of the BiH transition, and are in part a legacy of the pre-war as well as wartime periods. Lack of regulation and the legitimization of war elites have also played a role in the activities that deprive the government of revenue. In Kosovo, Prime Minister Ramush Haradinaj was indicted for war crimes at the Hague but released to assist UNMIK in peacebuilding.
- *Shadow economies.* Corrupt practices exist in conjunction with shadow economies and organised crime that has been significant in sustaining the activities of war criminals. However, the BiH criminal networks, while dangerous, are not big players by regional standards and have not been targeted by external networks. In contrast to Afghanistan and Iraq there is no obvious source of widespread illegal production in Southeast Europe, such as poppy or oil. Apart from timber, the illegal survival and coping economies depend on petty trading, smuggling, bribery and tax evasion. This is particularly widespread and, of course, based on cash. It is important to recognise that high level shadow economies provide employment at street level and a cushion against poverty for some people. If it is the case that 50% of Montenegrin gdp is based on cigarette smuggling, then such criminality clearly involves a large number of people.¹⁰ Coping economies enable people to survive and often facilitate access to goods, increase the range of choice and reinforce community links. This is also the case with remittances and informal employment.
- *Informal employment* in BiH ('corrupt' in the sense that this kind of tax evasion is often linked to fraudulent activities by employers), is such a significant aspect of the labour market that it is clearly an essential element in household consumption. It almost certainly keeps people above the poverty line, particularly in rural areas (agriculture being the biggest illicit employer) and among households headed by women who are more likely to take part-time, temporary and low-income jobs.¹¹
- *Remittances and transfers.* Not to be confused with corruption, but essential to coping economies are transfers and remittances. One of the most significant, non-observable coping mechanism in the former Yugoslavia is the availability of diaspora remittances that perpetuate a pre-war tradition. These are cited variously as accounting for anything between 11% and 30% of the BiH gdp and are significant in servicing the current account deficit.¹² In poor, rural Herzegovinan cantons remittances represent a disproportionate source of income, following a tradition of sending workers to Austria and Germany as *gastarbeiter*. This sector can be further disaggregated into:

⁹ Vesna Bojicic-Dzelilovic, 'Peace on whose Terms? War Veterans' Associations in Bosnia and Hercegovina', in: E. Newman, O. Richmond (eds) *Challenges to Peacebuilding: Managing Spoilers During Conflict Resolution*, Tokyo: UNU Press, 2006.

¹⁰ Peter Andreas 'Criminalizing Consequences of Sanctions: Embargo Busting and Its Legacy', *International Studies Quarterly*, vol.49, p.349.

¹¹ Fikret Causevic, *Foreign trade policy and trade balance of Bosnia and Hercegovina*, Sarajevo: Economic Institute, 2006.

¹² Interviews with Zlatko Hurtic (see above); Amir Hadziomeragic, Head of Economic Research and Statistics Unit, BiH Central Bank, Sarajevo, 5 September 2006.

observable electronic transfers, accounting for about 53% of remittances;
non-observable cash remittances brought by couriers;
seasonal labour on the Dalmatian coast;
in-kind transfers and diaspora expenditures (e.g. on car repairs and dentistry).

For households, diaspora assistance is essential for daily living expenses, special needs (such as medical treatment), housing, consumer goods and capital investment. But as contacts abroad attenuate and diasporas tend to increasingly invest in their new country, the diaspora slice is shrinking.

- *Shadow employment.* Informal employment in BiH ('corrupt' in the sense that this kind of tax evasion is often linked to fraudulent activities by employers), is such a significant aspect of the labour market that it is clearly an essential element in household consumption. It almost certainly keeps people above the poverty line, particularly in rural areas (agriculture being the biggest illicit employer) and among households headed by women who are more likely to take part-time, temporary and low-income jobs.¹³

- *The 'tricks of everyday life'.* These daily negotiations have a fundamental impact on local adaptation that promote survival, social relations and social inclusion.¹⁴ This kind of activity, not to be equated with high level crime and corruption, continues a tradition, often with inter-ethnic transactions that are not mediated by the externals, and in which volatile ethnicity issues are marginalised. The tricks of life do not conform to the rationalism of external economic engineering, but facilitate 'daily reinvented social norms around the claim to subsistence',¹⁵ and are often a function of sheer convenience (e.g. where the absence of domestic infrastructure makes translocal exchange across borders easier). People cope not only because of the benefits provided by an international presence but also in spite of it. The dismissal of 'tricks of life' as socially corrosive and leading to moral collapse,¹⁶ is to misunderstand the social cement that it provides in conditions where social corrosion is advanced by the introduction of peacebuilding norms.

