



## **DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS**

**EMBARGOED  
9:30 AM  
July 21, 2004**

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### **The Multilateral Development Banks and the Fight against Corruption**

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Testimony before the  
Senate Foreign Relations Committee  
United States Senate

July 21, 2004

Chairman Lugar, Ranking Member Biden, Members of the Committee, I welcome the opportunity to discuss with you U.S. efforts to fight corruption in the use of funds by the Multilateral Development Banks (MDBs). It's an issue we take very seriously. We are committed to every possible effort to help prevent, detect, and punish corruption associated with development assistance provided by the MDBs. Such corrupt acts are intolerable and, as custodians of taxpayer dollars intended to stimulate economic growth and alleviate global poverty, it is our obligation to help ensure that the MDBs take all the steps necessary to ensure an effective anti-corruption apparatus.

My testimony today will focus on five MDBs: the World Bank, the Inter-American Development Bank (IDB), the African Development Bank (AfDB), the Asian Development Bank (AsDB), and the European Bank for Reconstruction and Development (EBRD). I will describe the recent anti-corruption efforts and the U.S. role in reforming the institutions.

Our efforts to strengthen anti-corruption efforts are focused on three levels. First, at the institutional level, we are focused on improving the functioning of MDB internal control processes for internal auditing, investigative mechanisms, whistleblower protections, and

corporate procurement - and increasing the disclosure and accountability of MDB operations.

Second, at the project level, we are focused on encouraging the MDBs to conduct analysis and design projects that help reduce opportunities for corruption, strengthen fiduciary standards, and help ensure that Bank funds will be well spent.

Third, at the country level, we focus on enhancing the transparency and accountability of recipient countries' governance systems and disclosure in MDB operations and analysis, and to channel MDBs resources toward countries that have good governance in place. Treasury reports annually to the Congress on the country specific anti-corruption programs supported by each MDB, and actions taken by recipient countries.

At all these banks we are pursuing a reform agenda that is an essential tool in the fight against corruption – measuring results. The need for rigorous results measurement has been broadly accepted internationally. All of the institutions have begun to mainstream mechanisms to measure and report the results of their projects. The new reforms emphasize measurable results with specific timelines. They provide incentives to the institution by tying increased financial support to the establishment of results measurement systems and results achieved in all operations; especially in the design of country assistance strategies and individual projects and during project implementation. If the flow of money is tied to concrete and measurable results, the chance of diverting MDB resources for corrupt purposes will be lowered considerably. While more needs to be done, we have built broad support among shareholders and management on the importance of measurable results and accountability and will continue to pursue this priority aggressively.

We at the U.S. Treasury conduct our oversight of corruption-related and other issues at the MDBs through a variety of practices and processes. On a regular basis we work with the Executive Directors (USEDs) on their participation in Board policy discussions and with management of these institutions. In the case of corruption, this means urging the institutions to establish effective and accountable policies and mechanisms to reduce the opportunities for corruption and to detect and punish corruption when it occurs. Treasury reviews all loans, grants, and policy proposals to make sure they include fiduciary safeguards and measurable results. Treasury chairs the inter-agency Working Group on Multilateral Assistance which meets weekly to review all MDB loans and grants coming up for approval. This group includes State, Commerce, and USAID. My staff meets regularly with the NGO community and other interested parties to solicit input on MDB policies and projects. When we find problem projects, our first effort is always to work with management to improve loans or grants which we believe do not meet our standards. The ultimate voting decision on projects is the responsibility of the U.S. government. This working group and input from NGOs helps us gather expertise and the perspective of different agencies and the private sector in forming our decisions.

Let me now to describe the actions taken by the MDBs in the three levels described above.

