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COMBATING CORRUPTION IN THE MULTILATERAL DEVELOPMENT BANKS [PART I]

HEARING

BEFORE THE

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COMBATING CORRUPTION IN THE MULTILATERAL DEVELOPMENT BANKS [PART I]

THURSDAY, MAY 13, 2004

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The committee met at 9:33 a.m., in room SD–419, Dirksen Senate Office Building, Hon. Richard G. Lugar (chairman of the committee), presiding.

Present: Senators Lugar and Hagel.

OPENING STATEMENT OF SENATOR RICHARD G. LUGAR, CHAIRMAN

The CHAIRMAN. This hearing of the Senate Foreign Relations Committee is called to order.

Today the committee meets to examine the problem of corruption related to the activities of the multilateral development banks. The United States has a strong national security and humanitarian interest in alleviating poverty and promoting progress around the world. That is why the Congress funds multilateral development banks such as the World Bank, which can leverage our resources and promote economic growth and reduce poverty around the world. Of the 6 billion people living in the world today, more than 1 billion barely survive on less than $1 of income a day.

In the last fiscal year, the multilateral development banks financed projects totaling more than $35 billion. These projects helped poor countries pursue critical improvements in public administration, transportation, health, education, and many other vital areas. The development banks have in recent years introduced innovative programs that have enhanced their primary mission of poverty reduction. But even the most innovative policies will not be effective if they are distorted by corruption. It is critical that every development bank dollar reaches its intended recipient. Unfortunately, that has not occurred in all instances.

Over the past year, the Senate Foreign Relations Committee staff has collected information from public and confidential sources related to alleged corruption involving multilateral development bank activities and projects. The committee is engaging in a multitrack process to review specific allegations and to determine the effectiveness of the multilateral development banks' anti-corruption strategies. This is a process that hopefully will result in a stronger anti-corruption infrastructure within the development banks.

From the outset, I would recognize that the World Bank itself has identified corruption as the single greatest obstacle to economic and social development. James Wolfensohn, President of the World

Bank, understands the importance of anti-corruption efforts and has brought greater resources to bear on the corruption problem. The World Bank has increased its anti-corruption efforts in developing countries over the past 5 years through education, training, procurement restrictions, and other important methods.

But corruption remains a serious problem. Dr. Jeffrey Winters of Northwestern University, who will testify before us today, estimates that the World Bank—and I quote Dr. Winters—"has participated mostly passively in the corruption of roughly $100 billion of its loan funds intended for development." Other experts estimate that between 5 percent and 25 percent of the $525 billion that the World Bank has lent since 1946 has been misused. This is equivalent to between $26 billion and $130 billion. Even if the corruption is at the low end of the estimates, millions of people living in poverty may have lost opportunities to improve their health, education, and economic conditions.

Corruption thwarts development efforts in many ways. Bribes can influence important bank decisions on projects and on contractors. Misuse of funds can inflate project costs, deny needed assistance to the poor, and cause projects to fail. Stolen money may prop up dictatorships and finance human rights abuses. Moreover, when developing countries lose development bank funds through corruption, the taxpayers in those poor countries are still obligated to repay the development banks. So, not only are the impoverished cheated out of development benefits, they are left to repay the resulting debts to the banks.

The Foreign Relations Committee intends to illuminate more brightly the problem of corruption surrounding the development banks. Those of us who support the valuable work of these institutions—and they do have vital and important support in our committee—know how important it is to ensure that the development banks are doing everything they can to prevent and expose corruption within their own institutions, the borrowing governments, and the community of contractors who receive money.

This hearing is intended to give the committee an opportunity to examine ways that the U.S. Congress and our Government can contribute to the anti-corruption efforts already underway. We are engaged in what is sometimes called congressional oversight. I look forward to insights on how to improve the development banks' ability to limit misuse of funds, how to strengthen internal controls, how to impede corruption in project design, and how to ensure that audits are conducted in a thorough manner. I also would like to hear the views of witnesses about the impact of immunity privileges that apply to development bank employees.

Throughout this examination, we will keep in mind that the poor suffer most from the harmful effects of corruption because they are hardest hit by economic crime and are most reliant on the provision of public services and, finally, are the least capable of paying the extra costs associated with bribery and fraud.

We welcome two panels to discuss corruption and the multilateral development banks. On the first panel, we will hear from Ms. Carole Brookins, United States Executive Director at the World Bank, and Mr. Hector Morales, United States Alternate Executive Director at the Inter-American Development Bank. On our second panel, we will hear from Professor Jeffrey Winters of Northwestern University, Mr. Manish Bapna of the Bank Information Center, Ms. Nancy Zucker Boswell from Transparency International USA, and Professor Jerome Levinson from American University.

I would also note that we did invite the President of the World Bank, James Wolfensohn; the President of the Inter-American Development Bank, Enrique Iglesias; and the President of the African Development Bank, Omar Kabbaj to testify before the committee. They declined the invitations, citing the established practice of bank officials not to testify before the legislatures of their numerous member countries, but their letters[1] of regret will be included in the official record.

We do thank our witnesses who will be joining us today for their testimony. We look forward to their insights.

Let me indicate that the statements of all the witnesses in both panels will be made a part of the record in full. Perhaps the witnesses could summarize their testimony in 10-minute increments. The Chair will be liberal but, nevertheless, we want to make certain that all questions are heard.

We anticipate that if there are to be rollcall votes this morning, we are advised that they may come in about the 11:30–11:40 neighborhood. That could be disruptive in that there may be two or three votes at that point. Therefore, it is our hope in the next 2 hours to complete our testimony and our questioning.

Let me call now upon my colleague, Senator Hagel, to ask whether he has an opening comment or statement.

Senator HAGEL. No, Mr. Chairman, I do not. I want to compliment you on your leadership and focus on a very, very critical part of not only America's foreign policy responsibilities and the tools that we have to develop our relationships, but the other responsibilities that developed nations have in the world and your institutions that you represent are very, very critical institutions in that effort. So, Mr. Chairman, thank you. I look forward to their testimony.

The CHAIRMAN. Well, thank you, Senator Hagel.

I will ask for testimony in the order that I have introduced you. That would be Ms. Brookins to begin with and then Mr. Morales. Ms. Brookins.

STATEMENT OF CAROLE BROOKINS, U.S. EXECUTIVE DIRECTOR, THE WORLD BANK

Ms. BROOKINS. Thank you very much, Mr. Chairman, for your opening remarks which I think set the very important tone for these hearings today and for your leadership and the leadership of the committee. Senator Hagel, thank you for your opening remarks.

I welcome your invitation to come and speak with the committee today on a subject which is fundamental to economic development and poverty reduction. Improving governance, increasing transparency, and combating corruption are a major focus of President Bush and our agenda at the World Bank. As the President said, when he announced the Millennium Challenge Account, "Money that is not accompanied by legal and economic reform are often-

[1] The letters the chairman refers to can be found beginning on page 70.

times wasted. In many poor nations, corruption runs deep. When nations refuse to enact sound policies, progress against poverty is nearly impossible.”

Our administration’s view is well supported by the bank. In fact, combating corruption and building good governance have been major ongoing priorities of the World Bank since 1996. At the most recent annual meeting in Dubai of the World Bank and the International Monetary Fund last September, President Wolfensohn said, “There is still too much cronyism and corruption in the developing countries. In nearly every country, it is a matter of common knowledge where the problems are and who is responsible. Frankly, there is not enough bold and consistent action against corruption, particularly at the higher levels of influence.”

During my tenure as Executive Director, representing the United States on the bank’s board, I have seen up front the real impact of the World Bank on people’s lives and opportunities to emerge out of poverty that good governance supported by the World Bank can make, whether it is delivering textbooks to children in Nairobi, Kenya, or building a needed rural road to a village in Malang, Indonesia. But notwithstanding the compelling nature of these personal experiences, the question before us today is, how effective is the bank as an institution in its anti-corruption efforts, thereby ensuring that its assistance can be delivered effectively and efficiently to reduce poverty?

The World Bank continues to be the leader among international development institutions in a broad range of country-based initiatives to strengthen governance, to build effective local institutions and increase transparency. These three components are the infrastructure for fighting corruption, both its systemic causes and in specific cases where it appears. The bank has built a comprehensive structure that includes international advocacy, internal controls, analytical tools, education and training, and country and project operations. Among the MDBs, the bank provides the largest amount of finance to support good governance programs, lending over $5 billion per year for reforms to strengthen public sector institutions. Since 1996, the World Bank has launched more than 600 anti-corruption programs in nearly 100 countries.

The bank’s anti-corruption infrastructure has performed effectively in many aspects and in managing many challenges. However, there is much more that could be done to strengthen the system. Our administration is directly focused on getting results, both internally and on the ground in countries where the bank operates. Under the committee’s 2003 legislation, section 581 of the fiscal year 2004 Consolidated Appropriations Act, which the committee worked, along with Treasury, to craft, this is an important tool for our efforts to enhance accountability and transparency.

The bank’s mandate is to end poverty in member countries by strengthening their investment climates in support of jobs and growth, and in creating local capacity to deliver services to the poor. In many cases, the bank’s services are in the greatest demand in countries where governance standards and institutional capacities are lacking. Corruption problems are complex and in many cases deeply rooted, cutting across both the public and the private sectors. By the very nature of the mandate that the bank has, the bank needs to be involved in these countries to help improve their governance structures. The challenge is to establish procedures that successfully mitigate the risks posed by corruption and effectively deliver on the bank's mandate. The United States is fully committed to meeting this challenge.

My office has an ambitious agenda with respect to anti-corruption and transparency. We approach this at three levels. At the institutional level, we focus on improving the functioning of the bank's internal control processes for preventing and responding to corruption and fraud. At the project level, we focus on encouraging the bank to conduct analysis and design projects and lending policies that are directed to reduce opportunities for corruption and ensure that bank funds will be properly spent. And at the country level, my office is a driving force to increase transparency and disclosure of bank operations and analysis.

I will just very briefly address these areas.

As a major provider of development expertise and funding, the bank recognizes that it must lead by example. Therefore, the bank has established systems to ensure institutional integrity, accountability, and the rigorous investigation and resolution of cases involving fraud and corruption. There are 12 units responsible for internal controls.

What is most important I think in this hearing today is the Department of Institutional Integrity, which was created in November 2000 out of two preexisting offices tasked with combating corruption. INT has played an important role in investigating allegations of misconduct by firms, by individuals, and by bank staff. It supports training for bank staff to identify ways to detect and deter fraud and corruption in bank operations. It is proactive and does anti-fraud and anti-corruption training to all new bank operations staff as part of their introductory training, and additionally, there is training of field staff which includes integrity awareness in this 8-day program. The bank has a hotline, 1–800–831–0463, where the public or staff can report incidents of corruption or other inappropriate practices.

Whistleblower protection is ensured and complaints may be made anonymously or confidentially. And staff rules require that there can be no harassment or retaliation. The fact that the number of cases coming to INT right now from staff has risen from 20 percent to 50 percent I think attests to the effectiveness of whistleblower protection.

The bank has instituted several reforms that attempt to eliminate conflicts of interest and any possible corrupt practices among its staff and the board. The bank's internal auditing department guides World Bank management in establishing and maintaining strong internal controls and risk management procedures. The bank has also taken formal steps to review its internal controls. Beginning in 1995, the bank adopted the internationally recognized internal control framework known as COSO, Committee on Sponsoring Organizations.

In the area of accountability, the World Bank has two key institutions, the Operations and Evaluation Department and its equivalents at the IFC and MIGA, OEG and OEU, and the Quality Assessment Group.

The World Bank also has actively supported the creation of the U.N. Convention Against Corruption in December 2003.

At the project level, the World Bank utilizes a number of effective tools to mitigate the risk of corruption in designing projects, as well as mechanisms to address instances when it finds that corrupt practices have occurred in the course of project implementation.

First, the bank's 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. If the World Bank procurement guidelines have not been followed, then the bank can declare a misprocurement and the borrowing government will lose the relevant funding.

Related to this, the bank has actively enforced its administrative sanctions policy through the Sanctions Committee. Under this policy, the bank debars firms and individuals from participating in any further bank or bank-financed projects if they are determined to have engaged in corrupt, fraudulent, collusive, or coercive practices in competing for or in executing a bank contract. More than 180 companies and individuals have been debarred from doing business with the bank either temporarily or permanently, and the bank does make the list of the debarred firms and individuals publicly available on its Web site.

In 1993, the World Bank created the Inspection Panel as an independent forum to private citizens who believe that they have been or could be directly harmed by a project financed by the World Bank. Panel reports are publicly available as well on the bank's Web site.

However, more work is needed to address project level concerns. Currently the United States is pushing for the bank to adopt a more systemic approach to measuring project results. This will facilitate a proactive examination early and regularly in the project life cycle of whether bank projects are meeting their objectives, particularly where there are governance components. Such examination, we believe, can be a useful tool in identifying if corruption is playing a role.

Anti-corruption efforts are also taking place at the country level. As I mentioned before, the World Bank is providing over $5 billion a year to help countries reform and strengthen their systems and to punish corruption. Numerous examples of these programs are found in the annual report that the U.S. Treasury provides to Congress on anti-corruption actions taken by countries as a result of multilateral development bank assistance. They include programs that promote a wide range of judicial, fiscal procurement, and regulatory reform. The World Bank is also at the forefront of supporting anti-money laundering and anti-terrorist financing initiatives, and I believe that there have been as many as 40 projects up to date benefiting more than 115 countries. This is to deal with systemic problems.

The World Bank and other IFI's have intensified efforts to assist countries to improve the quality of public expenditures which can be the very root of corruption and bad governance. The bank has increased its assessment of the content and overall efficiency of public expenditures and of country procurement. My office is pushing hard to get these reports in all borrowing countries and to followup these assessments with technical assistance and projects that address the weaknesses identified. This is particularly necessary in our view in countries that are receiving or will receive adjustment lending funds or other direct budget support.

Another important bank diagnostic is the investment climate assessment which attempts to systematically analyze conditions for private investment and enterprise development in World Bank countries and includes surveys done and conducted with the private sector.

The bank has been a leader in the research and analysis of corruption. Particularly notable is the work of the World Bank Institute's Director of Governance which has developed new approaches to the measuring corruption and assessing its monetary and developmental impact.

The bank's commitment to governance and fighting corruption is also illustrated in the way in which the International Development Association, or IDA, resources are allocated to the 77 recipient countries, which include the world's poorest nations. Governance is the most important factor in the IDA performance-based allocation system which the U.S. championed beginning with IDA 12 and then again with IDA 13. The amount of money that countries can receive is based upon this assessment. Those who have poor governance receive less money or, in many cases, very little money versus those who perform well, and they are coming back to the bank now to try to find ways that they can better improve their policies because of this fact.

Another key element is the work on transparency in the battle against corruption where the bank has been at the forefront in terms of disclosure of documents and consultation with civil society. The bank has frequently updated its information disclosure policy to establish and institute best practices among the multilateral development banks. My office continues ongoing efforts to work with the board and management to ensure that further transparency is achieved in the context of additional improvements in the bank's disclosure policy, particularly consistent with legislation from Congress in the fiscal year 2004 appropriations process, as well as the international commitments made at the G–8 at last year's Evian summit.

In conclusion, Mr. Chairman, the bank has made considerable progress in establishing the foundation needed to address governance and corruption in its operations and in the countries where it works. The bank also has the leadership of senior management at the forefront of this critical issue. We cannot afford complacency, however. Continued work must be done both institutionally and in countries receiving assistance. We need to update and respond to new knowledge, new technologies, and new demands and structural problems that are identified. Going forward, we particularly need to achieve greater coherence across international institutions on such issues as public disclosure of debarment listings, procurement, consultant guidelines, fiduciary standards, and transparency. The greatest leverage we have is where all the institutions work together in a public and transparent way.

But most important to building a sustainable anti-corruption culture in the world is building ownership in borrowing countries. The goal must be to increase their demand for good governance so that they are accountable to their own citizens. Mr. Chairman, the United States is committed to the full scope of this effort and we will continue to exercise our leadership and influence in this vital cause.

Thank you.

[The prepared statement of Ms. Brookins follows:]

PREPARED STATEMENT OF CAROLE BROOKINS

ANTI-CORRUPTION EFFORTS OF THE MDBS

Mr. Chairman, Members of the Committee, I welcome your invitation to come and speak with the Committee today on a subject which is fundamental to economic development and poverty reduction. Improving governance, increasing transparency and combating corruption are a major focus of President Bush and our agenda at the World Bank (the Bank). As the President said when he announced the Millennium Challenge Account (MCA) on March 14, 2002: "Money that is not accompanied by legal and economic reform are often times wasted. In many poor nations, corruption runs deep . . . When nations refuse to enact sound policies, progress against poverty is nearly impossible."

Our Administration's view is well supported by the Bank. In fact, combating corruption and building good governance have been major ongoing priorities of the World Bank since 1996. At the most recent Annual Meeting in Dubai of the World Bank and International Monetary Fund (September 23, 2003), Bank President Wolfensohn said: "There is still too much cronyism and corruption (in the developing countries). In nearly every country, it is a matter of common knowledge where the problems are and who is responsible. Frankly, there is not enough bold and consistent action against corruption, particularly at the higher levels of influence."

During my tenure as Executive Director representing the United States on the Bank's Board, I have seen up front the real impact of the World Bank on people's lives and opportunities to emerge out of poverty that good governance supported by the World Bank can make in delivering textbooks to children in Nairobi, Kenya or building a needed rural road to a village in Malang, Indonesia. Notwithstanding the compelling nature of these personal experiences, the question before us today is: How effective is the Bank in its anti-corruption efforts, thereby ensuring that its assistance can be delivered effectively and efficiently to promote economic growth and reduce poverty?

The World Bank continues to be the leader among international development institutions in a broad range of country-based initiatives to strengthen governance, build effective local institutions and increase transparency. These three components are the infrastructure for fighting corruption—both its systemic causes and in specific cases where it appears. The Bank has built a comprehensive structure that includes international advocacy, internal controls, analytical/diagnostic tools, education and training, and country operations. Among the MDBs, the Bank provides the largest amount of finance to support good governance programs, lending over $5 billion per year for reforms to strengthen public sector institutions.

The Bank's anti-corruption infrastructure has performed effectively in many aspects and in managing many challenges. However, there is more that could be done to strengthen the system. Our Administration is directly pursuing ways to get the desired results both internally and on the ground in countries where the Bank operates. This Committee's 2003 legislation, Section 581 of the FY2004 Consolidated Appropriations Act, which the Committee (working with Treasury) crafted, is an important tool for our efforts to enhance accountability and transparency.

The Bank's mandate is to end poverty in member countries by strengthening their investment climates in support of jobs and growth, and by creating local capacity to deliver services to the poor. In many cases, the Bank's services are in great demand in countries where governance standards and institutional capacities are lacking. By the very nature of its mandate, the Bank needs to be involved in these countries to help improve their governance structures. The challenge is to establish procedures that successfully mitigate the risks posed by corruption and effectively deliver on the Bank's mandate. The U.S. is fully committed to meeting this challenge.

My office has an ambitious agenda with respect to anti-corruption and transparency efforts. It approaches this issue at three levels. At the institutional level, we focus on improving the functioning of the Bank's internal control processes for preventing and responding to corruption and fraud. At the project level, we focus on encouraging the Bank to conduct analysis and design projects and lending policies that help to reduce opportunities for corruption and ensure that Bank funds will be well spent. At the country level, my office is a driving force to increase transparency and disclosure of Bank operations and anaylsis.

Institutional Efforts

As a major provider of development expertise and funding, the Bank recognizes that it must lead by example. Therefore, the World Bank has established systems to ensure institutional integrity, accountability and the rigorous investigation and resolution of cases involving fraud and corruption.

In November 2000, the World Bank created the Department of Institutional Integrity (INT) out of two preexisting offices tasked with combating corruption. The INT has played an important role in investigating allegations of misconduct by firms, individuals, and Bank staff. INT also supports training for Bank staff to identify ways to detect and deter fraud and corruption in Bank operations. In order to be proactive, anti-fraud and corruption training is provided by INT to all new Bank operations staff as part of their introductory training. The Bank has a hotline (1-800-831-0463) where the public or staff can report incidents of corruption or other inappropriate practices. Whistleblower protection is ensured and complaints may be made annonomously or confidentially.

The Bank has instituted several reforms that attempt to eliminate conflicts of interests and any possible corrupt practices among its staff. In 2003, the Bank announced the strengthening of its financial disclosure obligations for senior staff. All of the Bank's senior managers and Board members are now required to provide an annual statement listing their financial interests and those of their immediate families.

The Bank's Internal Auditing Department (IAD) guides World Bank management in establishing and maintaining strong internal controls and risk management procedures. IAD performs audits of the internal controls of business processes to assess their integrity, and provides advice on the design, implementation, and operation of internal control systems. In 1997, a special unit within IAD was created specifically to review all allegations and guard against fraud or corruption within the World Bank Group. This group works with an Oversight Committee Against Fraud and Corruption.

The Bank has taken formal steps to review its internal controls. Beginning in 1995, the Bank adopted the internationally recognized internal control framework known as COSO (Committee on Sponsoring Organizations). More recently, as part of Bank management's annual assessment of internal controls, management and the independent auditor provide letters regarding the adequacy of internal controls over external financial reporting. The two letters are published with the financial statements in the Bank's annual report.