Conclusion

- In BiH there has been some resource/production base for combat and post-conflict corruption, notably in timber. But by far the most lucrative illicit activities during and after the violence have been in the service sector (import/exports, transport and accommodation, financial transactions and trade). The service economy rather than primary production or industry is more prone to corruption. Not by coincidence, this is the sector that: (a) the economic peacebuilders have supported most strongly through export-led growth policies, privatisation programmes and subsidies to small and medium enterprises; and (b) the capital sector and its political backers have

¹³ Fikret Causevic, *Foreign trade policy and trade balance of Bosnia and Herzegovina*, Sarajevo: Economic Institute, 2006.

¹⁴ Beatrice Pouligny, *Peacekeeping Seen From Below*, London: Hurst, 2006.

¹⁵ Larisa Jasarevic, 'Everyday Work: Subsistence Economy, Social Belonging and Moralities of Exchange at a Bosnian (Black) Market', in Xavier Bougarel, Elissa Helms and Ger Duijzings, *The New Bosnian Mosaic: Identities, memories and Moral Claims in a Post-War Society*, Aldershot: Ashgate, 2006, pp.274 (n.2), 284, 292.

¹⁶ Andreas (n.2 above), p.344.

favoured over agricultural and industrial production by denying institutional support to rival capitalists.

- Liberal peace processes introduce new tensions and neglect the functional aspects of unregulated political economy that nevertheless enable people to get by in situations where new regulatory norms are emerging. TWE (transforming war economies) research indicates that the imbalance arising from liberal policies of macroeconomic stability, neglect of production, failures of emergency job creation and poor social protection has an inhibiting impact on economic recovery and potential growth.

Provocations

A critical theory perspective contends that without incorporating economic justice into our views of security we shore up existing hegemonies.¹⁷ So I end with three elemental provocations.

- *Sophisticated corruption and crime in the context of modern conflict is unexceptional.* Current corruption in conflict zones is entirely consistent with the underground economies of the second world war (when a host of new crimes were also created by legislation). In the UK, armed robbery, prostitution and other rackets flourish. Thefts from the military at home and abroad were enormous. Administrators stole from stores, especially petrol. Some 200,000 military deserters created new identities, laundered money at race tracks, traded black market goods and forged ration books. Shopkeepers simply could not survive on selling rationed goods. Corruption was partly a response to new opportunity structures and partly to the great uncertainty of life. It was a way of ‘doing a good turn’ to people in need.¹⁸

- *In so far as peacebuilding has also spilled over into state-building, it involves corruption because of state building’s reliance on primitive accumulation.* This exists prior to, or in the interstices of, efficiently policed regulation.¹⁹ Moreover, statebuilding in a neoliberal framework introduces ‘free markets’ managed in the interests of the most powerful entrepreneurs who resist regulation when it suits them but demand subsidies and protection also when it suits them. This kind of free market increases the gap between rich and poor. The idea that everything, including health, education and public facilities, has to be submitted to so-called rational choice market strategies is a flawed perspective of ‘freedom’ that damages social cohesion and relies on fear and suspicion of fellow human beings rather than on cooperation.²⁰ And by definition this contradicts peacebuilding in its reconciliation purpose.

- *The argument that capitalism is inherently corrupt – and structured for corruption – can be supported by empirical evidence.* Flows of dirty money (‘money that breaks laws in its origin, movement, or use’), is supported by an elaborate structure of ‘tax

¹⁷ See Ken Booth, ‘Security and Self: Confessions of a Fallen Realist’, in Keith Krause and Michael C. Williams, *Critical Security Studies: Concepts and Cases*, London: UCL Press, 1997, p.111.

¹⁸ Donald Thomas, *An Underworld at War: Spivs, Deserters, Racketeers and Civilians in the Second World War*, London: John Murray, 2004.

¹⁹ See Christopher Cramer, *Civil War is Not a Stupid Thing: Accounting for Violence in Developing Countries*, London: Hurst, 2006.

²⁰ See Adam Curtis (dir.), ‘The Trap: What Happened to Our Dreams of Freedom’, documentary broadcast, BBC2, on 11, 18, 25 Mar. 2007, 9pm.

havens, secrecy jurisdictions, shell banks, dummy corporations... fake foundations, falsified pricing of trade transactions'. Over half of the dirty money (i.e. over \$500 bn a year) is estimated to move from undeveloped into developed countries, compared to the aid that averages \$50 to \$70 bn a year. Raymond Baker contends that: 'The richest countries are the biggest promoters of lawlessness in international trade and finance.... The money streams through mechanisms designed by western countries to bring hundreds of billions annually into western coffers.'²¹

*In sum, this implies that concerns about corruption in war-torn societies are no doubt relevant, but they also conceivably contribute to the silences that surround the dishonesty of so-called 'free market' systems, and contribute to deflecting attention from those elements of peacebuilding that do harm.*²²

²¹ Raymond W. Baker, *Capitalism's Achilles Heel: Dirty Money and How to Renew the Capitalist System*, Hoboken, NJ: Wiley, 2005, p.338; Raymond W. Baker and Jennifer Nordin, 'Dirty Money: What the Underworld Understands that Economists Do Not', *Economists' Voice*, Jan. 2007 (www.bepress.com/ev).