## Structural Changes within the Institutions

In the late 1990's the World Bank created what is now called the new Department of Institutional Integrity (INT). So far INT investigations have led to the Bank's imposing administrative sanctions on about 180 firms and individuals. The names of firms and individuals sanctioned are made public. The Bank has a hotline to which the public or staff can report incidents of corruption or other inappropriate practices. Complaints may be made confidentially or anonymously. We are working closely with management and other shareholders to provide the unit with the resources, both human and financial, and the authority it needs to do its job effectively on an ongoing basis. This includes implementation of the key recommendations of the report of former Attorney General Thornburgh on ways to strengthen the unit's capabilities, staffing and performance. The Bank's Executive Board reviewed and endorsed these recommendations yesterday, in fact, and we will be monitoring progress very attentively.

Last year, the Inter-American Development Bank established its Office of Institutional Integrity to enhance the scope of investigations previously undertaken by the Oversight Committee on Fraud and Corruption (OCFC). This office is now responsible for pursuing allegations of fraud and corruption by IDB staff or consultants, or in IDB-sponsored projects. The Oversight Committee of Fraud and Corruption (OCFC) now serves as the secretariat for the Office of Institutional Integrity, and trains officials in member countries on implementing anti-corruption programs. The OCFC also makes public a semi-annual report of its activities. Like the World Bank, the IDB has established a toll-free hotline and other mechanisms for reporting, on a confidential and anonymous basis, allegations of fraud and corruption with whistleblower protections. Last week, the IDB created a stand-alone Audit Committee of the Board.

The African Development Bank's Board of Directors has recently approved the establishment of an Oversight Committee on Corruption and Fraud (OCCF) that will be responsible for receiving and handling allegations of fraud and corruption. The Bank will adopt a formal whistleblower protection program once the OCCF becomes operational. The Bank has also modified its procurement regulations to be more explicit regarding corruption. Over the past few years, about 30 tenders have been cancelled, companies sanctioned, and, together with their affiliates, barred from participating in Bank projects.

The Asian Development Bank's Office of the Auditor General (OAG) is the point of contact for reports of allegations of fraud or corruption concerning AsDB-financed projects or its staff. In 2003, the OAG established an Anticorruption Unit (OAGA) to handle all such reports. The Bank has established a variety of mechanisms through which allegations of fraud and corruption can be conveyed in a confidential and discrete manner.

The European Bank for Reconstruction and Development just launched an inspection function, which will enable individuals to submit grievances about a project. The Chief Compliance Officer (CCO) works with independent experts to determine whether

banking operations were in full compliance with Bank policies, and, if necessary, the CCO undertakes problem-solving measures, which may include mediation and independent fact-finding. The EBRD has just hired a new CCO, an American with considerable experience working on anti-corruption issues. The new COO will coordinate the new inspection function and will also handle all matters related to fraud and corruption. The EBRD has a hotline through which individuals can anonymously report allegations of misconduct of Bank officials, employees, or consultants.

At each of the institutions, our U.S. Executive Directors have spearheaded efforts to increase transparency through information disclosure policies that require the MDBs to release more documents, especially those relating to Board discussions, country performance, measurable results, and anti-corruption measures. The Boards of Directors of the EBRD, the AfDB, and the IDB have all approved improvements in disclosure policies in the past 18 months and our Executive Directors will work to ensure their effective implementation. We expect similar actions will be taken at the World Bank and the AsDB in the near future. We continue to work with the MDBs management and other member countries to institute additional improvements.

### Projects

The World Bank has in place procurement and consultant guidelines that govern the purchase of goods, civil works, and consulting services financed in whole or in part from Bank loans for investment projects. The guidelines emphasize the need for economy and efficiency in the implementation of the project and the importance of transparency in the procurement process. They state that open competition is the basis for efficient public procurement. The guidelines include anti-fraud and corruption provisions and provide for debarment or other remedies if the Bank determines that firms have engaged in corrupt or fraudulent practices. If World Bank procurement guidelines have not been followed, then the Bank could declare a misprocurement and the borrowing government will lose the funding.

The IDB has recently authorized a comprehensive review by external consultants of its overall procurement practices. We are strongly advocating reforms that will adopt transparent and accountable procurement policies, and standard documents, fully harmonized with those of other MDBs.