In the area of accountability the World Bank has two key institutions, the Operations and Evaluation Department (OED) and its equivalents at the IFC and MIGA (OEG and OEU) and the Quality Assessment Group (QAG). Established in 1973, the Operations Evaluation Department (OED) is independent of management and reports directly to the Bank's Board of Executive Directors. OED evaluates the effectiveness of the Bank's operations at the project, sector, and country level, and assesses its lasting contribution to a country's overall development. Quality Assurance Group (QAG) was created in 1996 with the express purpose of improving the quality of Bank output within the broad context of alleviating poverty and achieving development impacts. QAG's mandate is to increase management and staff accountability by conducting real-time assessments of the quality of the Bank's portfolio under implementation as well as the quality of the initial formulation of projects and programs.

A related unit, The Quality Assurance and Compliance Unit (QACU) was established in 2001 as part of the World Bank's Environmentally and Socially Sustainable Development Vice Presidency. QACU ensures that safeguard policies are implemented consistently across the regions, and gives advice on compliance with the safeguard policies in projects. Safeguard coordinators, with dedicated funding, are appointed in each region to oversee project compliance with the policies and assure that the proper steps have been taken to avoid or mitigate negative impacts.

Project-Level Efforts

The World Bank utilizes a number of effective tools to mitigate the risk of corruption in designing projects, as well as mechanisms to address instances when it finds that corrupt practices have occurred in the course of project implementation.

First, the Bank has 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, the importance of transparency in the procurement process, and 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 relevant funding.

Related to this, the Bank has actively enforced its administrative sanctions policy. Under this policy, the Bank debars firms and individuals from participating in any further Bank, or Bank-financed, projects if they are determined to have engaged in corrupt, fraudulent, collusive, or coercive practices in competing for, or in executing, a Bank contract. More than 180 companies and individuals have been debarred from doing business with the Bank, either temporarily or permanently. In addition, the World Bank refers matters to national justice officials for prosecution in cases when its internal compliance unit uncovers evidence that laws have been broken. The Bank makes the list of the debarred firms and individuals publicly available on its website. This illustrates the strong commitment the Bank has to eliminating corruption at the project-level, as well as the financial and reputational costs to the private sector of engaging in corrupt or non-compliant activities.

In 1993, the World Bank created the Inspection Panel as an independent forum to private citizens who believe that they have been or could be directly harmed by a project financed by the World Bank. Twenty-seven formal requests have been received since Inspection Panel operations began in September 1994. Panel reports are publicly available on the Bank's website. The IFC, the Bank's private sector institution, and MIGA have a Compliance Advisor/Ombudsman whose role is three fold: (1) To advise and assist IFC/MIGA to address complaints by people directly impacted by projects in a manner that is fair, objective and constructive, (2) To oversee compliance audits of IFC/MIGA, overall environmental and social performance, and specific projects, and (3) To provide independent advice to the President and management on specific projects as well as broader environmental and social policies, guidelines, procedures and resources.

The IFC has also been crucial in developing the Equator Principles that were adopted by ten leading banks from seven countries announced on June 4, 2003. The Equator Principles are a voluntary set of guidelines for managing social and environmental issues related to the financing of development projects that are based on the policies and guidelines of the World Bank and the IFC. Together, these banks represent approximately 70% of the project loan syndication market globally. In adopting the Equator Principles, a bank undertakes to provide loans only to those projects whose sponsors can demonstrate, to the satisfaction of the bank, their ability and willingness to comply with comprehensive processes aimed at ensuring that projects are developed in a socially responsible manner and according to sound environmental management practices.

However, more work is needed to address project-level concerns. Currently, the U.S. is pushing for the Bank to adopt a more systematic approach to measuring project results. This will facilitate a proactive examination early and regularly in the project life-cycle of whether Bank projects are meeting their objectives. Such examination can be a useful tool in identifying if corruption is playing a role.

Anti-Corruption Efforts at the Country Level

As mentioned above, the World Bank provides over $5 billion per year to help countries reform and strengthen governance measures that prevent and punish corruption. Numerous examples of these programs can be found in the annual report that the U.S. Treasury provides to Congress on anti-corruption actions taken by countries as a result of MDB assistance. They include programs that promote a wide range of judicial, fiscal, procurement and regulatory reform.

The World Bank and other IFIs have intensified efforts to assist countries to improve the quality of public expenditures. The Bank has increased assessment of the content and overall efficiency of public expenditures with the help of Public Expenditure Reviews (PERs), Country Financial Accountability Assessments (CFAAs), and Country Procurement Assessment Reports (CPARs). Expenditure Tracking Assessments for Highly Indebted Poor Countries (HIPCs) have also been used to evaluate budget formulation, execution and reporting in twenty-four HIPCs over the last several years. My office is pushing hard to get the Bank to conduct PERs, CPARs, and CFAAs in all borrowing countries and follow up these assessments with technical assistance and projects that address the weaknesses identified. This is particularly necessary in countries that will be receiving adjustment lending funds or direct budget support.

Another important Bank diagnostic is the Investment Climate Assessment (ICAs), which attempts to systematically analyze conditions for private investment and enterprise development in World Bank countries. These assessments examine the factors constraining market activity, in particular, the weaknesses in a country's legal, regulatory, and institutional framework. As a result, ICAs are a useful tool in identifying those areas where country reforms could have the greatest impact in stimulating private sector activity and reducing official corruption.

The World Bank has also been a leader in the research and analysis of corruption. Particularly notable is the work of the World Bank Institute (WBI) which has developed new approaches to measuring corruption and assessing its monetary and developmental impact. The World Bank has joined with some of the very civil society groups represented on one of today's panels—Transparency International—to cohost an anti-corruption workshop highlighting the challenges in overcoming vested interests against reform. Through this and similar conferences the Bank is creating a frank dialogue about the roots of corruption in the hope of building a stronger social consensus on values and ethics in borrowing member countries.

The Bank's commitment to governance and fighting corruption is further illustrated by the way in which International Development Association (IDA) resources are allocated to the seventy-seven recipient countries, which include the world's poorest nations. Governance is a major factor in the IDA performance-based allocation system, which the Bank utilizes on an annual basis to determine the amount of resources countries are eligible to receive. Consequently, countries that improve governance and efforts to combat corruption are rewarded with additional IDA resources, while those whose governance scores decline receive fewer resources. As a result, the Bank has had many requests from countries for advice and assistance in addressing issues that would improve their governance scores.

Another key element in the battle against corruption is transparency, where the Bank has been at the forefront in terms of disclosure of documents and consultation with civil society. The Bank has frequently updated its information disclosure policy to establish and institute best practices among the MDBs. My office continues to work with the Board and Management to ensure that further transparency is achieved in the context of additional improvements to the Bank's disclosure policy, consistent with legislation from Congress in the FY04 appropriations process as well as international commitments by the G-8 at last year's summit in Evian, France.

CONCLUSION

The Bank has made considerable progress in establishing the foundation required to address governance and corruption in its operations and in the countries where it works. The Bank also has the leadership of senior management at the forefront on this critical issue. We cannot afford complacency however; continued effort and vigilance are required, both institutionally and in countries receiving assistance. Among the challenges going forward will be to achieve greater coherence across international institutions on issues like debarment, procurement and consultant guidelines, fiduciary standards and transparency. Most important to building a sustainable anti-corruption culture is building ownership in borrowing countries. The goal must be to increase their demand for good governance, so that they are accountable to their own citizens, who will then be better able to benefit directly from their own country's development. Mr. Chairman, the U.S. is committed to the full scope of this effort and we will continue to exercise our leadership and influence in this vital cause.

The CHAIRMAN. Well, thank you very much, Ms. Brookins. I very much appreciate your emphasis on transparency and the building of a culture in countries all over the world. As you know, just this week, the President announced 16 countries that will be a part of the Millennium Challenge situation, in which good governance and some of the items that we are talking about today are very much paramount, in terms of taxpayer funds that will go in foreign assistance on our own. The parallel work at the World Bank is much appreciated.

Mr. Morales.

STATEMENT OF HECTOR MORALES, ALTERNATE U.S. EXECUTIVE DIRECTOR, INTER-AMERICAN DEVELOPMENT BANK

Mr. MORALES. Thank you, Mr. Chairman. Senator Hagel, thank you for your opening remarks.

I am extremely pleased to be here to discuss the efforts of the Inter-American Development Bank to address corruption and increase transparency. Although I have not been in my current position for very long, I hope that I can answer the committee's questions and shed light on this important area of the IDB's work.

I would like to focus my remarks today on three levels of anticorruption efforts that the IDB has undertaken, at the institutional level, at the project level, and at the country level.

With regard to institutional, although much remains to be done, the IDB has made significant strides toward creating an institutional culture that promotes transparency. A new information disclosure policy, strongly advocated by this chair and adopted by the bank late last year, requires that information concerning the bank and its activities be made public in the absence of a compelling reason for confidentiality and that such information also be made available in the bank's member countries.

The policy also features mandates for release of the minutes of the executive board meetings and for an annual review of implementation to measure how effective its projects have been.

The bank has also created an Office of Institutional Integrity and gave it the responsibility of pursuing allegations of impropriety through committees on oversight, fraud, and corruption, conduct review, and ethics. Allegations may be reported anonymously via a toll-free hotline and informants receive full whistleblower protection.

The IDB also has an independent mechanism to investigate allegations that the bank has failed to correctly apply its own operational policies.

The U.S. chair is also championing reform of the IDB's corporate and project procurement systems, including the evaluation of both systems by outside consultants. When this review is completed, I will work diligently with IDB management and my fellow members of the board of directors to push for implementation of those recommendations that are consistent with the best practices at other MDBs.

Going forward, I see two areas of focus to improve institutional transparency at the IDB. First, increased disclosure of financial information and creation of an independent audit committee to identify and eliminate conflicts of interest. Second, an adoption of a policy of debarment for corruption to which firms participating in IDB-financed projects must adhere.

With regard to projects financed by the IDB, the bank's independent evaluation office recently completed a study of its system of project review and found that not all supervision requirements are being met on a regular basis and that there is no centralized authority responsible for monitoring compliance. The U.S. chair has urged the management to address flaws in the current system immediately by reducing the number of reporting requirements, while at the same time strengthening the consistency and the quality of the reporting.

Another fundamental area of reform is the project procurement system. This chair has urged IDB management to adopt the guidelines issued by the working group of the IFI heads of procurement so that that there are uniform policies and procedures at all MDBs. This includes the mandatory use of standardized bidding documents and a project procurement policy that is available to the public.

With respect to the private sector, the IDB group's new development strategy will promote best practices for corporate governance and social responsibility in line with the IFC's Equator Principles. The United States has strongly advocated that the MDB work exclusively with private sector firms that are committed to good corporate governance and to the use of environmental and social safeguards. I am disappointed more U.S. firms do not participate in IDB project procurement and I hope that by creating a more transparent mechanism, we can encourage American companies to become more actively involved in the bank's work.

With regard to efforts at the country level, the IDB's institutional mandate includes encouragement of governmental reforms to foster commerce and productivity. The IDB, through its long relationship with the countries in the region, is well placed to dig deeply into governmental policies and structures and to improve these governments' use of the IDB resources for the benefit of their societies.

In this same area, the IDB has created its business climate initiative which draws on the work of the World Bank and other multilateral institutions to assess weaknesses in the business climates of various countries in the region and proposes programs to target those weaknesses.

In conclusion, I am encouraged that the pace and number of institutional reforms to combat corruption have accelerated recently and I am hopeful that a positive synergy has emerged. Because the bank is a leader in the region, the United States is committed to seeing that this leadership is utilized to send a strong signal of the importance of anti-corruption and transparency and to seeing that these reforms have exponential effects.

Mr. Chairman, thank you.

[The prepared statement of Mr. Morales follows:]

PREPARED STATEMENT OF HECTOR MORALES

ANTI-CORRUPTION EFFORTS OF THE MDBS

Mr. Chairman, members of the Committee, I am extremely pleased to be here today to discuss efforts of the Inter-American Development Bank to address corruption and increase transparency. Although I have not been in my current position for very long, I hope I can answer the Committee's questions and shed light on how the IDB operates.

One of my primary concerns is development effectiveness; by effectiveness I mean that the development efforts of the IDB can only have their intended impact if projects and policies are implemented transparently and free of corruption from inception to completion. When the bank provides loans and technical assistance grants to the most vulnerable populations of the Western Hemisphere, guaranteeing the efficacy of those resources is critical. While multilateral development banks are accountable to all shareholders, they can be important vehicles to transmit U.S. policy interests.

I would like to focus my remarks today on three levels of anti-corruption efforts by the IDB: within the institution, by project, and by country, and provide you with a U.S. view of the Bank's progress in each of these areas. The IDB has accelerated its progress in these areas recently, but still has much work to do. The Office of the U.S. Executive Director has been, and will continue to be, a strong advocate for reform at the IDB. I am aware of the considerable challenges facing the IDB in the area of anti-corruption. My focus in the U.S. Executive Director's Office will continue to be on critical areas that impact the Bank's core development mandates. Among my current priorities are: an overhaul of the IDB's corporate and country project procurement systems, creation of a separate audit committee of the Board and adoption and implementation of an internationally recognized framework of internal controls, and further work on disclosure and transparency in IDB projects and policies.

Institutional Efforts

The IDB has made significant strides with respect to institutional anti-corruption issues. Progress is being made on creating an institutional culture which promotes transparency. The new Information Disclosure policy, adopted late last year, contains a strong statement on the presumption of disclosure. As a result of strong U.S. advocacy, the policy, including release of the Minutes of Executive Board meetings, advances the IDB beyond many of the standards in other MDBs and includes several of the objectives of the transparency language in Section 581 of the FY 2004 Appropriations Legislation on which the Treasury Department worked closely with this Committee. As part of the IDB policy, an annual review of implementation will be conducted. I will use this opportunity to advocate for additional measures to enhance disclosure.

As you may know, President Iglesias has made a strong commitment to fight against corruption within the Bank and in the Bank's member countries. To strengthen his pledge to fight corruption at the IDB, the Office of Institutional Integrity was created in 2003, and is now responsible for pursuing allegations of impropriety through three different Bank committees—the Oversight Committee on Fraud and Corruption, the Conduct Review Committee and the Ethics Committee. Allegations may be reported anonymously, via a toll-free hotline, with full whistleblower protections afforded as the result of a new policy in 2003. Semimonthly reports on the activities of the Oversight Committee on Fraud and Corruption are available on the IDB's public website. Since its inception in April 2002 through April of this year, 183 allegations have been received, averaging 7 per month. The OCFC/OII has opened 92 investigations during the past two years. Also in 2003, the Board of Executive Directors adopted for the first time its own Code of Ethics as distinct from the Code of Ethics for Bank Management.

These are important steps, but they need to be strengthened by encouraging participants in IDB projects to come forward with allegations, and for those allegations to be vigorously prosecuted.

There are two additional transparency-enhancing mechanisms at the IDB which I would like to highlight: the inspection panel and the Office of Oversight and Evaluation. The IDB's independent inspection mechanism was established in 1994 as part of the implementation of the Eighth General Increases in Resources of the Bank. During the negotiations for the Eighth Replenishment, the Governors of the Bank expressed a desire to increase the transparency, accountability and effectiveness of the Bank's performance by the introduction of an inspection function, to be performed independently of Management, which would investigate allegations by affected parties that the Bank had failed to apply correctly its own operational policies. To date there have been five requests for inspections and information on the activities of the inspection mechanism are available on the Bank's website.

The Office of Evaluation and Oversight reports directly to the Board of Directors and is independent of Bank management. The office undertakes independent and systematic evaluations of the Bank's strategies, policies, programs, activities, delivery support functions and systems. The evaluation office provides the Board of Directors with a vehicle for obtaining independent views of the effectiveness of the Bank's operations, policies, and programs. The Auditor General performs audits, reviews, and investigations designed to help assure management of the adequacy, effectiveness and efficiency of the Bank's internal controls and resource utilization.

The U.S. Chair has been a strong advocate for reform of the IDB's corporate and project procurement systems. We pushed for a review of both systems by external consultants and management is expected to recommend concrete reforms in the near future. The U.S. will continue to drive the agenda on this issue with the objective of creating a best-practice, transparent and accountable project procurement system at the IDB which is fully harmonized with that of the other MDBs.

Going forward, in addition to Section 581 reforms, I see three areas of focus to improve institutional transparency efforts at the IDB: mandatory disclosure of financial information for IDB employees, creation of an audit committee of the Board, and adoption and implementation of an internationally recognized framework of internal controls. To avoid conflicts of interest at the staff level, financial disclosure is a key component. The establishment of an audit committee and the adoption of a formal internal controls framework are consistent with U.S. policy.

IDB Financed Projects

To address corruption in the execution of bank-financed projects, the IDB has a supervision system of reviews and evaluations during the project cycle. The IDB's independent evaluation office recently completed a study of this system and found it to be deficient. Bank-wide, not all supervision requirements are met on a consistent basis, and there is no centralized authority in the Bank responsible for monitoring compliance on all of the supervision instruments. The U.S. Chair was supportive of the evaluation's recommendations for reform, and has urged the Management to immediately address flaws in the current system. By reducing the number of reporting requirements to key reports at the beginning, mid-term, and end of a project's implementation and at the same time strengthening the consistency and quality of reporting, we expect to see improved project supervision. I intend to hold IDB management accountable for addressing the weaknesses identified by the evaluation.

Another fundamental area where the IDB can play a role in improving governance at the project level is through reform of the project procurement system. This Chair has urged the IDB to work with the other MDBs to agree on a best-practice set of procurement and consultant guidelines, standard documents and processes. Updated project procurement and consultants policies must be available to the public and referenced in all IDB investment loan agreements with Borrowers and must mandate the use of appropriate standard documents.

With respect to the private sector, the IDB Group's new private sector development strategy will promote best practices for corporate governance and social responsibility. The U.S. has been a strong advocate of the MDBs working exclusively with those private sector firms committed to corporate governance. We have also encouraged the IDB to promote capacity building and best-practice awareness among smaller firms so that they might improve competitiveness along with governance and safeguards.

The IDB representation in each of the borrowing member countries is a key factor in improving project performance. The IDB needs to focus additional energy and resources, if necessary, on properly staffing and training the country offices so that they are capable of providing project supervision, exercising fiduciary oversight over procurement processes, and reporting back to the Bank when participants in local projects are unsatisfied with any of the fiduciary or governance aspects of IDB projects.

Anti-Corruption Efforts at the Country Level

I would like to highlight to the Committee that the Treasury Department prepares an annual report on the anti-corruption efforts of all of the Multilateral Development Banks. The report focuses on the country impact of MDB actions to improve governance.

The IDB's institutional strategy explicitly prioritizes modernization of the state as an area of Bank action. Before projects are developed, the country strategy which defines IDB's engagement will consider anti-corruption, governance, and institutional strengthening in the strategy. Public sector reform and modernization of public administration are key components in virtually every country strategy paper the IDB adopts.

In 2003, the IDB financed 19 projects for a total of $772 million for public sector reform and modernization. These projects ranged from strengthening internal controls in Brazil's Federal Court of Accounts to promoting fiscal reform in Bolivia and Peru. In 2004, the IDB has financed several projects of note: $7.8 million for capacity building of municipal governments in Panama; $25 million in concessional finance to Honduras to improve bank supervision; and a grant of $150,000 to Paraguay to improve management between the Executive and Legislative branches.

Through the Multilateral Investment Fund, the IDB also makes extensive use of grant financing for demonstration projects to show the benefits of politically difficult commitments that benefit the private sector, such as strengthening auditing and accounting standards in the Caribbean, and developing benchmarks to combat money laundering across the region. The MIF focuses on innovative private sector projects with large demonstration effects. Recent areas of activity include: accounting and auditing standards, financial sector reform and supervision, and improving regulatory frameworks.

To encourage market forces to provide a strong positive demonstration effect, the IDB has created its Business Climate Initiative, which will draw on the work of the

World Bank and other multilateral institutions. The initiative will fund a diagnostic assessment of the weaknesses in country business climates, and then propose a program to target these weaknesses.

Results from early governance and anti-corruption elements of larger loans have shown that conditions for disbursement related to anti-corruption efforts such as sub-national financial reporting and investigation of financial crimes have largely been met. We need to capitalize on these incentive mechanisms and enhance the Bank's ability to achieve improvements in anti-corruption activities.

In my view, a critical area for further reform at the country level is building the capacity of project executing agencies in the country, usually Ministries or coordinating bodies of the executive branch. Executing agencies are subject to tremendous political pressures and a governing culture which often does not lend itself to full transparency. The IDB, through its long relationship with countries, is well-placed to dig deeper into the institutional culture and improve the government's use of IDB resources for the benefit of civil society.

Conclusion

In conclusion, while the pace of institutional reforms to combat corruption has accelerated recently, I recognize that the IDB still has much work to do. Because the bank is a leader in the region, a strong signal of the importance of anti-corruption and transparency initiatives in the Bank's institutional culture will have exponential effects in the countries of the region. This is an aggressive agenda, but as the largest shareholder in the Bank, the U.S. is working aggressively on the need for further reform.

In his address to the IDB Board of Executive Directors last July, Secretary Snow remarked on the critical need to improve the investment climate in Latin America, saying that "capital is a coward" and only goes to places where it feels adequately protected. It is our job to enhance anti-corruption and transparency activities at the IDB to create the conditions for capital to flourish and for our development assistance to be effective.

The CHAIRMAN. Well, thank you very much, Mr. Morales, for that excellent report of work at the bank.

We will have a period of questioning now and we will limit ourselves to 10 minutes per Senator. Then we will have another round, if required, to complete our questioning.

Before I begin my questioning, I want to mention that in our audience today are women from Indiana. They are from the Women of Excellence series. This is a program that encourages outstanding leaders in Indiana to become more effective in public leadership in our State and in our Nation. We are proud of them, and we are especially pleased they could join this hearing this morning.