²² ● In the US, the Special Inspector General for Iraq Reconstruction (SIGIR) noted that, among other events: (a) a Pentagon contract employee admitted to stealing US\$2m from the reconstruction fund; (b) over half of Kellogg, Brown and Root's costs for oil industry repair went on overheads and the company overcharged the US military about \$60m. for fuel; (c) another company completed only 6 of its contracted 140 primary healthcare centres but was still paid in full ('Corruption: the "second insurgency" costing US\$4bn a year', *The Guardian* [London], 2 Dec. 2006, pp.16-17; 'How the US sent \$12bn in cash to Iraq. And watched it vanish', *The Guardian* 8 Feb. 2007, pp.1-2).

● The Government Accountability Project in the US revealed that the World Bank's management was unable to clarify who proposed and approved the irregular promotion and subsequent salary increase for Shaha Riza, long-time girlfriend of the President of the World Bank, Paul Wolfowitz ('Between Bush and the World: Turmoil at Bank Goes beyond Wolfowitz Fight', *New York Times*, 14 Apr. 2007, pp.A1,A6).

● The size of the Greek economy was boosted by 25% when it was decided to include the estimated black market of 60bn euros as a way of decreasing its budget deficit that would have otherwise likely attracted EU fines ('Greek economy up 25% – with a little help from prostitutes', *The Guardian*, 30 Sept. 2006, p.11).

● The UK government has been under investigation by the Metropolitan Police for a year in regard to a 'loans for peerages' scandal. The UK domestic corruption laws are antiquated, the most recent dating from 1916, and a new law on tackling corruption has been contemplated since 1997. A new consultation Commission will not report until at least 2009 ('Account for the cash', *The Guardian*, 15 Mar. 2007, p.38). Further, the government required the (independent) Attorney General to stop the Serious Fraud Office from continuing its investigations into bribery allegations against British Aerospace (BAe) in several countries, but particularly in Saudi Arabia, a major customer of UK defence industries. The OECD has expressed its serious concern about: (a) the failure of any British company to be prosecuted under the 1997 OECD Convention on combating bribery which the UK ratified in 1998; and (b) the UK government's role in preventing further investigation, which may be in breach of the Convention. A private legal action by an NGO has been taken out in the High Court (George Monbiot, 'The parallel universe of BAE: covert, dangerous and beyond the rule of law', *The Guardian*, 13 Feb. 2007, p.29; 'OECD rebukes Britain for ending inquiry into Saudi arms deal', *The Guardian*, 15 Mar. 2007, p.5).

● Internet banking fraud in the UK was estimated at £33.5 million (US\$65m) in 2006. (Good catches for "phishing" fraudsters as losses through fake bank websites leap 44% to £34m', *The Guardian*, 14 March 2007, city page). According to a survey conducted led by Cardiff University economic crime specialists for the UK Association of Chief Police Officers, fraud in the UK costs some £20bn a year at a conservative estimate. This includes a figure for carousel fraud, under-reporting and the cost of combating the problem. The Commissioner of the City of London Police observed that: 'Lying to secure financial benefit is fast becoming endemic in British life'. (BBC News, 7 Mar. 2007 <http://news.bbc.co.uk/1/hi/business/6425963.stm>). Carousel fraud in the EU costs the UK exchequer about £5bn a year. The fraudulent carousel tax reclaims were valued at £1.6bn in July 2006 alone. Some estimates place it at around 50bn euros a year. In a related move, Dutch officials raided a bank in Curacao, a tax haven, in 2006 ('Follow the money: the multibillion pound trail that led to Caribbean bank', *The Guardian*, 20 Sept. 2006, p.4).

● According to a leading tax expert, John Christensen of Tax Justice Network, Britain the US and Switzerland are among the world's most corrupt countries: 'The failure of these and other developed countries to clamp down on offshore tax havens is responsible for more hardship than any corrupt acts by third world leaders'. John Christensen 'Follow the money – how tax havens facilitate dirty money flows and distort global markets', (Economic Geography Research Group, Geographies of Corruption, RGS IBG Conference, Tax Justice Network: London, 1 Sept. 2006, www.taxjustice.net/cms/upload/pdf/Follow_the_Money_-_RGS-IBG_final_31-AUG-2006.pdf).