The AsDB has taken steps to improve the financial management and governance of projects by revising the guidelines that govern the financial management practices of executing agencies and by implementing an automated project rating system to improve consistency, standardize ratings, and reduce subjectivity. These procedures will enable better identification of financial irregularities in project implementation. In addition, corruption and fraud awareness workshops are held regularly for project staff.

The AfDB conducts Financial Management Reviews (FMRs) of projects. The FMR is designed to assess financial management and audit functions of specific projects. The Bank has successfully carried out FMRs in five countries (Cameroon, Madagascar,

Malawi, Uganda, and Zambia), covering four key sectors (agriculture, transport, public utilities, and the social sector). The AfDB's internal audit department evaluates the quality of independent audits of Bank projects. This department is investigating at least two projects for fraud and corruption.

At the urging of the United States, the EBRD now includes a certification of compliance with integrity check procedures for each project with the documents presented to the Board of Directors. The Bank is instituting mandatory training for staff on this process of "integrity" due diligence. In addition to due diligence, EBRD routinely incorporates improvements in accounting and corporate governance in the design of its projects.

Overall, the United States continues to push vigorously in all the MDBs for strong result measurement frameworks for all projects, so that we can monitor and assess the outputs and outcomes. What gets measured gets done, so establishing a strong result-based program will sharply reduce the likelihood that monies will be diverted for corrupt or fraudulent purposes.

#### At the Country Level

The windows of the MDBs that are devoted to the poorest countries have or are currently establishing performance-based allocation systems. These systems provide more resources to those countries that improve governance and take steps to combat corruption, while those who do not take such steps receive fewer resources. For example, under the most recent replenishment of funds in IDA, seventeen countries will have their resource allocations reduced. In the recently concluded AsDF negotiations, donors agreed to increase the weight given to good governance, which includes anti-corruption, in the performance allocation system for the AsDF. These systems provide incentive for countries to tackle these governance issues in order to receive greater resources.

Also at U.S. urging, the MDBs are doing more diagnostic work on governance issues. Governance and corruption are routinely discussed in MDB country assistance strategies. The World Bank, in some cases working with the IMF and regional development banks, has taken the lead in preparing key diagnostic studies such as Country Financial Accountability Assessments, which looks at public financial management; Public Expenditure Reviews, which looks at the effectiveness of expenditures in terms of outputs and outcomes; and Country Procurement Assessment Reports, which looks at the contract management process and public procurement. The U.S. insisted on the expansion of these diagnostics as part of our Incentive Contribution to IDA, the targets for which IDA has met and exceeded.

The MDBs have also provided substantial amounts of assistance to help build accountable public-sector institutions and develop national anti-corruption efforts. The World Bank is also a leader in fighting money laundering and the financing of terrorism. Also, the AsDB has issued an extensive manual on countering money laundering and the financing of terrorism.

In 2003, the IDB approved \$772 million, or 11 percent of total lending volume, for projects with the principal aim of improving governance at the country level. These include projects to modernize the Attorney General's Office in Colombia, strengthen tax administration in Peru and improve decentralization of administration in Uruguay.

The AfDB has developed a new diagnostic tool, the Country Governance Profile. The profile's analysis helps a member country and the AfDB develop governance programs and capacity building programs to address identified weaknesses in governance. Profiles for Nigeria, Ghana, Mauritania, Malawi, and Zambia are completed, and those for another ten countries are underway.

The AsDB approved a new policy enabling AsDB to increase its assistance to countries to counter terrorist financing and put in place anti-money laundering initiatives. The new policy has also enabled the AsDB to further strengthen its capability to protect internal funds from misuse. Further, the AsDB recently launched a Regional Trade and Financial Security Initiative. The \$7 million initiative, which is supported by cash and in-kind contributions from the U.S., Australia and Japan, will finance anti-money laundering activities and port security in Asian developing countries. Finally, in 2003, the AsDB approved \$458 million for projects to strengthen good governance in borrowing countries.