Let me begin by asking two questions about employees of your banks. I think that there is some recognition that, given the international quality of this lending, at some stage the country that receives the money is most responsible for the outcome. Employees of the banks cannot always foray into a sovereign country to pursue all of the aspects under consideration. On the other hand, the design of the loan, the criteria, the basis on which this money is disbursed are all factors that fall under the responsibility of employees of your institutions.

Is the quality of these loans an important factor in terms of staff evaluations? In other words, as people's careers proceed through the banks, is there some scrutiny of what kind of a batting average they have, or what kind of loans were made, how well designed they were, and their outcomes as criteria for how well they succeed in those careers? Ms. Brookins, do you have a comment on that?

Ms. BROOKINS. Mr. Chairman, first of all, I would like to join your welcome to the women from Indiana. I am from Indiana. I am a constituent of yours.

The CHAIRMAN. Yes, indeed.

Ms. BROOKINS. So I have met in the past in a former life with the leadership groups from Indiana. So I want to also personally welcome them.

The CHAIRMAN. That makes your testimony especially welcome on this occasion.

Ms. BROOKINS. I think the issue of quality of loans and whether there is an incentive for bank staff to push out money and not be responsible for results is always an issue. In any situation with a financial institution the incentive must be to have quality loans which will be repaid and will be managed properly. And it is particularly an issue with development institutions where this money is so precious to the people who are receiving it.

There has been, I think, in recent years much more focus on getting a results agenda going and the United States has been at the forefront of this. The bank has begun to implement a major results framework, in fact, designing loans from the very outset with impacts, outputs, outcomes, and with the type of interim indicators that are necessary. I think there still are some areas where people will try to get loans through for their clients, for the countries, but I think the bank is doing a great deal to change incentives, and we, the United States, have been at the forefront of moving in that direction. I agree with you totally that this is the core of the issue of effectiveness.

The CHAIRMAN. Given the extraordinary needs, just looking at this in a humanitarian way, a country comes along, and says, we have a lot of people that are near starvation. We very badly need this money for a particular humanitarian project. It could make an enormous difference for us. Now, the bank employees take a look at this situation. Here is a country that appears to have a long history of corruption. Its leadership siphons off money routinely. This is not only public knowledge, but it is almost respected in the culture of the country. How do you approach a situation of that variety?

Clearly, the development and humanitarian aspects, are enormous. There is some desire to push money toward the needy, but clearly you would have to be very hard-hearted not to understand that these folks who happen to be citizens, poor people in such a country, are between a rock and a hard place, with corrupt leadership, and poverty besides. How do you deal with that?

Ms. BROOKINS. Well, I think there are two to three different responses I would like to make to you because that is at the heart of the bank's work, which is to relieve poverty and certainly to address really chronic poverty conditions for people.

First of all, that was the purpose of the whole performance-based allocation system of IDA, where the United States took leadership beginning with IDA 12. We are now beginning the negotiations for IDA 14. So countries who do not perform well, who do not respond to their citizens properly, with governance being a key component, do not receive as much money. So if they are not receiving the money from IDA, be it in the form of grants or credits, which are highly concessional, they feel the pinch at the national level. So that is one way of controlling the amount of money going into less favorable or perceived corrupt environments.

The second area is the problem in terms of how to deal with areas in terms of post-conflict or where there has been an emergency or a crisis, in which case money can go in for preventing starvation or for particular issues like HIV/AIDS, but it is done in a very controlled way with a positive list of imports that the money can be paid out for. So it is controlled in that way to go for those purposes.

The other way, which is a deeper issue which I think you raised, is what do you do where your overall national environment is not conducive to clean government? The bank has found that there are many ways to go and get involved at the community level, with sub-national governments, or putting money through with NGOs involved and monitoring it so the money actually goes to those people affected.

I have been in Indonesia and I have been in Kenya over the past several months. In Indonesia I have seen what happens with a community project where half of the funds that the bank is lending are only going, in the past few years, to those community projects and good governance being taught, because the money that is being lent is posted right on the project wall. You have a committee of civil society and government people at that level. So that if there's a project of $12,000 or $14,000 to build a feeder road from that farm community, the people know it is being spent and it is tracked and there are criminal corruption procedures if it is not being spent properly. These funds are given to villages based on competition. So if there is a corrupt village, they cannot compete in the future for any funding. So this is beginning to work.

In Kenya or Uganda they are posting the amount of money that is supposed to be going into the school on the wall of the school, and there is a committee of local authorities.

I did not mean to go on so long, but I am pretty passionate about this and I know that you are also. I think that the issue for the bank is identifying where can we work, how can we work, and to tailor the interventions that the U.S. sees are appropriate for the bank and conveys this to bank authorities as to where the bank can be effective in getting funds to people who need it.

The CHAIRMAN. I appreciate your detail, because the common impression is that these loans are made to corrupt officials at a central spot. What you are pointing out is that the sophistication of this lending now comes down through NGOs or through specific village councils with a sophisticated level of accountability. That is a very different impression than I think is commonly held.

Let me ask about this problem of staff immunity. Essentially, immunity is conferred upon World Bank employees, for example, from prosecution by various countries. This is a common circumstance in international dealings, to ensure that there will not be discrimination or intimidation by participating countries that have all sorts of political systems.

What is the impact upon performance and behavior? In the first round of questions I was asking, we got into the batting average of how well these loans do. If there cannot be prosecution by all sorts of governments that are involved, how do you try to mitigate the problems that this might cause, in countries where people have this sense of immunity?

Ms. BROOKINS. Well, I think the immunity for employees arises from the founding documents of the institution, of the articles of agreement, and all officers and employees of the bank shall be immune from legal process with respect to acts performed by them in their official capacity except when the bank waives this immunity. So I do not know all the legal details of this, but I would certainly be happy to get back to you and also ask the bank and ask the Treasury legal counsel to give you any indication of where these waivers have applied.

[At the time of publication no information had been forwarded.]

The CHAIRMAN. That would be important to have in our committee record. There is some anecdotal evidence that these investigations start with maybe tens of people, say, out of 10,000, but then they sort of simmer down, and cases are dismissed, and ultimately almost no one is found culpable. I would like to get some track record of how your investigations go, if there are internal controls, leaving aside prosecution by sovereign nations. How is wrongdoing met?

Ms. BROOKINS. There are internal controls and the bank has conducted and very definitely does enforce these complaints—the hotline is very important also in terms of potential staff abuse.

The CHAIRMAN. What is the hotline?

Ms. BROOKINS. The hotline is the 1–800 number, 831–0463, where the public or staff can report incidents of corruption or other inappropriate policies or inappropriate practices. I think what is important, as I mentioned before, is that the number of cases being reported or complaints being reported by staff has risen from 20 percent of all complaints to the Department of Institutional Integrity up to 50 percent, and this is because of the proactive work of the bank in training both at the institutional level at the bank in Washington, but also in the field staff, training field staff to identify problems not just of staff but of outside procurement issues.

There have been I understand—and I can check these numbers for you, Mr. Chairman—27 cases that have come to the Department of Institutional Integrity regarding alleged staff misconduct, of which 8 members of staff have been terminated from the institution. And one member of staff was severely reprimanded because that staff member had been approached by someone to take a bribe, had not taken it, but had not reported it.

So I think that the internal controls of the institution are extraordinarily important to the United States and we, the United States, very much want to have a culture of zero tolerance, particularly of bank staff. If the staff of the World Bank is not fully compliant with zero tolerance, this is a very serious problem in terms of what the World Bank is expecting of the borrowing countries.

The CHAIRMAN. Senator Hagel.

Senator HAGEL. Mr. Chairman, thank you.

Mr. Chairman, just on a personal note, it is always good, reassuring to have a room full of Hoosiers with us.

I do not know if there are any Cornhuskers present. But we always appreciate the chairman's hospitality. He is very gracious with asking various groups from around the country to come and be part of these hearings and I think it is important that these various individuals, leaders of communities and States have an opportunity to get some sense of what we do here. We do not allow much criticism, however. That is part of the contract.

Thank you both for coming before us this morning and for what you do. Give your colleagues our regards and pass on our thanks as well.

Ms. Brookins, you mentioned in your statement that your office—I am reading from your statement—"has an ambitious agenda with respect to anti-corruption and transparency efforts and approaches this issue at three levels." And you define those three levels, starting with institutional efforts. If I could read one of your last points in that area. "In 1997, a special unit within IAD was created specifically to review all allegations and guard against fraud or corruption within the World Bank Group. This group works with an oversight committee against fraud and corruption."

My question is, is there an outside, independent oversight effort, an outside, independent oversight board, or do you use oversight from the inside?

Ms. BROOKINS. We have our own oversight committee, but we will bring outside attorneys or others, as needed, to conduct the investigations conducted by the bank units or to deal with specific issues when it is needed. I can get back to you with details of when they have been called in or under what conditions.

Senator HAGEL. But not a regular system or a regular oversight body that you would use.

Ms. BROOKINS. No.

Senator HAGEL. Staying in that general universe, in your response to one of Chairman Lugar's questions, you were talking about results criteria developed by the bank, established by internal guidelines. Again, that results criteria that you were talking about, is that only internally driven by internal guidelines or, again, is there any outside input? For example, NGOs, other institutions. Do you ask them for their input into this results criteria?

Ms. BROOKINS. There is regular consultation and discussion with members of civil society and with other organizations like Transparency International. In fact, on governance and corruption, the World Bank actually sponsored a meeting with Transparency International. The bank also has the Office of Operations and Evaluation Department which is the bank's audit group that reports directly to the board on evaluating the effectiveness of the bank's operations at the project, sector, and country level and assesses the contribution of whether these projects have been effective, whether the strategy in a certain area, like agricultural or rural development, is effective. As the bank calls it, OED, the Operations and Evaluation Department does use outside experts and does call them in and has independent review bodies, and these are presented then to the board and to management.

Senator HAGEL. Thank you.

Following in this same area here under the second group of priorities that you listed, project level efforts, a specific question. You mentioned related to this, the bank has actively enforced its administrative sanctions policy, and then you develop that and other points in the following paragraph.

Here is my question. Is there a recovery mechanism for money lost at the World Bank? You spend a lot of time talking about what you are trying to do to prevent it, to enhance transparency, good governance. But go back and reflect on how do you recover or can you or what do you do about that?

Ms. BROOKINS. Yes, there is. On an investment loan—and I will refer to legal counsel to clarify it and give you the exact terms on this, but as I understand it, when there has been a misprocurement on an investment loan—let us say there is a $50 million loan and it is discovered that the contractor has not done the right things with the road and that is $2 million or $3 million or $5 million or $10 million—it is the policy of the bank then, if it declares a misprocurement, to cancel that portion of the loan allocated to the goods and works that have been misprocured. So that is taken out of that country's money which has been lent to it for that loan. So it is deducted from that. So the money, in a sense, is taken back by the bank from the country.

Senator HAGEL. And that is a well-established process, mechanism.

Ms. BROOKINS. Yes, it is. It is in the bank's legal guidelines and I would be happy to get a copy of that to you.

Senator HAGEL. Thank you.

You mentioned later on in the testimony—I quote from your testimony—"currently the U.S. is pushing for the bank to adopt a more systematic approach to measuring project results. This will facilitate a proactive examination early and regularly in the project life cycle of whether bank projects are meeting their objectives."

Would you explain that in a little more detail, specifically the measuring? You referenced measuring project results. What do you mean by that and how do you do that?

Ms. BROOKINS. That is a very, very good question, Senator. In many cases—I think that Senator Lugar alluded to this earlier—money was being lent to countries in some cases because it let us lend money. We focus on whether the bank is spending the money effectively and whether it is meeting all our time tables to get the money spent. In some cases the loan design did not have the kind of outputs and impacts and outcomes desired. Results are not just whether money is going in to build schools. As the U.S., we ask: Do we have a baseline to identify how many children are in school in this village, how many girls are in school in this village, how many children over 10 years, how many children have completed a certain number of years in school?

So these types of data are being put in right in the beginning of the project cycle so that as you measure it over 1 year or 2 years or 3 years, your interim indicators can tell, No. 1, are you getting the results that you want. No. 2, if you are not, is it because the funds are not being properly spent, or is this village not performing and another city performing or one school district versus another because you have the data that you need and you have also set the outcome or the targets that you want.

This has been particularly important in the IDA 13 replenishment where there are absolutely measurable results data on measles immunization rates, on primary completion rates, which are required as part of IDA 13 for the poorest countries, and the third one is how many days does it take, as you all understand, to start a business and what is the cost of starting a business. Are you able to reduce those so that your private sector, your small and medium enterprises can start up. So it is getting very specific.

Many of the bank's loans in the past did have outcomes and impacts; the bank was looking for results, but in many cases lacked the specificity that we are trying to get built into that. And the bank has been very enthusiastic in the past 2 years about embracing this type of deeper and richer results agenda.

Senator HAGEL. Thank you.

Let me ask a question for each of you. Mr. Morales, we will let Ms. Brookins take a rest and we will go to you.

The same question. The chairman referenced the Millennium Challenge Account program, the Millennium Challenge Corporation. I think the chairman's points here are very much on target with each of your testimony this morning and what your institutions are attempting to do.

My question is explain to me how each of your institutions intends to, is now working in parallel with MCA because as you both know, the objectives of MCA are much the same as your institutions and cut right to the core issues and challenges and problems.

Mr. Morales.

Mr. MORALES. Thank you, Senator.

You are absolutely right. The same goals and initiatives that MCA has are very much in line with the Inter-American Bank. Fighting corruption is critical. We want to reward countries that are implementing the kind of policies that we know will lead to increased productivity and eventually reduce poverty.

In terms of outreach, the bank's management—and I have encouraged bank's management to do this, is to initiate discussions with MCA to specifically identify how we can work together. There are three countries, Bolivia, Nicaragua, and Honduras, that have been mentioned under the MCA designation. So clearly, we want to make certain that we work very closely with MCA to align those interests.

Senator HAGEL. Thank you.

Ms. Brookins.

Ms. BROOKINS. That is a great question because much of the bank's diagnostic or analytical work has gone in to help found or be part of the core work in terms of identifying who makes the cut in MCA. So there is work that is being provided by the banks to MCA in terms of making these determinations, in terms of tracking countries. I think it has been extraordinarily valuable and there has been an interaction between the MCA team from the very beginning and the World Bank in a very constructive way to see how the bank can be useful.

Most importantly, I think that MCA has created a whole new higher benchmark for countries. As I mentioned in my earlier testimony, the performance allocation for IDA and the poorest countries has been helpful in trying to get countries to better perform. But setting up this real carrot with MCA of having access to a really significant amount of money to help your people under the Millennium Challenge Account funding is just another example of how the United States has led this move toward excellence in terms of improving governance and improving the fight against poverty.

So I think MCA will continue to be strongly related to the World Bank's work. The bank will work in any way that it can and my office will facilitate. We will facilitate in any way we can knowledge or information that helps to strengthen MCA.

Senator HAGEL. Thank you. Thank you, each, very much. Mr. Chairman.

The CHAIRMAN. Thank you, Senator Hagel.

Let me ask just one final question of both of you. We have talked principally today about project loans. You have even described Ms. Brookins down to the school level or the community level or what have you. How do we evaluate loans that are not project loans but really do go to the governments themselves for dispensing the funds or administration of that? Can you describe? Are there criteria or methods that you found are most helpful in that respect?

Ms. BROOKINS. Well, as you work in the bank, you have a lot of acronyms, but this term "fiduciary diagnostics" is not exactly an acronym but it sometimes makes me feel like a doctor. The fiduciary diagnostics the bank conducts with countries in terms of public expenditure reviews, country financial accountability assessments, and country procurement assessment reports. These are all used to look at the country level to identify where there are weaknesses in terms of whether a country is ready to have budget support lending or programmatic lending. The key is to have a certain threshold of accountability so that money can go into the government budget directly without having to be accounted for under bank procurement guidelines and under investment lending restrictions.

So I think this is a very big issue. It is one that has to be constantly updated, when we raise the thresholds. There are these fiduciary controls in place and we take them very seriously and we, the United States, have been leading the efforts in the board to make sure that we improve the thresholds under which countries can be eligible for this type of direct budget support lending. It is a crucial issue.

The CHAIRMAN. You mentioned the term of diagnostics. Does the bank have a computer program, for example, in which you plug in various evaluations, much like the credit scores that average Americans have, and they can phone in, and find out what their score is? Does that pertain to this?

Ms. BROOKINS. Yes, absolutely. It includes governance. It is particularly used, as I said, for allocating funds to IDA countries who get the highly concessional moneys. But this is done for every country that is a recipient of bank lending.

The CHAIRMAN. That is helpful to know.

Mr. Morales, do you have a further comment on this subject?

Mr. MORALES. Mr. Chairman, we at the IDB use a macroeconomic debt sustainability analysis, and it is a series of ratios that are evaluated. Obviously, depending on the country, those ratios may change, but the point is before any policy based lending or emergency lending is made, there has to be a program that is in place and sustainable. In fact, with regard to emergency lending, the bank looks to the fund programs to make certain that they are in compliance. So clearly, before any of that type of lending is done, there is a check that is made.

The CHAIRMAN. Thank you.

Senator Hagel, do you have further questions of the witnesses?

Senator HAGEL. One brief question for each of our witnesses. We have spent the last hour talking about the U.S. effort to clean up the process, transparency, good governance, all the other areas that you have spent some time developing. What about other nations, the other developed nations, senior nations like the United States who are large contributors to this effort? Are they putting commensurate efforts into cleaning up the process, doing the things that you have talked about? Are they lagging behind? If so, why and who, and what do we need to do to encourage their efforts? Or are we all on the same frequency here and working intensely to accomplish your objectives?

Ms. BROOKINS. The G–8 at the Evian summit did fully support disclosure and transparency efforts at the institution. Working with the other 23 board members and the other 183 countries who are shareholders of the bank, there has been a very strong support for anti-corruption efforts and a very strong support for strengthening bank policies and practices in both the Committee on Development Effectiveness, and the Audit Committee. There has not been any indication that we have seen that there is not a full ownership into this.

There is a recognition, in fact, among many of the developing countries, who are also represented on the board. They have to face these issues day in and day out in their countries and we see very strong support, by and large, from them as well because they see this as truly impeding their efforts at improving the lives of the people in their countries. There may be specific issues where we oftentimes will want to see more investment lending, some other countries will want to see more adjustment lending going into budget support, and we will discuss these and try to build consensus on it. But I think overall the leadership of the head of the institution, President Wolfensohn, and his senior management team and the leadership of the other developed countries is very unanimous on this.

Senator HAGEL. Thank you.

Mr. Morales.

Mr. MORALES. Senator, in my experience the environment is certainly pointed in the right direction. I think an example of that is the information disclosure policy that was recently passed. That could not have been passed without strong support. So clearly there is a message that transparency is important and corruption only serves to undermine the development effectiveness of the bank. So I think the trend is in the right direction.

Having said that, a lot more needs to be done and that is certainly the charge of this chair and I am making it a priority.

Senator HAGEL. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Hagel.

We thank both of you for your testimony, for your papers, and for your responses. Please followup on the additional questions and information that you have indicated you would supply for the record.

Mr. MORALES. Thank you, Mr. Chairman. Thank you, Senator.

The CHAIRMAN. The chair would now like to introduce our second panel. It will be comprised of Dr. Jeffrey Winters, associate professor, Northwestern University, Evanston, Illinois; Mr. Manish Bapna, executive director, Bank Information Center, Washington, DC; Ms. Nancy Zucker Boswell, managing director, Transparency International USA, Washington, DC; and Professor Jerome Levinson, distinguished lawyer in residence, Washington College of Law, American University in Washington, DC.

I mentioned to the earlier panel that the statements you have written will be placed in the record in full. My hope is that you might be able to summarize your testimony in 10 minutes, more or less. We will then proceed with questions, as we did with the first panel.

I will ask you to testify in the order that I introduced you, which would mean, first of all, Dr. Winters, then Mr. Bapna, Ms. Boswell, and Professor Levinson. Would you please proceed, Dr. Winters?

STATEMENT OF DR. JEFFREY A. WINTERS, ASSOCIATE PROFESSOR, NORTHWESTERN UNIVERSITY

Dr. WINTERS. Chairman Lugar, thank you very much. I am grateful for this opportunity to present the results of nearly 15 years of research on the multilateral development banks, the matter of corruption, and particularly how the problem is manifested in the region of Southeast Asia, my geographical area of specialization.

I am co-editor of a recently published book entitled "Reinventing the World Bank," and this book contains two chapters devoted to the problem of corruption, specifically in the World Bank.

Since its founding, the World Bank has participated mostly passively in the corruption of roughly $100 billion of its loan funds intended for development. If we include the corruption of loan funds from other multilateral development banks over the same period, the figure roughly doubles to $200 billion.

I refer to these loan funds as criminal debt. The debt is criminal in two senses: first, because it was a crime to allow the development funds to be stolen in the first place, and second, because it is, as you mentioned, an injustice to expect poor populations around the world that never received these funds to bear the heavy burden of repayment. On average, the poor have received about 70 cents on the dollar in loan funds from MDBs and yet they are obligated to repay 100 percent of the loans, plus interest.

Although part of my scholarly work has been devoted to criticisms of the MDBs, I would like to preface my comments by saying that I am deeply committed to public sector lending. I do not sign onto those who think that institutions like the World Bank should be shut down. I think this is a problem which can be addressed and I am happy that this committee's work is part of getting to that problem.

I would like to make a few specific points and then make a couple of observations and close.

For a very long time, the MDBs, and in particular the World Bank, has had what I refer to as a "don't ask/don't tell" posture on corruption. More recently, especially since the mid and late 1990s, the World Bank and other MDBs have paid more attention to the problem of corruption, but the impact of this attention has been, in my view, minimal in stopping most of the theft of loans because the bank's approach is inappropriate to the problem.

Most of the way that the bank has approached the problem is to try to lend its way out of the criminal debt problem. That is, it comes as a natural response to the bank to increase programs, spend more money to try to solve the problem of the theft of money.

I would like to emphasize that the problem of corruption occurs mainly at three levels, what I would call the micro, the middle, and the macro level. The macro level is, of course, the global governance problem related to corruption, and I would admit that that is a governance issue. At the middle level, that is, the problem of corruption across whole societies, that is also a governance issue. But at the micro level—and that is the nexus between the multilateral development banks and their clients in their projects and in their programmatic loans—I would argue that this is not a governance issue. This is an issue of supervision and auditing.

Unfortunately, the bank's greatest core competence should and ought to be in watching its own programmatic and loan funds, but this happens to be the area in which the least effort is made. In fact, the greatest effort is made, as we heard in the testimony just a moment ago, in trying to deal with governance and corruption at the broader societal level. That is an admirable goal, but I do not think it is the most effective way. I think what the bank needs to do is get its own programmatic and project money safeguarded first and deal secondarily with the broader problem of corruption across whole societies, which by the way is not the bank's job. That is the job of civil society and the people struggling in their own countries.

The MDBs must do a much better job supervising and auditing projects and loans, but the only effective way, in my view, to protect against corruption of development funds is to establish an international auditing body that is independent of the MDBs and of private sector auditing firms, nearly all of which have deep conflicts of interest. This multilateral auditing agency should be empowered to spot-audit all MDB operations, loans, and projects. Career advancement within what I am calling the MAA, the multilateral auditing agency, must be linked to success in detecting fraud and the theft of development funds.

All of the incentives built into MDB operations facilitate rather than retard the criminal debt problem. A pressure to lend creates a bias in favor of quantitative rather than qualitative results, and corrupt elements in client governments know this. No matter how much money is stolen, the MDBs currently bear no financial burden for these losses.

The vast majority of criminal debt arises in the relationship between the MDBs and borrowing governments, and yet this is the nexus where the least effort has been made to stem losses. While it is admirable that the World Bank now investigates its own employees and has caught a few of them red-handed, corruption among these individuals is actually minimal. Similarly, the blacklisting of international firms engaged in corrupt practices is also a positive move. However, the scale of losses through corrupt firms internationally is also minimal.

My research indicates that at the rhetorical there has, indeed, been progress. No one ever used to talk about corruption. We are now talking about it. We now have Senate hearings about it. But on the ground, the progress has been much more limited.

There was mention of whistleblowing. One of the problems with having an 800 number is that you cannot dial an 800 number from outside of the United States, and the vast majority of the places where one would need to have access to a whistleblower are actually in the client countries themselves.

Let me mention a couple specific cases. The case of Dennis DeTray, who was a top World Bank official in Jakarta in the 1990s, is illuminating. When an individual running a bank-funded project in Indonesia came to Mr. DeTray to ask the bank to do something about blatant theft of project funds, he was told, "Wrong address, call the police."

When I blew the whistle in 1997 on the fact that a third of all World Bank loan funds to Indonesia had been stolen, a senior vice president at the bank headquarters in Washington issued a press release denying the allegations and labeling me an irresponsible scholar. Within a year, two secret documents from inside the bank would leak fully supporting the allegations I had made.

Does the World Bank make effective arrangements to safeguard the loans and the loan process and project implementation? Is supervision really taken seriously? My research and interviews indicate, especially with task managers, those people who work most closely with projects and the distribution of money, suggest that it is not.

Let me give you a quote. Katharine Marshall, a senior bank official in a direct interview with me, said the following. "We look more than anything else at what the project achieves, not really the money. We look, for instance, at whether schools get built, not how the money was spent to build them."

Julian Schweitzer, another senior bank official, went even further in our joint interview, making direct reference to the estimate that a third of the bank's funds loaned to Indonesia had been stolen. He said, "If you take the amount of a 30 percent loss, it means 70 cents on the dollar got used for development after all. That's a lot better than in some places with only 10 cents on the dollar," actually being used effectively.

I will just close by saying we will never have precise figures on levels of criminal debt accumulated since the MDBs began operation. However, citizens groups in the client countries have already begun demonstrating. It is more fashionable to demonstrate against the IMF. The World Bank has begun to have demonstrations outside their headquarters in countries around the world on the criminal debt issue.

Those who are demanding relief for criminal debt, between $100 billion and $200 billion globally, are not trying to repudiate their debts. What they are trying to do is gain relief for funds for having to repay funds that they never received, and that is something that I think would be very good for the lender countries such as the United States to get on board with.

Thank you.

[The prepared statement of Dr. Winters follows:]

PREPARED STATEMENT OF DR. JEFFREY A. WINTERS

Chairman Lugar, Senator Biden, distinguished Senators:

I am grateful for this opportunity to present the results of nearly 15 years of research on the MDBs, the matter of corruption, and particularly how the problem is manifested in the region of Southeast Asia, my geographical area of specialization. Together with my co-editor, Jonathan Pincus from the University of London, we have recently published a book entitled "Reinventing the World Bank." The book contains two chapters devoted to the problem of corruption and the World Bank.

Since its founding, the World Bank has participated mostly passively in the corruption of roughly $100 billion of its loan funds intended for development. If we include the corruption of loan funds from the other Multilateral Development Banks (MDBs) over the same period, the figure roughly doubles to $200 billion.

In our book I refer to these lost funds as "Criminal Debt." [1] The debt is criminal in two senses—first because it was a crime to allow the development funds to be stolen, and second because it is an injustice to expect poor populations around the world that never received these funds to bear the heavy burden of repayment. On average, the poor have received about 70 cents on the dollar in loan funds from MDBs. And yet they are obligated to repay 100% of the loans plus interest.

I would like to begin by making a few key points, followed by additional explanation:

1. The World Bank and other MDBs have paid more attention to the problem of corruption since the late 1990s. But the impact of this attention has been minimal in stopping most of the theft of loan funds because the Bank's approach is inappropriate to the problem.

2. The MDBs must do a much better job supervising and auditing projects and loans. But the only effective way to protect against corruption of development funds is to establish an international auditing body that is independent of the MDBs and of private sector auditing firms (nearly all of which have deep conflicts of interest). This Multilateral Auditing Agency should be empowered to spot-audit all MDB operations, loans, and projects. Career advancement within the MAA must be linked to success in detecting fraud and theft of development funds.

3. All the incentives built into MDB operations facilitate rather than retard the criminal debt problem. The "pressure to lend" creates a bias in favor of quantitative rather than qualitative results, and corrupt elements in client governments know this. No matter how much money is stolen, the MDBs currently bear no financial burden for the losses.

4. Under international law, the Articles of Agreement explicitly require the World Bank to make arrangements to ensure that the funds it lends or guarantees are used for their intended purpose. For decades it did not do this, despite extensive knowledge that loan funds were being systematically stolen. Recent efforts to stem corruption have had minimal effects. And current immunities for the MDBs block aggrieved populations from pursuing legal relief from having to repay funds they never received. It is the people who repay debt, not governments. But the people have no advocate and no legal standing to seek debt relief. Also, no one is protecting the money of taxpayers in the lender countries from falling into the hands of kleptocrats in borrower states.

5. The more fundamental question behind the corruption problem is: what are institutions like the World Bank supposed to be and do? Our position is that the Bank's core competence is in being a public sector lender. The MDBs have evolved over the decades into unwieldy bodies, the components of which function poorly. The World Bank is not an effective "knowledge bank," nor do its thousands of economists produce cutting edge research. The World Bank is not an effective environmental agency, nor a development agency, nor anti-poverty crusader, nor is it an NGO well suited to advance gender relations or "participation." The World Bank will work best if it is scaled back to its core function as a public sector lender. As such, it can devote more resources to ensuring that its loan portfolio is well protected against systematic theft. The other elements of the MDBs should be spun off, unpacked, or closed.

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[1] Jeffrey A. Winters, "Criminal Debt," in *Reinventing the World Bank,* Jonathan R. Pincus and Jeffrey A. Winters, eds. (Ithaca, N.Y. and London: Cornell University Press, 2002), pp. 101-130. Criminal debt is distinct from "odious debt," which refers to loans that help an oppressive government further oppress its citizens. Criminal debt refers more narrowly to only that portion of loan funds that are stolen by officials before they can be used for development.

6. Whether on corruption or other MDB matters, it is unrealistic to expect an institution that has grown to unmanageable proportions on the basis of internally driven change to manage its own reform program. The World Bank cannot be reformed and certainly cannot reform itself. It must be reinvented. It is the responsibility of the major shareholding countries to undertake this task. Anything else will be patchwork on a broken system.

CRIMINAL DEBT

The vast majority of criminal debt arises in the relationship between the MDBs and borrowing governments. And yet this is the nexus where the least effort has been made to stem losses from theft. While it is admirable that the World Bank now investigates its own employees (and has caught a few red-handed), corruption among these individuals is minimal. Similarly, the blacklisting of international firms engaged in corrupt practices is a positive move. But the scale of losses through corrupt firms is also minimal.

The lion's share of the theft of development funds occurs in the implementation of projects and the use of loan funds by client governments.

Not everyone at the MDBs is to blame for allowing so much of their loan funds to be systematically stolen. Many individual task managers, who deal with projects at a more micro level, have long complained that too much theft was going on and that projects and the broader developmental effort were being compromised.

But for decades, the top management at the MDBs averted their eyes from the abundant evidence of systematic corruption in almost every country where they were operating—as did the major shareholder governments such as the U.S. Institutions like the World Bank had a global "don't ask, don't tell" policy regarding criminal debt. Why? Because the only people with an incentive to speak up—the world's poor and indebted—were not being listened to, and they lacked the power to restrain greedy and powerful elites.

From the end of WWII until the mid-1990s, the MDBs themselves had no incentive even to speak or write the word "corruption" regarding their own loans, and indeed they did not. No matter how much was stolen, the MDBs were confident they would not have to shoulder any of the financial burdens. And moving up in the Bank hierarchy is a function of successful lending, defined almost entirely by the impressive size of one's lending portfolio, not how much of the money was actually used for its intended purpose.

For an ambitious Bank employee, there are still no career rewards today for focusing on corruption at any stage in the lending process. And a key problem is that there never will be.

The case of Dennis DeTray, the top World Bank official in Jakarta in the 1990s, is illuminating. When an individual running a Bank-funded project in Indonesia came to Mr. DeTray to ask the Bank to do something about the blatant theft of project funds, he was told, "Wrong address, call the police."

When I blew the whistle in 1997 on the fact that a third of all World Bank loan funds to Indonesia had been stolen, a senior vice-president at Bank headquarters in Washington issued a press release denying the allegations and labeling me an irresponsible scholar. Within a year, two secret documents from inside the Bank would leak fully supporting the allegations.

CORRUPTION AND GOVERNANCE—THE BANKS' MISTAKEN APPROACH

It is fashionable in MDB circles to cast the criminal debt problem as a broader "governance" matter. Corruption at the societal level does indeed reflect a national governance failure, just as corruption at the global level reflects an international governance failure.

But corruption in World Bank lending operations reflects a World Bank supervisory and auditing failure. Before the MDBs attempt to solve the daunting problem of reducing corruption across entire societies, it would be far more useful to do a competent job of reducing the theft of funds *within the Banks' own lending and project portfolios.*

The World Bank's misguided answer to the corruption problem is driven primarily by an institutional compulsion to respond in ways that generate additional lending and require the provision of expensive technical expertise.

Power relations and impunity lie at the heart of corruption. It is the absence of effective detection, constraint, and punishment that makes corruption possible and probable. At the national level, these are absent because power is concentrated in ways that block effective checks and balances in politics.

Corruption ranges in scale from petty to grand, in scope from personal to systemic, and in impact from negligible to ruinous. But it is rarely caused by a lack of education or training (everyone knows what corruption is) and can rarely be addressed significantly by writing better laws, reorganizing institutions, or upgrading personnel through "integrity" workshops.

Most countries where corruption is endemic have reasonably good laws on the books. The problem is implementation and enforcement. This leads to an immediate question: What should be the primary focus of the MDBs' response to the challenge of corruption? To answer, it is important first to distinguish clearly between efforts directed at reducing corruption on a micro level, in projects and programs financed by the Banks, at a middle level, within and across whole societies, and at a macro level, in the relations and transactions among countries globally.

> *Recommendation:* The MDBs currently focus most of their efforts at the middle level (corruption across whole societies), when they should instead focus on the micro and macro levels (that is, on supervision and auditing of their own lending, and on strengthening international coordination and safeguards).

It is precisely in the nexus between the Banks and their borrowers that the Banks have both the leverage and the legal justification to act forcefully and consistently against corrupt practices. As multilateral bodies, they also can play an effective coordinating and legitimating role to strengthen international institutions, norms, and sanctions linked to corruption.

The Banks are at their weakest, most ineffective, and most politically vulnerable in the middle zone—in the battle against systemic corruption across whole governments. The Banks will have a muted impact at this level while encountering the greatest disruptions in their relations with borrower countries, the Banks' Boards of Directors, and the international community.

Moreover, it is not the World Bank's job to solve a society's corruption problem. It is the proper task of *groups and actors in each society* where corruption is rampant to challenge the power relations that make the abuses possible. The MDBs are ill-equipped to put checks and balances in place—except in their own projects and activities, and in the international environment.

And yet, it is precisely in this middle range of the corruption problem that the MDBs have decided to focus their efforts. "The main thrust of the Bank's support for countries' anticorruption efforts," declares a key World Bank document on the subject, "will be in helping to design and implement government programs."

The MDBs cannot lend their way out of the criminal debt problem.

The benefits for the Bank of focusing its efforts at the micro and macro levels and avoiding a mezzo approach are several. First, because the Bank can control through internal decisions how its loans are used, it can respond rapidly and credibly to the chorus of critics charging that Bank funds are being stolen on a massive scale (which damages the reputation of the Bank and exposes the institution to legal challenges).

Second, it quite properly removes responsibility from the Bank's shoulders for any lack of progress in reducing corruption at the broader *societal* level. The Bank's own studies recognize that systemic corruption is complex and cannot be addressed quickly. Reducing corruption across the country should not be the centerpiece of the Bank's response to kleptocracy.

And third, by using tighter fiscal supervision built into its own projects as a "best practices" model, the Bank can more credibly position itself as a leader in the international effort to combat corruption in bilateral and multilateral lending.

THE ARTICLES OF AGREEMENT—FAILURE ON THE GROUND

The Articles of Agreement represent the founding charter of the World Bank, setting forth the Bank's purpose, membership, operations, rights, limitations, and responsibilities. It is a binding Constitution subject to all the rules and norms of international law. For purposes of the present discussion of corruption and accountability, the most relevant part of the charter is Article III, Section 5, Paragraph (c), which states: "The Bank shall make arrangements to ensure that the proceeds of any loan are used only for the purposes for which the loan was granted, with due attention to considerations of economy and efficiency and without regard to political or other non-economic influences or considerations."

This is an unambiguous statement against allowing Bank funds to be corrupted. It places a clear burden and responsibility on the Bank to make arrangements that ensure its funds are not stolen or misallocated, and it admonishes the Bank to carry out this function in a manner that is economical, efficient, and unbiased politically.

Does the World Bank make effective arrangements to safeguard the loan process and project implementation? Is supervision taken seriously? My research and interviews with Bank officials and task managers suggest it is not.

"We look more than anything else at what the project achieves," explained Katharine Marshall, a senior official with the Bank, "not really the money. We look, for instance, at whether schools get built, not how the money was spent to build them."

Julian Schweitzer, another senior official at the Bank, went even further in our joint interview, making direct reference to the estimate that a third of the Bank's funds loaned to Indonesia had been stolen and became criminal debt. "If you take the amount of 30 percent loss," Schweitzer stated, "it means 70 cents [on the dollar] got used for development after all. That's a lot better than some places with only 10 cents on the dollar."[2] He was referring to certain Bank clients in Africa where nearly all of the loan funds are misallocated, diverted, unaccounted for, or simply stolen.

One World Bank task manager who struggled for years to get his employer to take the corruption issue seriously responded to the "glass is 70% full" perspective:

> That's the old argument, isn't it? They've been saying that for years. [. . . .] There are a couple fallacies there, and it is much too cavalier an attitude. That's because, in fact, my experience has been—and it's the experience of a lot of other people there [on the operations side of the Bank]—if they're busy stealing 30 percent, they're not paying any real attention to the other 70, even assuming 30 percent is all they're taking. What you're really doing is really ruining the whole effectiveness of the investment itself. I try to tell people [. . . .] it's like giving the money to buy a car but they're stealing the money that would buy the gasoline. So what good is the car? It is a fact, I can demonstrate it, and I'll stand by it. I'll prove it anytime.

He offered the following example:

> You cut corners and nobody cares. If you let out a contract for $2 million, and you get the few civil servants at the top sharing $600,000 or 30 percent, do they care if the contractor puts in concrete that is just sand and water? Do they care if the contractor doesn't put reinforcing steel in the structures? They don't care. So when Bank people say we're at least getting 70 cents of good development on the dollar, no you don't. Because the contractor either has to make back the money that he's kicked back, or he just figures, "hey, it's open season, I do what I want and no one is going to challenge me." And so you have this feeding frenzy, and the end result is you get very little development.

Putting aside who is fiscally responsible to repay the lost 30 percent, he questioned what genuine value a country or the poor really get from projects conducted in ways where such levels of theft are tolerated.

> If you get only one dollar out of ten that goes to the poor, is that really worth it? And have you done anything to strengthen the economy for the long term? No. You've only nourished a corrupt government that has no intention of providing services. To me, those arguments are hollow.

RELIEF FROM CRIMINAL DEBT

The primary concern of the Senate in these hearings is combating corruption in MDB operations. This is a forward-looking agenda, and it is to be commended. There are a range of likely motivations for engaging in this combat. U.S. representatives want to ensure that the development funds from U.S. taxpayers are not wasted or used to buy mansions or fund sectarian militias. They must also be motivated by a desire to make development spending effective in alleviating the poverty around the world, which carries too many benefits to list here.

In the spirit of being forward-looking, I have offered some specific ideas about what approaches or reforms can and should be adopted. But being forward-looking leaves an important part of the criminal debt problem untouched.

One problem with accumulated debt burdens is that they have this tendency to be mired in the past. Since it is unlikely that the debt slate is going to be wiped clean for borrowing countries, it is simply not possible to be exclusively forward-looking.

We will never have precise figures on levels of criminal debt accumulated since the MDBs began operations. My own research suggests that the figure of $200 billion presented at the outset is, if anything, an under-estimate. When citizens groups and NGO in developing countries demand, as they have several times in demonstrations in Indonesia and elsewhere, that the criminal portion of their debt be written off, they are not acting irresponsibly or trying to repudiate their obligations.

[2] See Winters, "Criminal Debt," 2002, p. 111.

They are simply pointing out that there is something very wrong about demanding repayment for funds the people never received. The money was delivered from the World Bank and other MDBs, but it was intercepted along the way and "privatized" illegally. It is easy to demonstrate that officials in the MDBs were aware of these practices for decades and, in violation of legal obligations under the Articles of Agreement, did nothing at all to stop the corruption. On the contrary, in almost every case, flows of funds from the MDBs increased as pressures to lend mounted.

This was a bonanza for those positioned to skim the riches. And the populations below could do little or nothing to constrain the behavior of the authoritarian leaders over them. The only powerful actors with the leverage to make arrangements to ensure that development funds were used for their intended purpose, the MDBs themselves, cooperated with the foxes raiding the chicken coop.

The indebted poor of the world are legally entitled to an immediate debt reduction of $200 billion, not as an act of charity or generosity, but because the debt is criminal in every sense of the word.

The CHAIRMAN. Thank you very much, Dr. Winters.

Mr. Bapna.

STATEMENT OF MANISH BAPNA, EXECUTIVE DIRECTOR, BANK INFORMATION CENTER

Mr. BAPNA. I would like to begin by thanking you, Chairman Lugar, and the committee for organizing this important and timely hearing on corruption in the multilateral development banks.

I am the executive director of the Bank Information Center. BIC's mission is to empower citizens and civil society organizations in developing countries to influence the projects and policies of the World Bank and multilateral development banks in a manner that fosters social justice and ecological sustainability. BIC has promoted transparency, citizen participation, and public accountability in the activities of the multilateral development banks since 1987.

Previously, I had worked as a senior economist and a task team leader at the World Bank itself for 7 years.

I am grateful to Professor Winters for describing the context, a bit about the nature and impacts of corruption in MDB activities. I would like to make just one more kind of initial contextual statement on corruption.

MDBs can and must clearly do more to reduce corruption and thereby improved development outcomes. Success at a more systemic level will require positive steps and commitment from multiple actors in a multi-pronged approach, including strong political commitment from governments and a vibrant and independent society, in addition to major substantive improvements in anti-corruption efforts by MDBs themselves.

I would like to concentrate my oral testimony on five specific policy and program recommendations related to MDB operations that, if taken collectively and with strong political commitments, would help meaningfully mitigate corruption in MDB-financed projects.

First, MDBs need to more explicitly evaluate corruption risks in project and sector operations. As a first step, MDBs should develop and implement clear diagnostic tools for staff to conduct a rigorous assessment of corruption risks in project and sector operations. These methodologies should clearly set out guidelines for preparing country and sector strategy documents, project appraisal reports, and project monitoring reports.