The EBRD has less direct influence on recipient countries' governance than the other MDBs because it focuses primarily on investments in the private sector. However, it has undertaken efforts to improve governance and combat corruption, such as its input into Transparency International's work on business principles for countering bribery. Where feasible and appropriate, the EBRD also engages in policy dialogue with the host country, in the context of projects, to highlight where regulatory frameworks could be improved, thus reducing the opportunities for corruption. In addition, the EBRD periodically reviews the business environment of its countries of operations.

### Transparency and Section 581

A central part of our effort going now is the implementation of Section 581 in the FY04 Appropriations Act signed into law on January 23, 2004. This provision, which was the product of discussions between Treasury and Congress, aims to increase transparency and accountability. This is an objective we all strongly share.

On March 2, 2004, I sent a memo to each of our U.S. Executive Directors in which I conveyed the Section 581 language along with a request that they use every appropriate opportunity to press for the goals set forth in that section. Working with the Executive Directors, we have already made considerable headway. For example,

- At the Inter-American Development Bank, the new information disclosure policy includes a provision for release of the Board minutes within 60 days of their approval, a first within the MDB system.

- The new African Development Bank policy includes a commitment to make country strategies and operation policies public at least 50 days prior to formal Board discussion.
- The EBRD is implementing a Committee of Sponsoring Organizations (COSO) system of internal controls over the financial statements, the implementation of which will be reflected in a letter from management and from the external auditor in the EBRD's 2004 annual report.
- A new draft Asian Development Bank policy includes a large number of the transparency provisions of Section 581, including making public an annual report containing statistical summaries of fraud and corruption cases pursued by their investigative unit.

For our part, the U.S. Treasury has begun posting a record of our votes on MDB projects on our website on a monthly basis as well as the U.S. position on inspection panel cases that we send to the Executive Directors.

In my view, more needs to be done to build on this progress. We need to increase the use of public fiduciary and governance diagnostics. We need to create additional incentives for establishing and achieving measurable results, and improve governance in borrowing countries. The U.S. continues to urge further measures to maintain progress. Among the priorities we are currently pursuing are the following:

- As a key element of implementing our results agenda, we will continue to advocate for the establishment of independent evaluation functions where they do not currently exist, such as at the AfDB and the EBRD, which functions would report directly to the Boards of Directors with the heads of evaluation hired by and accountable to the Board. Evaluation of results is both critical to achieving results and to ensuring that funds are used as intended by the governments that are the beneficiaries.
- The MDBs must also work towards achieving uniform best practice procurement policies, procedures, and documents that will be used by all the MDBs.
- At the IDB, the office of the U.S. Executive Director is engaged in several initiatives in procurement: 1) the overhaul of the IDB's project procurement systems with the objective of a new system using MDB-system wide best practices for policies, procedures and standard bidding documents; 2) reform of corporate procurement; and 3) the creation of a Sanctions Committee to give the Bank authority to disbar firms.
- We are also pushing the World Bank and the African Development Bank to release the country ratings (Country Policy and Institutions Assessment, CPIA) – including governance – that determine country resource allocations under its performance-based allocation system.
- The MDBs need to further improve and mainstream staff education, incentives, and processes for anti-corruption work. Each MDB must enforce clear guidelines defining corrupt behavior and stringent penalties for staff that violate the rules.

- The MDBs should continue to strengthen their whistleblower protections.
- We will continue to work with the World Bank to ensure that the Department of Institutional Integrity (INT) has the necessary resources and authority from the Board to carry out its responsibilities of investigating allegations of corruption and ensuring accountability of staff in all the Bank's operations.

### Conclusion

In conclusion, Mr. Chairman, let me reiterate that this Administration takes very seriously the threat that corruption poses to economic development and to the effective use of MDB resources. As I have described in my testimony, the MDBs have taken important steps to combat corruption and the United States is at the forefront of continuing efforts to broaden and deepen those initiatives, including ensuring the full effectiveness of new anti-corruption units. The managements of the MDBs are to be commended for the positive steps they have taken in recent years to fight corruption, following the example set by the World Bank. Clearly more needs to be done, and we are fully dedicated to these efforts, and look forward to continuing to consult with Congress on our progress.