More specifically, the methodologies should provide guidance to staff to determine the nature and scale of corruption risks; assess the likely impacts of corruption; design appropriate mitigation and supervision action plans; importantly, to avoid financing certain operations where the risks in the project or in the sector are too high; and last, to report periodically on the impacts of the above activities in reducing corruption.

It is critical that these tools actually inform the design and implementation of project and country operations. This has been the main failing in the past. Diagnostics are done, but no changes are actually made.

BIC has done recently a study on the Asian Development Bank's ability to comply with its own policy and has concluded that there has been major shortcomings in the ability to implement the policy effectively because, in large part, the failure to implement these tools as I just described.

Second, MDBs should focus first on public and corporate governance, especially in controversial sectors. Corruption is especially acute in extractive industries, oil, mining, gas, in large infrastructure and in certain private sector operations because of the unique investments in these particular sectors. Arguably, the most important step that can be taken to reduce corruption and ensure that investments generate positive development impact is to focus first on public and corporate governance. Investment lending in controversial sectors should only take place after adequate governance exists to manage the inherent risks. Moreover, early lessons from MDB experiences in extractive industries indicate that transparent and accountable revenue management systems is a prerequisite to addressing corruption in extractives and enhancing participation in the overall public budgeting processes can help mitigate corruption in the broad societal country level.

With respect to private sector operations, focusing on partner selection and improving transparency, including a more nuanced interpretation of business confidentiality, are also critical steps.

Third, domestic and international donors should promote the active participation of civil society and the media. Civil society organizations, media, churches, and the general public are the most important resources that can be deployed in the fight against corruption. In order to address the systemic nature of corruption, civil society actors will need to be at the center of anti-corruption efforts.

Steps at two levels should be promoted.

First, MDBs should encourage stronger civil society participation in their operations. Although some improvements have been made, clearly more needs to be done.

Second, we need to recognize and support more generally the role of independent civil society organizations and media to play a watch dog role in ensuring that country, sector, and project level revenues and expenditures are managed transparently and appropriately.

Fourth, transparency and disclosure needs to be enhanced in MDB operations. Openness is essential to guard against corruption. Congress, the Treasury Department, and the U.S. executive directors can do more, especially during the IDA replenishment process to enhance transparency and improve information disclosure by promoting greater openness and information disclosure throughout the project cycle from project preparation through board approval to project completion and evaluation; to promote disclosure of draft policies and strategies, including draft country strategies, in order to allow for public comment or consultation prior to policy or strategy approval; to ensure full disclosure of a list of debarred firms ineligible for funding at the multilateral development banks; stronger whistleblower protection to provide protection to employees when seeking to report corruption, fraud, violations of law, or other serious problems; and disclosure of all written statements from the U.S. executive directors to the board of directors at the multilateral development banks.

Fifth is the importance of aligning institutional incentives to strengthen anti-corruption initiatives. Critical to mitigating corruption is to get the incentives right, and this is getting at the heart of the matter. Although improvements have been made in some multilateral development banks, management incentives still reflect a pressure to lend and a culture of approval where promotions and rewards are based more on the amount of loans approved than on development impact, quality, and compliance with key safeguard and fiduciary policies. This incentive bias manifests itself in many ways such as it underpins pressure to engage in countries and sectors with poor governance. It gives a preference for large projects. It is also reflected in the resources dedicated to project preparation versus project supervision.

Aligning institutional incentives to the multilateral development banks' missions is ultimately required if the multifaceted anti-corruption initiatives proposed above are to take route. Changing management and staff incentives is a difficult and fundamental challenge but one that I suggest we consider carefully, and I think this requires further thought.

I have outlined more concrete policy steps including specific actions related to existing or future legislation in my written testimony, including reviewing the International Organization Immunities Act to explore trimming back immunity that it or the courts may have granted that is in excess of what is required. Stronger committee oversight to ensure full implementation of title 13 of the International Financial Institutions Act, in particular, implementation of the new legislation, section 1504 of this act, which establishes important accountability, transparency, audit, law enforcement, and policy enforcement goals. And third, to ensure timely authorization of U.S. participation in the MDBs in order to provide the committee greater voice in these important matters.

To conclude, I believe that establishing a more effective model to channel development aid resources is critical in overcoming poverty. It deserves the dedicated attention of the entire development community. Mitigating corruption in MDB operations is an important but one of many steps in this process.

Thank you for this opportunity to talk.

[The prepared statement of Mr. Bapna follows:]

Prepared Statement of Manish Bapna

I. INTRODUCTORY REMARKS

It is an honor to be invited to share my views on the deep-rooted and systemic problem of corruption in multilateral development bank financed operations, and to suggest some steps that the banks should take to overcome it. I would like to thank you, Mr. Chairman, and Senator Biden, for the leadership you and your staff have demonstrated in advancing dialogue on the important role of multilateral development banks (MDBs) in international development and the challenges that these global institutions face in fulfilling their missions.

I am testifying today on behalf of a number of US-based non-governmental organizations: Bank Information Center, Environmental Defense, Government Accountability Project, and Public Services International. I am the Executive Director of the Bank Information Center (BIC). BIC's mission is to empower citizens and civil society organizations in developing countries to influence World Bank and other Multilateral Development Bank projects and policies in a manner that fosters social justice and ecological sustainability. BIC has promoted transparency, citizen participation, and public accountability in the activities of MDBs since 1987.

II. THE MULTIPLE IMPACTS OF CORRUPTION

Corruption, generally defined as "the abuse of public office or private office for personal gain,"[1] can notably undermine the overarching missions of the MDBs. These institutions are important conduits for financing development projects to reduce poverty and stimulate sustainable and equitable growth in borrowing countries. The misuse of these scarce public resources, and the MDBs failure to properly discharge their fiduciary duty to safeguard them, has several significant impacts that undercut these objectives, including:

- *increases debt in developing countries.* Corruption diverts resources from their intended use to benefit society at large and instead confers benefits on an elite few. However, citizens (most of whom are poor) of developing countries that borrow from the MDBs bear the burden of the debt that their governments are still contractually liable to repay. In countries where corrupt regimes have incurred large foreign debt burdens, an increasing number of citizen groups view this debt as criminal and illicit, for which subsequent governments should not be obliged to repay in full. (Professor Jeffrey Winters addresses this issue in more detail concerning the case of Indonesia.) Given the unsustainable levels of debt in many low-income countries, the additional burden posed by corruption is unacceptable and undermines their prospects for development.
- *undermines the development objectives of MDB financed projects and programs.* Equally important, corruption in MDB-financed projects often causes significant negative economic, social, and environmental impacts. Corruption can undermine the development impact of these projects in countless ways. Examples of project-level corruption impacts include diluting the quality of cement in civil works (e.g. rural roads, irrigation canals, etc.) which reduces the safety, efficiency and sustainability of these investments; permitting illegal timber harvesting in restricted forest areas; and granting profitable public contracts to well-connected cronies of Government officials. Corruption can also be a major issue in non-project, policy-based adjustment lending, which is an increasing proportion of MDB loans (recently 30-40% in the World Bank).
- *undermines the legitimacy of MDB financed projects and programs.* Corruption in MDB financed development projects and programs also contributes to a loss of confidence in public decision-making. Public decisions taken for private gain lack legitimacy under any defensible understanding of representative or democratic governance, especially where they entail the allocation of considerable social benefits and costs. Corruption also breeds public cynicism towards political processes—which in turn diminishes the credibility of the Government to serve the interests of its citizens. This poses a particular problem for MDBs whose principal counterpart is the Government.
- *diverts resources from priority sectors.* Corruption can divert scarce public resources from priority sectors such as health and education and squander them on uneconomic projects that generate lucrative payoffs. Political and commercial pressures often create a bias towards large projects and large contracts (extractive industries, infrastructure).

Footnote references are at end of statement.

Despite the fact that corruption threatens their core missions, most MDBs have been slow to address it in a forthright and comprehensive manner. While MDBs profess "zero tolerance" for corruption in their projects and programs, this rhetorical commitment has not always been meaningfully implemented. Pressure to lend and a "culture of loan approval" have inhibited a "culture of accountability" from taking root—although this does vary across MDBs. As a result, there is little if any internal or external accountability for anticorruption results. For example, BIC's recent review of the ADB's anticorruption policy and its implementation found that ADB was not doing enough and almost never complied with its policy commitments to explicitly address corruption issues in its country and project level reports, assessments, and evaluations.[2]

III. THE NATURE AND SCALE OF CORRUPTION

Corruption and initiatives to reduce it take place at different levels, and though the levels are distinct they are also inter-related and inter-connected. There is corruption at the level of individual MDB staff. In any large organization with thousands of employees there will be problems with a few individuals. Funds from internal MDB administrative budgets can be diverted, or the corruption could involve, for example, kickbacks from borrowing country and/or contracting company officials. There is corruption at the level of procurement with local and international companies for goods and services for specific projects. Individual MDB staff, local government officials and ministries, and employees and management of contracting companies may all be involved. A number of fairly notorious MDB financed projects have been associated with allegations of large-scale procurement corruption. It is these first two areas that have received the most attention from the donor community in general and the World Bank in particular, which several years ago established a Department of Institutional Integrity to investigate corruption allegations.

However, the most systemic corruption is the pervasive, across the board corruption embedded in governments. Here whole government ministries and governments themselves have semi-institutionalized the systematic diversion of funds from international and domestic sources, including from MDBs and other donor agencies. In the case of Indonesia, which Professor Winters discusses in more detail, for some three decades through the late 1990s the World Bank Jakarta office itself estimated in a leaked 1997 memorandum and reiterated in subsequent Bank documents in 1998 and 1999, that an average of 30% of World Bank lending was diverted for corrupt purposes—and in some government ministries, as much as 50%. The total amount stolen from World Bank lending in Indonesia was estimated to be more than US$8 billion dollars.

Although the World Bank claims it is addressing corruption better in its current lending to Indonesia, there is an important question of how much MDB lending is being systematically diverted in other major borrowing countries with weak governance and well publicized problems of corruption. If the average amount of corrupt diversion for all MDB lending is only ten or fifteen percent, and this is a rather conservative estimate—this would total billions annually.

The MDBs have unique institutional characteristics which make accountability for corruption more difficult and thus, if not counteracted by specific measures to address the problem, facilitate it. The notion of a bank is usually connected with the idea of financial risk for the lending institution. If a private commercial bank lends to notoriously corrupt borrowers, it may entail a higher risk of default; and if it makes such lending a practice it may suffer financial losses. But the MDBs are repaid by borrowing governments out of general revenues as preferred creditors in the international system. In the unlikely event of a whole government defaulting, then MDB losses are covered by the paid-in and callable capital of donor governments. In the world of MDB lending, there is no institutional financial risk in approving loans which in significant part are not used for the economic or social investments intended. Nor, because of the legal immunity in the MDB charters, is there potential civil or criminal liability for corrupt lending practices where gross negligence is proved. Thus, the need for multifaceted strategies and measures to address corruption in MDB lending is all the more necessary and urgent.

IV. POLICY AND PROGRAM RECOMMENDATIONS TO BE ADOPTED BY THE MDBS

Our recommendations below are intended to help provide an organizing framework to understand the nature of corruption in multilateral development bank financed operations and to describe steps that can be taken to overcome this pervasive problem.[3] The recommendations should be adopted collectively and will require commitment at the highest levels of management and at the Board of Directors in each MDB. It is interesting to note that the varying performance in anticorruption initiatives at the MDBs can be attributed to differences in leadership commitment. Moreover, the respective MDB Boards will need to play a more proactive role in reducing corruption but the asymmetric nature of the Board (only developing countries are to comply with anticorruption provisions) creates a real challenge that requires further thought. That said, political commitment is an absolute prerequisite—where the commitment is in place, the recommendations can be usefully taken up, but without it there is little hope for progress.

The organizing framework demonstrates that anticorruption recommendations will require steps in multiple areas of MDB operations [4] including (i) improving tools and methodologies for evaluating corruption risks explicitly; (ii) focusing first on public and corporate governance; (iii) enhancing transparency and disclosure; (iv) promoting the active participation of civil society and media; (v) aligning institutional incentives; and (vi) developing strong recourse mechanisms.

A. Evaluating Corruption Risks in Project and Sector Operations Explicitly

Although MDB charters and operational policies require the institutions to ensure that their funds are used for their intended purposes, it is clear that both the political commitment and a comprehensive system to fully implement these directives are absent. The risks of corruption in a particular project or within a particular sector are not systematically assessed by all of the MDBs. Measures to mitigate corruption risks beyond existing procurement guidelines, supervision missions, and audits are not regularly adopted, and these financial controls are often inadequate. Perhaps most critically, there appear to be no standard thresholds above which the risks of corruption are so great that a particular project or an entire sector-lending program in a country is reconsidered. (See Attachment 1 at end of statement for an example from Thailand.)

As a first step, MDBs should develop clear diagnostic tools for staff to conduct a rigorous assessment of corruption risks in project and sector operations. These methodologies should clearly set out guidelines for preparing country and sector strategy documents, project appraisal reports, and project monitoring reports. Separate approaches should be developed for project loans and budget support loans to account for the different issues that arise in each context. More specifically, the methodologies should provide guidance to staff to:

(i) determine the nature and scale of corruption risks in the operation in question;

(ii) assess the likely impacts of corruption and factor these impacts into the calculation of the project's economic rate of return (the preferred metric for evaluating project viability) and into the environmental and social impact assessments;

(iii) design appropriate mitigation and supervision action plans;

(iv) avoid financing certain operations where the risks in the project or in the sector are too high; and

(v) report periodically on the impact of the above activities in reducing corruption.

It is critical that these actions inform the design of project and country operations. This has historically been a major problem; key studies are often conducted in isolation and do not affect project design. Therefore, the analysis above should feed directly into the selection and design of each project operation. Staff should be held accountable for the quality and consistency with which they implement these guidelines.

B. Focusing First on Public and Corporate Governance in Controversial Sectors

Extractive Industries (Oil, Mining, and Gas)—Certain controversial sectors, such as extractive industries or large-scale infrastructure, are particularly vulnerable to corruption. It is at the sector and country level where the most profound and devastating impacts of corruption take place and where more rigorous scrutiny is required. The World Bank recently commissioned an independent Extractive Industries Review which concluded that extractive projects are not likely to produce positive development outcomes in countries where governance is weak and government commitment and ability to manage project risks is questionable. Proceeding with these operations in an environment of inadequate governance amounts to negligence: a layering of governance risk upon environmental, social, technical and financial risks. Moreover, large projects in small countries rife with corruption often result in excessive public debt—creating an unacceptable burden for the country's citizens for decades to come.

MDBs should not lend in controversial sectors like extractive industries or large-scale infrastructure unless and until public and corporate governance is strong enough to appropriately manage the inherent risks. If the MDBs are to be involved, the institutions should:

(i) ensure that the host country meets a minimum standard of governance based on an open assessment of "core macro" (see Attachment 2) and "sector" governance criteria;

(ii) carry out sector and project-level due diligence (diagnostic tools described in previous recommendation) to identify and mitigate corruption risks; and

(iii) help create an open environment conducive for civil society and media to monitor the project (e.g. procurement, revenue management, etc.) throughout implementation.

Importantly, another main recommendation from the Extractive Industries Review and several other similar initiatives is the importance of ensuring that revenues generated from extractive industries are managed in a transparent and accountable manner. The "resource curse" which has affected many developing countries highlights the challenges in revenue management and public expenditures. This is especially true in small economies with limited experience in democracy and a weak civil society. To help contain arguably the most egregious opportunities for corruption, MDBs should ensure that transparent and accountable revenue management systems are in place before supporting an extractive project that has the potential to generate income for the country.[5] Experiences to date (for example, see Attachment 3 on the Chad-Cameroon Pipeline Project) demonstrate the profound difficulties in establishing an open, transparent system that can counter the pervasive corruption that often accompanies these projects.

Private Sector Operations. Annually, MDBs lend billions of dollars to support private sector operations in developing countries. These public resources are channeled through private and public loans and represent a different yet major risk and source of corruption—in part because of the more secretive nature of private sector operations. The following issues deserve attention:

Partner Selection. The most important step to help reduce corruption in private sector operations is to improve partner selection. MDBs need to adopt a more rigorous process to screen their private clients especially, with respect to corporate governance and social responsibility. A more systematic and consistent approach to identifying and debarring firms that misuse public resources needs to be adopted by all MDBs. Moreover, penalties to engaging in corruption are not severe and should be strengthened. For example, the Inter-American Development Bank still does not disclose a list of private firms that violate anticorruption policies.

Corporate Transparency. U.S. Executive Directors should request MDBs to adopt much broader corporate transparency and disclosure requirements for companies receiving public finance through the MDBs. One interesting initiative, Publish What You Pay, calls on MDBs to promote mandatory disclosure of extractive industries revenues in the projects they finance as well as require disclosure of production sharing agreements and related contracts.

Business Confidentiality. Private firms that borrow from MDBs often refuse to divulge most project information on the grounds that the information is commercially sensitive. While there are legitimate reasons not to disclose certain information (e.g. loan terms), all too often business confidentiality is overextended to include, for example, royalty and other payments to Government; project sponsor's commitments to the local community; environmental mitigation measures, etc. Business confidentiality can give cover to corruption in the private sector. The MDBs therefore need to address explicitly the extent to which business confidentiality poses a legitimate constraint to the public's interest in information disclosure. The U.S. Executive Directors can help promote greater transparency in the private sector operations of MDBs.

Public Sector Reform. Loans that finance privatization or concession of public services have a particular history of corruption. Without adequate controls or oversight, high-level government officials use borrowed funds to renovate public service enterprises and sell or concession them to "associates" at prices well below their actual market values. As a result, the public suffers job losses, rate increases, and debt increases at the same time. Often the deterioration of services occur as well, as the contracted renovations do not take place as specified. It is in this process that corruption manifests one of its most dangerous consequences: popular disillusionment with democratic governance.[6]

C. Promoting the Active Participation of Civil Society and the Media

Civil society organizations, media, churches, and the general public are arguably the most important resources that can be deployed in the fight against corruption. Often, citizens and civil society organizations have the most nuanced understanding of the forms and pathways of local corruption and can provide invaluable information on where corruption may be occurring and how to prevent it. Moreover, involving press and the public in overseeing projects and programs can deter corruption by increasing the likelihood of exposure. By bringing the insights and interests of the public to bear on the fight against corruption, the public can be mobilized to serve as an "army of auditors" of government operations. Citizen empowerment by strengthening participation and public voice and increasing transparency are essential to any comprehensive anticorruption strategy and would complement more conventional public sector management tools such as increasing civil service wages or strengthening internal oversight and enforcement. Researchers at the World Bank confirmed this finding in a recent study, which concluded that "corruption [usually] has been reduced not so much by overreaching visions of good government as by the growing ability of people and groups outside the state to defend themselves against official abuse and to check the unfair advantages of others." This should take place at two levels:

Encourage participation in MDB operations. Although some improvements have been made, MDBs should facilitate more proactive participation in the operations they finance. Potential initiatives include, *inter alia:* (a) conducting regular consultations during preparation and implementation with affected peoples, local governments, professional organizations, other civil society organizations;[7] (b) carrying out client surveys to determine corruption in procurement, contracting, and service delivery within a project; (c) requiring increased transparency on project costs and expenditures; and (d) instituting strong whistleblower protections and incentives for speaking out against corruption. At the country level, MDBs should expedite initial efforts to promote participatory budgeting and monitoring of public expenditures. Increasing transparency and public participation in the Government's budgeting process at the country level would be a significant step towards reducing corruption at a broader level.

Oversight by independent "watch-dog" civil society organizations and media. Beyond stronger participation in MDB operations, it is critical that independent "watch-dog" civil society organizations and media emerge and play a more proactive role in monitoring corruption and the role of Government and international institutions. Since the independence of these organizations is key to their effectiveness, direct support from MDBs or Government is not the answer. Ideally, more independent sources of funding (e.g. private foundations) can be secured to support these organizations and the indispensable watch-dog role they can and do play.

D. Enhancing Transparency and Disclosure in MDB Operations

Openness is essential to guard against corruption. Exposing clandestine government operations to the disinfecting light of public scrutiny is one of the most powerful tools available for uncovering and deterring corruption. This entails ensuring that government decision making and policy making are transparent, and that civil society, media, and Parliaments have timely, complete, and convenient access to the information they need to meaningfully scrutinize official activities. MDBs should therefore view improving transparency and access to information as critical to controlling fraud and corruption in every project or program they support. As public institutions, the MDBs need to do a much better job of providing access to information regarding all aspects of their operations.

Congress has begun to demand greater transparency and accountability standards at the MDBs in Section 580 and 581 of the Consolidated Appropriations Act FY2004 (P.L. 108–199). However, the United States can still do more to enhance transparency and fight corruption in MDB operations. In the context of the ongoing and future Information Disclosure Policy Reviews and MDB replenishment negotiations, the US Executive Directors should promote the following:

(i) greater openness and information disclosure throughout the project cycle—from project preparation through Board approval to project completion and evaluation. This should include greatly expanded public access to such critical information as economic and technical feasibility studies, aide memoires, appraisal documents, loan covenants in the public interest, and project monitoring reports.

(ii) disclosure of draft policies and strategies, including draft country strategies, in order to allow for public comment or consultation prior to policy or strategy approval.

(iii) disclosure of full reports of independent audits of the MDB's operational effectiveness and internal control mechanisms.

(iv) disclosure of a list of debarred firms ineligible for funding at each MDB.

(v) stronger whistleblower protection for employees seeking to report corruption, fraud, violations of law or other serious problems.[8]

(vi) disclosure of all written statements from the US Executive Directors to the Board of Directors at the MDBs (establish best practice by leading through example).

Furthermore, the Disclosure Policies at the MDBs are governed by a "presumption in favor of disclosure." However, none of the Banks has effectively put in practice this principle. Instead, the MDBs generally operate under a "presumption against disclosure" unless specific direction is given to disclose. This represents a negative bias within the institutions which fosters confidentiality, reduces the effectiveness of participation, and masks corruption. In order to enhance transparency at the MDBs, the United States Congress can begin to investigate current disclosure practices and identify gaps in MDB standards. BIC recently completed a comparative analysis which examines the transparency standards of the World Bank and major regional development Banks across almost 250 indicators of transparency.[9]

E. Aligning Institutional Incentives to Strengthen Anti-Corruption Initiatives

Most MDBs currently lack clear institutional direction and a culture of accountability with respect to anticorruption. Overall, mixed signals exist on whether fighting corruption (in its many forms) is an institutional priority. This is evident in the incentive structure within the institutions themselves. Management incentives still reflect a "pressure to lend" and a "culture of approval" where promotions and rewards are based more on the amount of loans approved than on development impact, implementation quality, and compliance with key safeguard and fiduciary policies. This incentive bias is reflected in the resources dedicated to project preparation versus supervision. Most independent evaluations at the MDBs have concluded that the quality of project supervision remains weak along many dimensions (not only corruption) and that the lack of adequate administrative resources is one important explanation. Moreover, the institutional imperative to lend often leads to engagement in countries and sectors with poor governance and to a preference for large projects which present greater opportunities for high-level corruption. Finally, appropriate recourse does not exist for MDB negligence or complicity related to corruption. As a result, MDBs are not sufficiently accountable for their actions. Without a more appropriate system of recourse and accountability in those instances that the MDBs are indeed negligent, it is difficult to understand how political commitment within the MDBs will emerge.

F. Further Steps Toward Redress

Greater focus on compliance with applicable laws: Congress has taken important initial steps in the new Section 1504 of the IFI's Act, enacted this January, by requiring reports on the extent to which each MDB has included in each public sector loan (and in several other kinds of documents), the resources and conditionality necessary to ensure that applicable laws are obeyed. Congress may want to ask the Treasury Department how it intends to recommend that the MDBs address this "rule of law" provision.

The question of immunity: There are many sound reasons why international institutions are provided varying degrees of legal immunity. However one must recognize that a certain moral hazard problem emerges in regards to corruption in MDB-financed operations. Immune from lawsuits and legal challenges, the MDBs know that they will be paid-back regardless of how much money is diverted or stolen. This situation provides weak incentive to properly exercise full fiduciary duty to ensure that the money goes to its proper purposes. The Articles of Agreement of the World Bank indicate every intention to comply with final judicial rulings, even as to the attachment of assets, and certainly to rulings that do not threaten its ability to carry out its development purposes. The UN Convention Against Corruption recommends recognizing the criminal liability of institutions as well as of natural persons and waiving immunity of such institutions in cases of corruption. Thus the Congress may want to review the International Organizations Immunities Act to explore trimming back immunity that it or the courts may have granted that is in excess of that required.

Compliance with US Law. The United States has a number of important legal requirements pertaining to its membership in the MDB system:

- Title 13 of the International Financial Institutions Act establishes critical review and reporting requirements on natural resource impacts and overall development effectiveness by US agencies when considering proposals of MDBs. Several of these requirements have not yet been fully implemented and deserve Congressional attention;

- Section 1504 of the International Financial Institutions Act, (as noted briefly above) establishes important accountability, transparency, audit, law enforcement and policy enforcement goals to be sought by the U.S. Government by June of 2005 in the MDBs, with reports due to Congress from Treasury by September 2004 and March 2005. Congressional oversight of progress with these goals and reports is important;
- SEC regulations that provide for the SEC to require MDBs (that float bonds on the US market) to report information to the public concerning risks and other factors relevant to their overall financial health (in the Sarbanes-Oxley Act, Congress increased the reporting required of corporations but did not address the MDB requirements). Therefore, Congress may want to ask the SEC whether it intends to use its existing authority to bring the reporting requirements for the MDBs up to date so that the MDBs are not perceived as undercutting corporations and other entities who compete with the MDBs on the bond market but must report in seemingly greater detail to the potential bond-buying public;
- Furthermore, it is worth exploring whether the Treasury Department could ensure that U.S. companies involved in MDB projects are in compliance with relevant U.S. anti-corruption laws, such as the Foreign Corrupt Practices Act (FCPA). Researchers have identified a number of cases, from Nigeria to Bolivia, where MDBs seemed to ignore evidence and allegations of corruption in violation of the FCPA. This law not only forbids bribing government officials overseas, but also requires US corporations to keep their books in such a way as to help the Justice Department determine whether such bribes have been paid.

V. CONCLUDING REMARKS

I would like to thank you, Mr. Chairman, for the opportunity to share our views with you today on corruption and the Multilateral Development Banks. I hope that the testimonies provide the Committee with constructive and concrete ideas of mitigating corruption in MDB financed projects and programs and also help identify other development challenges facing the MDBs. The role of appropriate and effective international development aid is critical in overcoming poverty and deserves the dedicated attention of the entire development community.

[Attachment 1]

SAMUT PRAKARN WASTEWATER MANAGEMENT PROJECT IN THAILAND

A FAILURE TO FOLLOW POLICIES

The Asian Development Bank (ADB) funded Samut Prakarn Wastewater Management Project in Thailand is a clear example of how corruption can transform a potentially important initiative into a major development debacle. Based on a feasibility study funded by the ADB, a "two facility" site was selected for the project in 1995. The ADB Board approved the project which proposed a "turnkey contract" for each facility. When land acquisition became a problem, the Thai Government changed the project design and allowed bids for a single treatment plant. Only one contractor submitted a final bid for a single treatment plan not on the original site approved by the ADB but near the village of Kiong Dan, 20 kilometers away from the approved location. The ADB accepted all changes as a routine matter. Construction on Samut Prakarn was stopped in 2002 when Thai investigators determined that corruption by government officials, private investors, and land owners led to the inflation of the land price by as much as 1000%. The ADB did not intervene even though project changes had led to an 87% increase in costs prior to loan signing. The Samut Prakarn case illustrates that:

- affected communities are often the last to know about projects that impact their lives.
- the ADB had no meaningful impact in limiting or exposing the corruption at any stage of the project cycle, despite its "Zero Tolerance" Anti-corruption Policy.
- the ADB believed a "turnkey" contract exempted the institution from its oversight responsibilities such as questioning substantial design changes that contravened ADB policies and the loan covenants.

- the ADB accepted the site change despite the fact that no environmental, social or alternatives assessment was ever conducted and the Procurement Policy was violated.
- the ADB did not object when a single bidder was awarded the contract despite international competitive bidding procedures.

When the ADB finally responded to corruption allegations raised by the Kiong Dan community, its Special Review Mission found no evidence of any irregularities. When the community asked the ADS Board and Anti-corruption Unit (ACU) to investigate the matter, the Board never pursued the matter and delegated it to the ACU which never conducted an appropriate investigation. This is in stark contrast to the Thai Government project investigation that has confirmed corruption and started to prosecute those involved.

[Attachment 2]

World Bank Extractive Industry Review

recommendations on core governance

The criteria of governance adequacy should be developed transparently and with the involvement of all stakeholders and should include minimum core and sectoral governance criteria. For the core macro-governance, they should include:

- government capacity and willingness to publish and manage revenues transparently and to maintain macroeconomic stability;
- government willingness to allow independent audits of its receipts from the extractive sector;
- the existence of effective frameworks for revenue sharing among local, regional, and national authorities;
- the quality of the rule of law;
- the absence of armed conflict or of a high risk of such conflict
- the government's respect for labor standards and human rights; as indicated by its adherence to international human rights treaties it has ratified; and
- the government's recognition of and willingness to protect the internationally guaranteed rights of indigenous peoples.

The above is taken directly from Striking a Better Balance, the Final Report of the Extractive Industries Review, December 2003.

[Attachment 3]

Chad-Cameroon Oil Pipeline

the challenges of governance and revenue management in reducing corruption

The World Bank-financed Chad-Cameroon oil pipeline is frequently cited as a model extractive industry development because of the revenue management, oversight and monitoring measures designed for the project. However, in reality, these extra-ordinary mechanisms have been layered on top of an unsound foundation. The (as of yet undemonstrated) ability to mitigate risks of corruption and negative impacts related to oil development ultimately depends on the broader governance context and political will in the country. To date, the indications are not good: the first oil bonus money was used to purchase arms; expenditure on priority sectors has lagged behind targets; the President is attempting to modify the constitution to allow him to stay in office indefinitely and has appointed his brother-in-law to the oil revenue oversight mechanism, to name a few examples.

Despite persistent problems with the management of public revenues, misuse of HIPC funds and other earmarked resources in Chad, MDB funds were approved for the Chad-Cameroon pipeline project, paving the way for a potential doubling of the government's national revenues. The World Bank's own documents indicate that governance problems pose the most fundamental risks to development prospects in Chad, generally, and the success of the oil project in particular, including the risk of "political turbulence and deteriorations in the rule of law more broadly." They note that "[a]s oil revenues begin to accrue and the stakes rise, power may be contested by violent means. And road blocking, violent crime, and the theft of public resources may increase." (CAS, December 2003, pp 31-32). If these risks materialize, the costs will be borne by the population living in Chad—i.e. the purported "beneficiaries" of the project. Thus without determining whether countries meet minimum governance criteria (based on an open assessment of core and sector governance indicators) prior to supporting projects in sensitive sectors, MDBs risk facilitating corruption—providing money not to benefit the poor but an elite few.

FOOTNOTES

[1] It is useful to note, however, that in US law, an agreement or attempt to commit any offense, or violation of federal law, or to defraud the US or any agency of the US includes, under 18 U.S.C. 371 of the criminal code, any ". . . conspiracy for the purpose of impairing, obstructing, or defeating the lawful functions of any department . . . " which is broader than abuse for personal gain. (See, *Haas v. Henkel,* 216 U.S. 462.)

[2] See *"Zero Tolerance?—Assessing the Asian Development Bank's Efforts to Limit Corruption in its Lending Operations,"* Bank Information Center, 2004. *www.bicusa.org*

[3] These recommendations are intended to build upon the recommendations made by the General Accounting Office in its series of reports on the MDBs, including reports of April 2000 on measures for controlling corruption in World Bank lending, and the reports of December 2001 and June 2003 on external audits of the regional banks and World Bank respectively.

[4] Corruption within the procurement processes of MDB lending operations has received perhaps the most significant amount of attention at the institutions, with the establishment of fraud and corruption units, and guidelines for procurement and consulting services. I have consciously not focused this testimony on this issue given its detailed treatment in other recent literature including by the US Government.

[5] See Ian Gary and Terry Karl, *Bottom of the Barrel: Africa's Oil Boom and the Poor,* Catholic Relief Services, June 2003. *www.catholicrelief.org/africanoil.cfm*

[6] See for example, Eduardo Lora and Ugo Panizza, *Structural Reforms in Latin America,* Inter-American Development Bank, Washington, D.C., March 11, 2002. These analysts suggest that the level of corruption inherent in the privatization processes in some countries has actually undermined popular support for democratic governance.

[7] The GAO found significant weaknesses in public consultation on environmental assessments of World Bank in its September 1998 review. The World Bank's Inspection Panel and the IFC's Compliance Advisory Ombudsman have continued to find violations of the policies requiring proper consultation on proposals and alternatives to them.

[8] See forthcoming assessments of whistleblower protection at the four largest MDBs now being completed by the law firm and advocacy group, the Government Accountability Project (GAP).

[9] This study was prepared by the Bank Information Center and an early draft of the data and summary (April 2004) is available upon request.

The CHAIRMAN. Well, thank you very much, sir, for that testimony.

Ms. Boswell.

STATEMENT OF NANCY ZUCKER BOSWELL, MANAGING DIRECTOR, TRANSPARENCY INTERNATIONAL USA

Ms. BOSWELL. Thank you, Mr. Chairman, and thank you for taking the time to look at this important issue, and for inviting Transparency International to participate.

I am the managing director of the U.S. chapter of Transparency International, as well as a member of its international board of directors.

I am here today on behalf of Peter Eigen, the founder and Chairman of our organization, and it may interest the committee to know that Peter spent his entire career at the World Bank. In the early 1990s, when he expressed his deep concern about the impact of corruption on the bank's efforts to alleviate poverty, the bank leadership refused to take the issue on. So it was that in 1993 he left the bank to found Transparency International as a nongovernmental, nonpartisan organization committed to raising awareness about this issue and to securing systemic reform.

Ten years later, TI now has national chapters in over 90 countries and the World Bank has a president who is, as has been noted, committed to fighting corruption. We believe this reflects a growing understanding that the bank's mission to alleviate poverty depends on success in this issue and, indeed, the achievement of the millennium development goals also depends on reducing corruption.

The World Bank Institute research now clearly demonstrates the devastating impact. We note a recent estimate that more than $1 trillion are paid annually in bribes, both in rich and developing countries. Clearly it means that corruption increases the cost of doing business and that the private sector contributes enormously to the problem. But this figure does not include embezzlement of public funds, theft of public assets, high costs and poor quality purchases, or most important, the social and economic impact on the poorest where corruption is most prevalent.

This is an intolerable situation that requires urgent attention, and we would like to offer two specific recommendations drawn on the experience of our chapters around the world. They apply equally to the World Bank as to the regional banks.

First, every opportunity should be taken so that lending decisions are based on governments taking specific steps to increase their transparency and accountability to their citizens, and second, that the banks take steps to reduce private sector bribery. As you note, Mr. Chairman, a bank policy that rewards such actions will reinforce a similar approach under the Millennium Challenge Account.

By transparency, we mean publication of information that affects citizens and how public funds are used. It includes publication of laws, regulations, judicial decisions, assets of public officials, budgets, procurement, campaign finance, and voting records, and legislation to ensure that when that information is not routinely published, citizens can get access to it.

These may seem like routine issues but they are not in most countries and they contribute to the problem that we are confronting. Without such transparency in government operations there can be no accountability and citizens can neither monitor nor have an impact on decisions that affect their daily lives. Moreover, business cannot know with certainty what the rules are, leaving opportunities for manipulation and distortion, and thus we find that foreign investment does not flow to those countries where corruption is a problem.

The bank has several mechanisms through which to promote transparency. You have been discussing some of them: country assistance strategies, budget support lending, investment lending, and procurement, in addition to the moral suasion of the leadership.

In country assistance strategies, governance is already a factor in determining the amount and content of financial assistance, but the benchmarks are not explicit. We believe they need to include transparency measures that I have just listed. We note that many of the borrowers have already made such commitments in adopting anti-corruption conventions and trade agreements. Many are participating in important followup mechanisms on the anti-corruption conventions, which the U.S. Government is very generously funding. Those mechanisms identify deficiencies in compliance and issue recommendations for remedial action.

Encouragement and help from the multilateral banks to governments to carry out these commitments should be a priority. The bank can use its significant influence by raising these issues in discussions with governments and encouraging their inclusion in activities and in the benchmarks.

In all of this, the bank needs to provide the technical support to both the governments and to bank staff to reach these benchmarks. Our understanding is that bank staff with expertise is much in need. For example, the bank has such expertise for environmental issues. It is not currently in the bank for anti-corruption and transparency programs.

As to project evaluation that Senator Hagel raised, after a project is completed, OED should assess not only operational effectiveness but also the level of transparency and anti-corruption.

Another opportunity is one you raised in connection with budget support lending. The bank is shifting significant amounts of lending through this mechanism, and the example of community engagement that you and Ms. Brookins discussed earlier—those amounts are dwarfed by the amount of money that flows through general budget support. It is essential that such flows be conditioned on essential transparency reforms that I mentioned earlier, and the bank needs to ensure that these conditions are actually met.

The bank also needs to address the fact that adjustment lending cannot be traced in the same way that investment lending can, and so it needs to build into these agreements the covenants and mechanisms necessary to permit effective followup monitoring.

Turning to the area of bank lending and procurement, there are still opportunities for the bank to use its substantial leverage to further strengthen procurement processes when it comes to transparency. In our written testimony, we have provided a very detailed list of reforms. Let me just mention a few that could help remedy the deficiencies.

First of all, significant project documents must be made public so that citizens can be fully informed about the amounts, scope of work, and companies and contractors involved. The decision to publish such documents should not be deferred to governments as the current practice too frequently is that governments do not disclose this information. Publication in a timely manner on the bank's Web site would enable citizens and local officials to exercise meaningful oversight for projects.

Second, reducing corruption requires tight controls, and staff time for supervision in the field, we understand, has been reduced and too often there is not the opportunity to do more than ask controlling questions of local project staff. More staff must be allocated for this oversight function.

Third, a growing share of total bank-financed procurement is not according to open international competitive bidding rules, and when this is the case, we believe bank staff decisions to permit other processes should be justified and published so as to allow later review.

I want to also emphasize the critically important work of the Department of Institutional Integrity and the Sanctions Committee that was discussed earlier. We do believe that the published black list does create a strong deterrence for future misconduct. It also identifies systemic problems and these need to be mainstreamed through bank programs.

Let me turn to the other central issue that we believe needs attention and that is a bank requirement that all bidders on bank financed projects must have anti-bribery compliance programs. If anti-corruption and anti-bribery conventions are to be effective, the private sector simply must abide by new rules. The OECD convention, which this committee did so much to bring into force, depends on whether the 34 other signatories, companies enact anti-bribery compliance programs.

A World Bank requirement would do a great deal to move toward that outcome. We are pleased to note that the bank seems willing to review its prior decision not to adopt such a requirement and we hope that this hearing today and the new circumstances will permit it to move forward on this very easy, preventive, risk management tool.

Finally, I would concur with my colleague from BIC that improvements are needed in the bank's institutional transparency. There are still instances where key documents are kept confidential or released only after commitments have been made. As a public institution, lending public funds for a public purpose, the bank has a duty to ensure that the public is informed in a timely manner.

In conclusion, let me say that bank has made impressive progress, but it is time to accelerate the pace and the resources necessary for specific action to enhance transparency and reduce bribery. As you note, Mr. Chairman, and as was raised by the prior testimony, it must also ensure that bank staff are confident that their efforts to reduce corruption will be as highly valued as their more traditional functions and that they will be supported by sufficient supervisory staff.

We know there are still obstacles to overcome. Members of the bank are at once its borrowers, and at times some of them are at the heart of the problem. Some have little patience with calls for greater transparency and may have a vested interest in the status quo. Even some contributors have special interests.

Therefore, sustained pressure by the U.S. Government will be necessary to strengthen the proponents of reform within the bank. The leadership that you have demonstrated today at this committee is vital in the global fight against corruption with regard to the bank, and more generally across the board. It will be critical in the future as other priorities compete for attention and resources. So we thank you for this hearing today and we look forward to your questions.

[The prepared statement of Ms. Boswell follows:]

PREPARED STATEMENT OF NANCY ZUCKER BOSWELL

I would like to thank the Chairman and the Committee for inviting Transparency International to address this hearing on "Combating Corruption in Multilateral Development Banks." I am the Managing Director of the U.S. Chapter of Transparency

International and a member of TI's international board of directors. I appear today on behalf of Peter Eigen, founder and Chairman of Transparency International, who spent his career at the World Bank.

In the early 1990's, Peter expressed his growing concern to the Bank hierarchy about the devastating impact of corruption on efforts to promote economic and social development. He urged the Bank to address the problem. The Bank leadership refused, finding the issue too "political" and not an economic issue for the bank to address.

In 1993, convinced of the importance of the issue, Peter left the Bank to create Transparency International, a politically non-partisan, non-governmental organization, committed to raising awareness about the impact of corruption and to securing systemic reforms.

Today, TI has national chapters in over 90 countries and the World Bank has a president who is committed to fighting corruption! Since his 1996 speech to the World Bank/IMF meetings on the "cancer of corruption," James Wolfensohn has demonstrated great courage and leadership in reversing the Bank's prior policy position and in seeking to institute measures to eliminate fraud and corruption from within the Bank and in the countries where it operates. He has given this issue far greater priority, recognizing that the Bank's mission to alleviate poverty depends on it.

TI commends Mr. Wolfensohn and his colleagues for the steps taken to date. We recognize that this is a long-term undertaking and many challenges remain. For purposes of our testimony today, we would like to offer only a few specific recommendations to help achieve the reduction in corruption we are all seeking. While they are in the context of the World Bank, these recommendations apply equally to all the multilateral banks.

First, the Bank should use every opportunity to see that governments provide the broad range of transparency measures that permits citizens to hold their governments accountable. Second, the Bank should ensure that the private sector plays its role, by requiring bidders on Bank-financed projects to adopt anti-bribery policies.

Before I elaborate on these recommendations, let me say a few words about TI's approach to fighting corruption and how it affects my testimony.

I. TI'S SYSTEMIC APPROACH TO FIGHTING CORRUPTION

TI's approach to combating corruption is holistic, recognizing that it requires a range of systemic and institutional steps. These include preventive measures as well as criminal laws and prosecutions.

TI works with government and with the private sector, encouraging each to play its part in reducing the incidence of bribery and corruption. TI chapters are independent and locally-based, setting their agendas to reflect local circumstances. Nonetheless, they value the anti-corruption conventions concluded by the OECD, OAS, Council of Europe and the UN. These conventions provide a roadmap for reform in both the public and private sectors, represent the political commitment of the government and provide a platform for citizens to hold their governments accountable.

TI focuses on systemic reform and not on individual cases of corruption. Accordingly, my comments today do not discuss the specific projects about which the Committee has raised questions. Rather, they address steps the Bank has and should take to minimize the likelihood of those questions arising in the future.

My testimony includes some recommendations TI has already submitted to the Bank in a meeting initiated by Mr. Wolfensohn in March 2003. Some action has been taken. I should also note that this testimony does not pretend to fully reflect all the steps the Bank has taken or an exhaustive assessment of those that should be taken. Finally, our recommendations should be considered to apply to all the multilateral banks.

II. THE COMPELLING CASE FOR THE BANK FIGHTING CORRUPTION

The Bank has made great strides in addressing the issue of corruption, starting with its acceptance of the view that corruption undermines the Bank's efforts to alleviate poverty. The World Bank Institute (WBI) has done formidable research, demonstrating the devastating impact of corruption on economic development and putting to rest old arguments that some types of corruption can be beneficial.

The WBI recently estimated that more than $1 trillion dollars is paid each year in bribes—in both rich and developing countries. This figure dwarfs earlier estimates, but as stunning as this figure is, it does not include the cost of embezzlement of public funds or theft of public assets or higher costs and poorer quality purchases or, most important, the economic impact on the poorest in those countries where it is most prevalent.

WBI Director of Governance, Daniel Kauffman, notes that "the total amount of corrupt transactions is only part of the overall costs of corruption, which constitutes a major obstacle to reducing poverty, inequality and infant mortality in emerging economies." The result can be social breakdown and alienation, with the potential for instability and sometimes violence.

Corruption also discourages sorely needed foreign investment. Lack of transparency undermines predictability and creates opportunities for extortion. In short, it increases the cost of business.

Having made a compelling case regarding the costs of corruption and the need to address it, the Bank is moving forward. The following recommendations indicate ways to strengthen its efforts.

III. BANK MECHANISMS TO SECURE TRANSPARENCY

TI recommends that the Bank condition country assistance strategies, structural adjustment, project lending and procurement on making progress on specific transparency reforms. Bank policy rewarding a demonstrated commitment to transparency and reducing corruption reinforces a similar approach under the Millennium Challenge Account.

Among the required transparency measures are legal and regulatory transparency, access to information legislation, asset disclosure by public officials, budget and procurement transparency and transparency of campaign finance and voting records. Recent anti-corruption conventions and trade agreements reflect a consensus that these transparency measures are an essential and integral part of an anticorruption program.

Promoting government transparency will strengthen accountability and create a sound investment climate that will support economic development. This will permit private sector development, leading to job creation, higher incomes and tax revenues essential for public expenditures.

Without transparency in all aspects of government operations, there can be no accountability. Citizens can neither monitor nor have an impact on government decisions or expenditures that affect their daily lives. Business cannot know with certainty what the rules are, leaving opportunities for manipulation and distortions in decision-making. Lack of transparency discourages long-term foreign investment.

A. Country Assistance Strategies:

Country assistance strategies (CAS) should underscore and promote more explicit and effective programs to increase transparency. The Bank has taken an important first step, making "governance" a factor that must be considered in determining the amount of financial assistance as well as the specific content of lending and non-lending programs. CAS objectives have included transparency, accountability and integrity of government, but the benchmarks have not been adequately specific to accomplish this objective.

TI recommends that the benchmarks for securing financial assistance include publication of laws, regulations, budgets, procurement rules, officials' assets and other key aspects of government operations. Programs to improve public resource management and a more effective regulatory framework will be enhanced by incorporating transparency requirements. Programs focusing on other sectors will also be more effective if transparency requirements are an integral part.

The Bank should provide the necessary technical support to enable governments to reach these benchmarks. To this end, the Bank should develop adequate in-house expertise to assist in the design and execution of transparency and other anti-corruption components of country projects. Although the Bank has determined that governance is an important factor to be addressed, it has not provided the resources and level of expertise needed by bank staff as it has, for example, on environmental issues. Without the necessary expertise and already heavily burdened with other priorities, Bank staff are unlikely to be able to provide the detailed attention required. The considerable WBI expertise, developed in some instances in concert with TI and its national chapters, should be more routinely "mainstreamed" into the Bank's country programs. For a start, a practical handbook with detailed recommendations would be useful for Bank staff.

Finally, after a project is completed, it should be assessed not only for its operational effectiveness but also on the level of transparency and absence of corruption.

B. Structural Adjustment Lending

Given the Bank's increasing shift to providing significant amounts of lending through budget support mechanisms, the Bank should condition such lending on implementation of the essential transparency reforms outlined above, including procurement reform. This is a constructive and straightforward use of Bank leverage to increase transparency for both local citizens as well as the international community.

Recognizing that conditions imposed are frequently not performed or performed in form, but not in substance, the Bank should ensure that transparency and anti-corruption conditions are actually carried out.

Another issue requiring Bank attention reflects the nature of adjustment lending. With investment lending, the Bank can trace whether funds have been used as specified. With adjustment lending, the funds are, essentially, transferred to a national treasury, where they are commingled with other assets and become impossible to trace. The Bank should build into structural adjustment agreements the covenants and mechanisms necessary to permit effective follow-up monitoring.

C. International Initiatives

Many of the Bank's borrowers have already made transparency and other anti-corruption commitments in adopting anti-corruption conventions and trade agreements. For example, the Inter-American Convention Against Corruption and the new UN Convention on Corruption call for asset disclosure, procurement transparency and greater access to information. The WTO Government Procurement Agreement has detailed procurement transparency requirements. Recent trade agreements, such as the CAFTA, also have detailed procurement transparency requirements, and call for publication of laws and regulations and for providing an opportunity for prior comment.

Encouraging and helping governments carry out these commitments should be a Bank priority. The Bank can use its significant influence by raising the convention commitments in discussions with governments and encouraging their inclusion in relevant activities in country programs. We note, for example, that most government procurement is not financed by the Bank and, therefore, is not subject to Bank guidelines. Bank programs to reform procurement systems should ensure that domestic systems are in compliance with agreed transparency norms.

For those governments participating in convention follow-up mechanisms, the Bank should help them remedy the deficiencies identified by these mechanisms. It should provide the resources and skills many countries urgently need to give their legal and judicial institutions, regulatory and administrative agencies the capacity to fight corruption.

The 2003 G-8 Leaders Action Plan and the Nuevo Leon Declaration in this hemisphere call on the Bank to provide such support for these initiatives.

D. Bank Lending and Procurement

TI welcomes the important steps the Bank has taken to reduce corruption in bank lending and procurement, from specific anti-corruption and anti-fraud provisions in its Procurement Guidelines and Guidelines for the Selection of Consultants to blacklisting offenders. There are still opportunities for the Bank to use its substantial leverage to further strengthen these processes, particularly with regard to transparency.

We note that there has been some progress toward "harmonization" of procurement documents among the World Bank and regional development banks. However, greater consistency is still needed for procurement guidelines and use of standard documents. A common approach, especially with increasing co-financing, is in the interest of the borrowers and the suppliers. Further progress is also needed with regard to consistent definitions, investigations and sanctions procedures and to sharing and respecting each other's blacklists.

1. Strengthening Transparency Requirements

As TI has noted in its prior submissions to the Bank, it must take every opportunity to ensure a transparent procurement process from inception through execution. The following Bank requirements can help achieve this.

- Borrowers should publish project features and justification in advance and provide an opportunity, such as a public hearing, for public comment well before final decisions are made.
- All significant project documents must be made public. The Bank should publish or obligate governments to publish all contracts and sub-contracts entered into on projects financed, even in part, by the bank. Information, including the amounts, scope of work, and companies or contractors involved, should be made public. There should be a presumption that such documents are public unless there is a demonstrated need for confidentiality. The decision to publish should not be deferred to governments as all too frequently they do not disclose this

information, and there are no domestic legal mechanisms for citizens to require disclosure. Publication in a timely manner on the Bank's website will enable citizens and local officials to exercise meaningful oversight throughout the process.

- Borrowers should publish contract awards and the basis on which competing bids were evaluated. This would help reduce manipulation.
- There should be a grace period between the "publication of the award" and signing the contract to permit legitimate complaints to be taken into account while there is still time for consideration.
- Clarification sought by bidders must not be permitted to change the substance of the bid and should be notified to other bidders. Such "hidden changes" are not uncommon and should be reviewed carefully as part of the Bank's supervision.
- Borrower discretion should be minimized as it permits corruption. While some discretion may be necessary, the exercise of even a minor degree should be recorded, justified and disclosed.

Finally, in those cases where contractors and other stakeholders may need Bank assistance in dealing with Borrowers, the Bank should provide a central office where complaints or protests can be lodged. It should see that complaints are investigated and, in appropriate circumstances, intercede.

2. Audit and Supervision

Keeping procurement corruption-free requires tight controls as well as stringent rules. Staff time for supervision in the field has been reduced and staff too often does not have the opportunity to do more than ask "controlling questions" of local project staff. Adequate staff must be allocated for supervision.

3. Other Practices

Non-ICB Bidding: A growing share of total Bank-financed procurement does not follow open international competitive bidding (ICB) rules. Bank staff decisions to permit other processes should be justified and the decision recorded, so as to allow later review.

Change Orders: Improper change orders have become a common form of corruption during project implementation. Change orders should not be used to change the contract. The Bank should require borrowers to introduce a domestic review by senior staff (or tender committees or boards) when cumulative change exceeds a 15% threshold. This would avoid collusion between the site engineer and contractors to approve relatively small change orders which, in the aggregate, lead to major cost increases.

Selection of Consultants: The bank should help ensure that consultants do not undermine the integrity of the project. Consultants should certify in their contract application that they have no conflict of interest. The Bank should take steps to assure that consultants have the appropriate expertise, particularly when rare or highly technical expertise is needed .

4. Investigations and Sanctions

The work of the Department of Institutional Integrity and the Sanctions Committee is critically important to creating a strong deterrence for future misconduct and for identifying systemic problems brought to light by particular cases. These objectives would be furthered by publication of the number of cases under investigation, the types of allegations and the results of investigations.

Lessons learned should be systematically addressed, including in country assistance and project lending. The Bank should assist with technical capacity and training for prosecutors and judges for countries eager to pursue wrongdoing. Prior cases demonstrate that some of the poorest governments cannot easily bear the burden and may not have the requisite skills to gather evidence abroad and prepare cases against companies around the world.

TI believes that the sanctions reforms recently sent to the Bank board have the important potential to de-politicize the process, such as by expanding Sanctions Committee membership to outside experts. Other issues requiring further consideration are the application of the Sanctions process to IFC lending and the weight to accord court convictions with regard to Bank blacklisting.

The blacklist has been a constructive and powerful instrument for promoting private sector reform. The Bank should consider moving beyond the information posted on the website regarding the INT and Sanctions Committees work and procedures to a broader awareness-raising program. The private sector has expressed interest in learning more and could contribute valuable insights. One such important issue is voluntary disclosure, which can assist the Bank in determining where systemic problems are most acute.

IV. ANTI-BRIBERY BIDDER REQUIREMENTS

Let me turn to the other central recommendation that will help in the Bank's efforts to reduce the risk of bribery in Bank-financed projects: a requirement that all bidders have anti-bribery compliance programs. According to the TI Bribe Payers Index (BPI), bribery is still a common practice. The BPI finds that large multinationals are still engaging in grand scale payments and that domestic concerns are even more likely than foreign enterprises to engage in bribery.

This situation should begin to change with recent anti-corruption conventions prohibiting bribery and providing tools, such as mutual legal assistance, to pursue cases. The OECD Convention on Bribery of Foreign Public Officials is particularly important because it extends transnational bribery prohibitions, similar to those in the Foreign Corrupt Practices Act, to most of the world's major exporters. Its entry-into-force in 1999 was encouraged by the prompt action of this Committee to secure US ratification.

Since then, all 35 OECD signatories have enacted new laws criminalizing foreign bribery, and an OECD monitoring process is promoting their enforcement. Some major companies are adopting compliance programs.

A World Bank requirement that all bidders on bank-finance projects must adopt anti-bribery compliance programs would stimulate broader adoption of such programs, promoting compliance with these new laws. This would be a powerful preventive measure, reducing the likelihood of bribery on bank-financed projects. It would also help ensure that exporters from non-OECD member countries abide by similar practices.

There are plenty of models for companies to consider in developing their own programs, including the TI Business Principles for Countering Bribery. Under the Business Principles, companies commit to prohibit bribery in all forms and to adopt an implementation program. They commit to maintain accurate books and records which properly document all financial transactions and prohibit off-the-book accounts. These provisions are consistent with the FCPA and with the OECD Convention requirements.

In light of Sarbanes-Oxley, it is also notable that the Business Principles require the enterprise to maintain internal control systems, in particular accounting and record keeping practices, and submit them to regular audits to provide assurance that they are effective in countering bribery.

The TI Business Principles were developed by a multi-stakeholder task force including multinationals from different industry sectors. They were adopted this year by leading companies in the engineering and construction sector. Members of a task force, led by the Fluor Corporation working with TI, have since joined in calling on the World Bank to enact such a requirement. They see it as an effective means to level the playing field and to combat extortion.

TI's work with other industry sectors, including energy, extractives, pharmaceuticals and defense, would be facilitated by a World Bank requirement. TI national chapters have also conducted country workshops to promote broader adherence of the Business Principles. These workshops reach an audience of local companies and subsidiaries of MNEs. Cooperation with the Bank in such outreach activities could help reduce corruption in the supply-chain on Bank-financed projects.

Concern has been raised that imposing a bidder requirement might exclude small and medium size enterprises from bidding. However, no bidder, regardless of size, is excluded from legal prohibitions against bribery. The Bank should encourage compliance by all bidders, and even the smallest can develop appropriate policies using the available models without imposing a significant burden. The Bank could start by implementing the requirement on contracts above a certain threshold.

We are pleased to note that the Bank has agreed to permit governments to use a TI tool, the Integrity Pact, under which the borrower will only accept bids from those who have anti-bribery codes and who certify they will not bribe. The government agrees to conduct a transparent process, often with expert oversight. This new tool has contributed to lower costs and less corruption in several countries. It has demonstrated that integrity is possible even in an environment or an industry that has historically been corrupt. TI hopes that the Bank will do more to encourage its broader use.

TI also looks forward to working more closely with the IFC and Global Corporate Governance Forum on giving greater prominence to the issues of bribery, corruption and internal controls in their corporate governance training and materials. TI believes this will be important to expanding the number of enterprises adhering to best practices. This will not only help create a better investment climate but will also improve the performance of IFC investments.

V. INSTITUTIONAL TRANSPARENCY

Throughout this testimony, TI has highlighted examples of improvements in the Bank's own institutional transparency as well as areas where further improvement is still needed. There are still instances where key documents have been kept confidential or have been released only after commitments have been made, rather than when they were under discussion. As a public institution lending public funds for public purposes, the Bank has a duty to ensure there is public participation in the design and implementation of Bank policies and activities. Transparency should be practiced not only by the Bank's members but by the Bank itself. This requires timely and accessible dissemination of information by the Bank and its members.

CONCLUSION

In TI's judgment, the Bank has made impressive progress under the leadership of Jim Wolfensohn. However, it must take additional, specific steps to mainstream the fight against corruption throughout its operations and activities. It must also ensure that Bank staff receive as much encouragement for their efforts in this arena as for more traditional functions.

TI intends to continue its campaign to promote action on the recommendations outlined in this testimony. We know that there are still obstacles to overcome. The shareholders of the Bank are at once its borrowers and, at times, at the heart of the problem. Some have little patience with calls for greater transparency or may have vested interests in the status quo.

Therefore, sustained pressure by the US Government will be necessary to strengthen proponents of reform within the Bank. We welcome the Committee's ongoing interest in this issue and we hope the foregoing makes a constructive contribution to the Committee's work. The leadership of the US Government and of this Committee has been vital to the global fight against corruption. It will be critical in the future as other priorities compete for attention and resources. We hope we may count on your continuing interest and support and we welcome your questions.

Thank you.

The CHAIRMAN. Well, thank you very much, Ms. Boswell, for a remarkable statement, as well as the more voluminous testimony which backs this, and the reforms that you have mentioned. We appreciate it.

Dr. Levinson.

STATEMENT OF PROFESSOR JEROME I. LEVINSON, DISTINGUISHED LAWYER IN RESIDENCE, WASHINGTON COLLEGE OF LAW, AMERICAN UNIVERSITY

Dr. LEVINSON. Thank you, Mr. Chairman. In a previous incarnation, I sat on the other side, so this is a transformation for me, if you will.

I will be brief in my oral comments.

I think paradoxically the larger the project and the more international bidding, the easier it is to control the prospects of corruption because on the large projects, you generally have international competitive bidding. You have the two envelope system. The first envelope, prequalification on technical grounds without reference to price, only after the first set has been passed of qualified bidders, do you get to the second, the price issue. The envelopes have to be opened in public session, and if it is properly administered, it should be a completely transparent process with the prospect of corruption minimal in my opinion.

This is not to say that there will not be controversy. In every case which I saw as general counsel to the Inter-American Development Bank, where you have a large project, you are going to have the losers complain that they lost because of corrupt payments rather than the fact that their price was higher or that their goods were inferior. That is why you have procurement committees within the institutions to review these matters.

By and large, I think that where you have competitive international bidding on projects, it is very exceptional to find significant corruption in that part of the project, subject to that competitive bidding.

The problem of corruption on large projects comes particularly with suppliers credits where particularly the Europeans build into the price of the product illegal payments, and as you well know, in many countries in Europe those payments have been deductible as ordinary business expenses. The OECD convention urges countries to discontinue this process, but it is dependent upon individual countries adopting the necessary measures. As you also know, a number of countries have been slow to do that. So we should not exaggerate what the multilateral financial institutions can and cannot do.

My own view is that where they are financing on a large project, a significant input and their input is desirable from the point of view of the private participants, they have every right to demand that the bidding processes apply not only to that part of the project being specifically financed by the MFI, the multilateral financial institutions, but to the entire project because they cannot insulate themselves from corruption and claim, well, that was not on the part that we were financing. It contaminates the whole project and destroys their credibility. So I think that is very reasonable, and it is not always the case, but I think they ought to extend that practice.

The other thing I think which is quite effective is this business, which has been in the last decade adopted, of the Sanctions Committee where firms which do engage and are shown to have engaged in such corrupt practices can be barred from particularly World Bank projects, and now the IDB has a similar program under consideration. I understand that they expect that it will be shortly enacted.

What is interesting, I think impressive, is the degree of specificity and institutional maturity in terms of due process for the companies that are accused. The easy case is the Lesotho water dam project, water dam authority, where the head of the authority was convicted in the Lesotho courts and the contractors were convicted. But not every country is going to use its judicial process in such a really effective and transparent way. So that imposes a requirement upon the institutions to conduct their own independent investigation and that requires internal processes which assure due process to the companies. I think as I have looked at those processes they are quite impressive in assuring due process. The companies that are, in fact, sanctioned have very little basis to complain. I think that this is a very effective innovation.

I do not understand this idea that Professor Winters has put forward of hundreds of millions of dollars in criminal payments being siphoned off from the direct lending of these institutions. As I say, on the large projects where there is international competitive bidding, I think there are such built-in checks and balances that I am skeptical about that.

In the project approval process, in the Inter-American Development Bank, you have a project team on every project that is going to be financed. It consists of a lawyer. It consists usually of an economist, a financial analyst, an institutional specialist or water specialist, depending on what the project being financed is. Before a project is authorized, it has to go for preliminary approval to a committee headed by the president of the bank. Only when it passes that approval committee is the project team organized. Any individual in the bank has a very hard time bringing about approval of a project by him or herself because it is surrounded by so many checks and balances. Then the project has to go to the loan committee for approval. It then has to be approved by the board of executive directors. At these different levels of scrutiny, you have so many people involved, so many institutional checks and balances, that the approval process itself, it seems to me, is relatively integrated from accusations of corruption.

I think the more difficult issue which has been alluded to by the previous speaker is the structural adjustment lending where the money goes to the central bank. It is then conditioned upon reforms where the reforms are disconnected from the use of the money. The central bank can use the money. It can keep it in its reserves. It can use it for remittances. It can use it for general consumption imports, not necessarily for the reforms, say, in the banking sector or in the electric power sector where you are asking for institutional reforms the money is not necessarily directed to that particular sector which is different from a project where the money is used for specific purposes.

How then do you trace the money? It has gone into the central bank funds. Money is fungible. The money from the World Bank or the IDB does not have a little ticker on top which says this is an IDB or World Bank dollar. It goes through the system. So you cannot generally trace that with a great degree of security. Everybody recognizes that is a problem. They try and deal with it by post-audit financing, but even that is at least questionable.

When I first became general counsel of the Inter-American Development Bank, the Mexicans invited me to Mexico, as they always do with high officials of these institutions. And they are wonderful hosts and my host was a high official in the finance ministry. At the lunch which began at 2 and ended at 5 and we were into the second bottle of wine, things got warmer. And I asked him, why are you doing this?

The IDB at that time in the early 1980s could only provide $250 million to the big countries, what they call the A countries in the IDB, Argentina, Brazil, Mexico, and Venezuela. This is a pittance. Mexico was going to the financial markets to raise a $2 billion jumbo loan. I said, so why are you bothering with me? I mean, it is wonderful. I am having a wonderful time. The lunch is elegant and everything else.

And he said to me you underestimate the quality of the multilateral financial institutional lending. You are going to give us $250 million. That is going to go into an agricultural credit project. Because of our size, we put up $500 million. So that is $750 million for this program. You also require that the entire program, not just your funds, be audited by an independent auditor. That was always a fight with the Mexicans who wanted to have a government auditor and we always insisted that it be an auditor independent of the government. He said, I know with reasonable certainly what happened to that money, not only the $250 million but the $500 million that we put up as a counterpart. He said, in all candor, I cannot say that to you with respect to this $2 billion jumbo loan that we are going to the market for.

So I think that there are reasonable checks and balances. This is not to say they are perfect, especially when you are giving money. For example, rather than financing specific schools, you are giving it to the ministry of education which then is expending the money. It is very difficult. I think it would be foolish to say that there is not some kind of kickback or so on in the expenditure of that money of the ministry, which gets mixed up with the bank money. You can have all the post-audits you want, at the local level, there is going to be some level of corruption.

Let me just conclude with one other factor because it has been alluded to in terms of the general climate of corruption in a country. There are extreme cases, for example, Kenya, where the IMF actually insisted that a UK national be put in charge of the central bank because the corruption was so pervasive. It was almost a return to colonialism, but the Kenyans accepted it because the corruption was so notorious.

Reference has been made to Indonesia. There is no question that Indonesia under Suharto was an egregious case. And there is a remarkable June 16, 1998 article in the Wall Street Journal which says exactly what Professor Winters says, that the World Bank officials in Indonesia knew that some of their money was being siphoned off.

I once had a conversation with Lou Preston, who was then president of the World Bank, who tragically died of cancer, and he was telling me how he was really looking forward to going to Indonesia because the staff was telling him what a star performer Indonesia was. I said to him, has the staff also suggested to you that on every major deal in Indonesia, a member of the Suharto family has to be cut in, that the absence of free trade unions and a free press and an independent judiciary, that there are no checks and balances in this place? What is the plan for post-Suharto political transition? Have they discussed that with you? And he said, no. He said, I guess I will have to inquire about that when I get back.

There was an excessively technocratic economic approach which was blind to these other factors. I think to a great extent we have gone much further now in recognizing that development is an integrated whole and you cannot isolate the political.

Just let me say in conclusion that the best antidote to corruption in a society are the institutions of political democracy: a competitive political party system, a free press, independent trade unions, and independent judiciary. And the case that illustrates that most graphically is Argentina because Argentina in the decade of the 1990s was acclaimed as one of the star performers. It was implementing a neo-liberal economic agenda of the World Bank and the IMF and the U.S. Treasury at the time.

But the corruption was endemic in the Menem government. There are other reasons why the Menem government failed, the failure of the economic program, divisions within the majority party, but every informed observer would tell you that corruption was a major consequence of the fall of the Menem government and his inability to get his term extended and his inability to mount a comeback.

The system worked. It flushed out the corrupt political leadership and corruption became a defining issue in the Argentine political context. Now, is that not what we should want, that the system, not the external agents, the World Bank, the IMF, et cetera, and Transparency International and the U.S. Government flush it out, but that the system itself of the country? And the best antidote is the institutions of political democracy.

Thank you.

[The prepared statement of Dr. Levinson follows:]

PREPARED STATEMENT OF PROFESSOR JEROME I. LEVINSON

Thank you for giving me this opportunity to address this important issue. As Chief Counsel to the Subcommittee on Multinational Corporations of this Committee (1972-1977, General Counsel of the Inter-American Development Bank (1977-1989), and, more recently, as a Democratic appointee to the International Financial Institution Advisory Commission of the Congress, popularly known as the Meltzer Commission, I have had some experience in dealing with the multiple facets of corruption in international financial transactions and the issues faced by the MFIs.

As I see it, there are three aspects to the problem. First, in projects and programs directly financed by the institutions, how do the institutions assure that the decisions with respect to the awarding of contracts are made on the basis of transparency and the merits of the proposals, free of any taint of corruption? Second, where the institutions have conditioned their financing upon certain reforms being enacted and implemented by the government but the MFI financing is not directly connected to the reforms, how does the MFI ensure that the funds disbursed are properly used? What responsibility do the institutions have to ensure that the reforms that they have publicly endorsed are implemented in a transparent manner free of corrupt practices? Finally, what responsibility, if any, do the MFIs have for assessing the level of corrupt practices in a particular country and calling attention to such practices as an obstacle to development?

A. DIRECT FINANCING

How do the institutions ensure that their own officials are not bought off by contractors or recipient governments in decisions such as the approval of projects and the award of contracts? I believe that this is a minimal risk. The internal project approval process is surrounded by checks and balances that virtually guarantee that such wrongdoing cannot take place. First, a project team is formed to evaluate the economic, financial and technical feasibility of a proposed project. In the IDB, with which I am most familiar, that team will have as a minimum, a lawyer, and, depending upon the nature of the project being financed, such additional technical staff as is necessary.

Before the formation of a project team, the proposal in preliminary form must be approved by an upper management committee, which is chaired by the President of the Bank, and includes senior operational members of the IDB staff the most senior members of the staff of the IDB. The final analysis by the Project Committee of the feasibility of the project in all of it facets must be submitted for, at the staff level, final approval to a Loan Committee, chaired by the Executive Vice-President of the IDB. Each project must be approved Final by the Board of Executive Directors. A similar process, although different in some details, is followed in the World Bank.

At each stage of the process of analysis and approval there are so many individuals involved and checks and balances built into the system, that no one individual can control the decision. Hence, I think that the risk of individuals within the institutions making corrupt decisions which determine the project approval is minimal. However, in particular where there is purchase of goods and services, there are almost invariably disputes over the award of contracts. Where the purchase of such goods and services is being financed with MFI resources, except in extraordinary and specified circumstances, all contracts are awarded by a process of competitive bidding. That process administered by the borrower following agreed MFI procurement guidelines. In larger contracts where international competitive bidding is used, a two-envelope system is used. At the first stage, the bidders must submit technical qualifications in which price does not figure. Only after the first stage of technical pre-qualification has been approved, does the second envelope of price come into play. All bids must be opened in a public session. The process and the final award must receive the non-objection of MFI officials.

Ideally, the process if properly administered, should be open and transparent and thus insulated from the possibility of corruption in the award of the contracts. Inevitably, though, there will be challenges to the process and the final result. The losing bidders will complain that they lost by virtue of a flawed process, corruption in the award, or any number of other reasons. Very often, they will seek the intervention of their governments which will direct their Executive Directors in the institution to seek redress for their complaints.

The venue in the IDB for hearing appeals is the Procurement Committee, which is chaired by the Manager for the Regional Operations Department of the particular country where procurement is taking place and other senior managers of the Bank. The Procurement Committee makes its own investigation of the validity of the complaints and reports in writing its conclusion to the Executive Vice-President of the IDB, who can endorse or overturn the report. The World Bank internal appeal process traditionally has been more informal. (Procurement issues are not within the purview of the World Bank(s Inspection Panels). On that part of a project directly financed by an MFI, I think that the award of contracts is fairly transparent and insulated from corruption.

The problems arise, I believe, on that part of a huge construction project where the financing is independent of the MFIs. There may be an issue with the borrower country and entity in charge of the project about whether the MFI procurement guidelines ought to apply to the entire project, including that part not being financed and supervised by the MFI. This is particularly sensitive where supplier credits are a part of the financing. What role, if any does the MFI have in approval of the process and final award of such credits? Can it really insulate itself from possible abuses where its financing is not directly involved? I think not.

American companies may be at a particular disadvantage. They are subject to the Foreign Corrupt Practices Act, which makes it a felony for the company through its officials or agents to make corrupt payments to foreign government officials in connection with procurement decisions by that government. Many European governments have traditionally treated such corrupt payments as ordinary business expenses, deductible for tax purposes. The OECD Convention on Bribery urges member governments to end such tax treatment, but it is dependent upon the action of individual governments, many of which have been slow to act. American companies are consequently particularly dependent upon the MFIs to effectively assure the integrity of the project.

A recent project in Lesotho, Africa illustrates the issue. The Director of the Lesotho Highland Water Authority was convicted in the courts of that country of corruption in the award of contracts in connection with the project. Part of the project was financed by the World Bank. There is no allegation of corruption in the award of contracts on that part of the project financed by the World Bank. The Lesotho authorities then convicted as well two international contractors who had paid the bribes. The World Bank, potentially, has an effective, if draconian, remedy. It could place the international contractors on a proscribed list barring them from bidding on any future World Bank financed projects anywhere in the world. Usually, the project is financed or administered through a subsidiary of the parent company organized for the individual project; once the project is completed, the subsidiary is dissolved. In order to be effective the sanction must pass through the subsidiary to the parent company, usually an internationally recognized company.

A more difficult case is the huge multipurpose dam project, Yacyreta, a tripartite project among Argentina/Brazil/Paraguay, which has been financed in part by both the World Bank and the IDB. I should note that at the time of the original loans from the World Bank and IDB, I was the General Counsel of the IDB. From its inception, the project was complicated if for no other reason than three countries were involved but the most controversial issue involved the relocation of thousands of Paraguayan families, for which the government of Paraguay had neither the financial resources, nor the administrative competence or the political willingness to effectively follow-through on the relocation plan which was an integral part of the project.

The international institutions can provide the financial resources but not the administrative competence or political will. The Paraguayans were masters at playing off the two larger neighboring countries to maximize the financial benefits for a small clique surrounding the then Paraguayan strong-man Stroessner. The form this financial extortion took was ensuring that Paraguayan companies controlled by Stroessner's cronies were included in the larger country construction consortia. Yet, it was also difficult to oppose the inclusion of such companies which were justified in the interest of technical capacity-building in Paraguay.

In fairness, I should note that at the time (1979-80), Argentina and Brazil were determined to proceed with the project and were willing to pay whatever the price demanded by the Paraguayans. Both countries were oil-import dependent and had been highly traumatized by the oil price revolution of 1973/74. Deep water oil discoveries in Brazil and Argentine on-land oil discoveries had not yet been proved. Hydro power was an attractive alternative for both of the larger countries. The MFIs, it was thought at the time, could ensure the integrity of the bidding process for very large international contracts and an adequate relocation program. On the first part, the integrity of the bidding process, I think they were relatively successful. On the second part, the relocation issue, they were less successful. And, as a recent report by the World Bank Inspection Panel notes, the relocation issue continues to plague the project.

The Lesotho case may be the easy one. One has a local court proceeding and finding of criminal conduct by the local project manager and consulting companies. If the World Bank placed the offending companies on the proscribed list, it is difficult to see how the regional development banks could sanction awarding contracts to the same companies on projects financed by them. The potential sanction is thus truly draconian. The World Bank and the Asian Development Bank have sanctions proceedings in place which provide for investigation, and a hearing for any company proposed to be subject to the sanctions. The IDB has a similar process now under consideration.

How many other countries are as zealous as that of Lesotho in pursuing the matter within their own judicial systems? And if they don't do so, what is the responsibility of the MFIs? It is unlikely that they can pursue such an investigation where the government shows no disposition on its own to investigate allegations of corruption on that part of a project not financed by an MFI and which is not subject to the procurement guidelines of the MFI. If we are serious about addressing the cancer of corruption in projects even partially financed with public international funding, I think that it is reasonable to insist upon the entire project being subject to procurement guidelines that assure transparency in the award of international contracts and thus minimize the risk of corrupt payments in connection with such contracts.

More recently, attention has focused on getting the national export credit financing agencies of the creditor countries to address the issue of padding the supplier credits with corrupt payments in the award of the contracts. Given the intense competition in this segment of the international economy, I am not optimistic that any time soon this issue will be effectively addressed.

B. STRUCTURAL REFORM CONDITIONALITY

In the late 1980s and during the decade of the 90s, increasingly, the MFIs conditioned a substantial part of their lending upon borrowing countries undertaking major structural reforms such as privatization of state owned enterprises. The major vehicle of financing for these reforms were structural adjustment or sector adjustment loans. What distinguishes these loans from more conventional project financing is that the use of funds is not necessarily related to the structural reforms upon which the loans are conditioned. Typically, a loan is authorized conditioned upon the country, for example, privatizing the banking sector or the state owned electricity companies. Loan funds go to the Central Bank and need not be expended for purposes related to the privatization which is the condition for the loan. The funds can be used for purposes that are not specifically prohibited: paying creditors, held in the currency reserves of the country, or for general imports. A first "tranche" of the funds is usually disbursed to the Central Bank upon signing of the loan contract. After six months, a review is conducted to determine whether the country has implemented the agreed reforms. If performance by the borrower in implementing the agreed reforms is satisfactory, the remainder of the loan is disbursed to the borrower.

The MFIs must also ensure that disbursed funds for non-specific purposes are not used for corrupt purposes. This is usually accomplished by a post-audit of the use of the disbursed funds. Realistically, however, this is the weakest link in the system. Money is fungible. It is extremely difficult, if not impossible to trace the MFI disbursed funds. You basically are relying on the probity of the Central bank officials.

As the importance of the structural adjustment lending has over the years grown in importance and magnitude for the MFIs another equally important issue arises: what responsibility do the MFIs have to assure that the reform process they are endorsing, particularly where privatization of state-owned assets is involved, is transparent and free from corruption? By endorsing the privatization reforms, the MFIs, particularly the World Bank, place the imprimatur of international approval upon the process.

Yet, in many instances, that process is so flawed and marred by corruption that it discredits the agreed reform. No country has been more acclaimed for its structural reforms than Mexico. This is the way that Andres Oppenheimer, the chief Latin American correspondent for the Miami Herald, in his book, "Bordering on Chaos", described privatization in that country: "In his bid to increase capital inflows, Salinas had put state banks on the block at three times their book value and often more . . . But in exchange for high prices, Salinas offered their buyers sweet regulatory deals and long term promises of fabulous riches through NAFTA, which would soon allow some of the new private owners to sell their monopolies to multinational corporations at record profits . . . Through a policy of 'directed' deregulation or selective liberalization, Salinas paved the way for the formation of more than a dozen monopolies that would control industries such as copper mining and telecommunications."

After the Mexican devaluation of December 1994, the World Bank and the IDB poured billions of dollars into the Mexican banking industry to "bail out" the banks from their profligate lending, designed to recuperate the exaggerated prices they had paid for the state owned banking assets that were privatized. Mexico is not an isolated case. The same pattern has been noted in Russia and Argentina, both countries, which were at the time acclaimed for their reforms, particularly the privatization of state owned assets. Subsequently, the process, the lack of transparency, the massive corruption that accompanied the process, became in both countries major political issues.

I think it is unreasonable to expect that the World Bank, and or the regional development bank, can by themselves ensure the integrity of the process. The political and financial interests, and the stake of the government in the policy are too great. The process will be driven by domestic considerations and the domestic balance of power. What I think is reasonable however is to expect that where the corruption that has accompanied the process is as notorious as it was in Mexico, Argentina and Russia, the international financial community, through the MFIs, not give its stamp of approval, as was done in all three cases, to such a flawed process by extravagant praise of the "reforms."

What then is the remedy? Political democracy. Argentina is the country which best illustrates the point. The government of President Carlos Saul Menem by the end of the decade of the 90s was thoroughly discredited. Menem failed in his initiatives to amend the constitution to permit him to succeed himself as President and then to mount a political comeback. The reasons are complex, rooted in part in the failure of the government's economic plan and the rivalries within his own political party. But all informed observers agree that the perception and the reality of massive corruption in the government, and particularly the privatization of state owned enterprises, played a major role in the demise of Menem's political career.

A competitive political party system, an aggressive free press, and a previously discredited judiciary all played crucial roles in ensuring that the corruption issue was a central part of the Argentine political decision-making. The system worked the way we should hope it would. And that is why I remain skeptical of the role of outside entities in addressing corruption in any particular society. The best and most effective remedy is the existence of the institutions of political democracy—a competitive political party system, a free press, free trade unions, an independent judicial system.

Too often, that objective has been sacrificed to an excessively technocratic economic outlook within the MFIs. The most egregious example is that of Indonesia under the government of Suharto. Indonesia was acclaimed by the World Bank as a "star" of the system because of its economic performance and alleged reduction in absolute poverty. And there were gains, both in economic management and in the reduction of those living in abject poverty. But in a remarkably detailed report the Wall Street Journal (Brauchili, 6/14/98), observed that "World Bank officials knew corruption in bank-funded projects was common" and "went along with government estimates that showed epic improvements in living standards, despite indications the numbers were inflated." The Journal notes that the World Bank lent Indonesia more than $25 billion over three decades and quotes James Wolfensohn, the President of the World Bank, explaining that "We were caught up in the enthusiasm of Indonesia." Hopefully, we are now beyond the excessively economic technocratic thinking that led World Bank officials to overlook and justify the seamier side of development in the Suharto era.

The CHAIRMAN. Well, thank you very much, Professor Levinson. I appreciate the historical background which each of you bring to the discussion.

Frequently in the body politic, the whole situation of term limits is mentioned, and the thought is that it would be useful, for people in our calling in the Senate or the House, or what have you, after a certain amount of time, to yield and let others take our place. There may be some virtue in refreshment of the system in that respect.

One advantage of the current system, however, is institutional memory. A few people are here for a long time. Professor Levinson, you have been around for a long time, and your memory is helpful in this. Professor Winters talked about 15 years of research in this. Ms. Boswell has talked about the evolution of the interest in this subject in the World Bank, and in particular the lack of interest which really may have led to the foundation of the group that you represent today.

I remember, as a junior Senator, in 1977, serving on the Banking Committee. Senator Proxmire was then the chairman, and we were discussing the issue of the deductibility of bribes. This was a serious issue then. This was 27 years ago. American businesses were coming to us and saying, what about this? We are trying to do more exporting. We are trying to do deals, and our competitors literally have tax systems that either overtly or covertly lead to severe disadvantage for us. The American Government even then tried to institute various policies that would discourage this. As you pointed out, the OECD situation is one which we are still attempting to perfect, to move the ball ahead.

The dilemma we are talking about today is that of the many nations that assert their sovereignty. These nations sometimes go so far as to contend that, corrupt or not, the problem is theirs, and they do not brook tolerance by us folks with all of our moralism and fastidiousness. They seek to run their own affairs in an entirely understandable spirit of independence.

On the other hand, serious issues arise, in terms of equity for poor people around the world, quite apart from the general morality of politics. I can recall the Indonesian experience and President Suharto, on my first visit to that country, which came fairly shortly after observation of the Philippine elections involving Ferdinand Marcos and Corazon Aquino. The degree of corruption in the Marcos regime was fairly obvious, but this runs up against another problem and that is the sense of real politics at the time, whether Marcos was our friend, our ally in the cold war, leaving aside whatever might be happening with regard to international loans or anybody else's money. There is still some of that. You have problems of governments that somehow or other, regardless of which war or which period we are in, there is a good bit of overlooking of all this. This runs up against another problem; that is the politics of the time. Was Marcos our friend, our ally in the cold war, regardless of the administration of international loans? We are still faced with that sort of problem today.

This committee has the temerity to have a hearing of this sort. We hope to do this periodically, as opposed to having one go at it, and hoping you all do well. We are attempting to illuminate what sort of progress we are making. I sense that the American people—and I think this is true of the citizens of many countries—have little tolerance for political corruption, and the misuse of money. You must have found, in your reforming efforts, constituents who really believe somebody ought to be doing this kind of work, and doing so comprehensively.

Now, having said that, doing it is tough going, as you have illustrated, although some of you have been optimistic about how we proceed in these things.

There are a good number of people who do not like the international lending institutions. They have felt that America's support for these was a dubious prospect. They listen to hearings such as this one, in which it is suggested that millions, maybe billions historically, have been misappropriated and misspent. This leads to further justification, in their own mind's eye.

Fortunately all of you have approached that angle. This is clearly true of our first witnesses. These institutions are critically important. Anyone approaching this from a humanitarian standpoint is not looking at the corruption investigation as a way of winding it all up, and saying we ought to quit this sort of thing, and just get out of the business. It is very important, I think, for us to emphasize the reason we are in this business. We are having the hearing because we believe that strengthened confidence in all of this is imperative. The world is more transparent generally. The press has become better in following these stories. So have political parties in some affected nations. So I appreciate the spirit with which you have approached this.

I asked the first panel about these large loans to government. I think, Professor Levinson, that you were right on the mark in trying to give us an illustration of this. Let us say to the ministry of agriculture or the ministry of education, maybe you could take a look and see if there are some educational results, such as schools coming up, and so forth. Is there accountability? We had testimony earlier on that some would say, well, by golly, some schools got built and all things considered, thank goodness. Even if only 70 percent of the money got there, something happened.

Governments themselves say, we are sovereign. We really resist people coming in and taking a look at our situations. Now, you could say, if you were a bank, OK, you do not get any money. That is that. But some of these people who are in these positions may not be that interested in the poor. We may be more interested in their poor people than they are, as a matter of fact. That is our humanitarian dilemma. How in the world, given systemic failure of this variety, do you get the money to the poor people?

Where are we getting more leverage with the governments? How can we do better in the Congress, and in the administration? Yes, Professor Levinson.

Dr. LEVINSON. I was a Democratic appointee to the Meltzer Commission on International Financial Institutions. There were constant allusions to the fact that schools were built without teachers, et cetera. Frankly, what I saw and through the years have seen, is that there has been a tremendous evolution. Nobody is just interested in building schools anymore. You have to show as part of that project you are going to have teachers, that the teachers are going to be trained, that there is going to be a post-construction evaluation process. Sometimes it is done jointly with the government and the institution. The IDB has an evaluations office which does post facto evaluations of programs and projects and then tries to build in what they found into future lending.

I think that we have to make a distinction between projects where the institution can demand that the procedures are transparent and visible and competitive. It is another thing when you provide money—take your example of money to an education ministry. Sometimes the education ministries are very weak politically and administratively. So the question is, how do you assure that the money that is going to go through the ministry is going to, in fact, build the schools without—I think 30 percent would be an extraordinarily high percentage being siphoned off, frankly. I think it would be outrageous and I think if it was discovered, the institution would have to stop the program and stop future lending to that institution and maybe to the government because I do not think that is acceptable and I do not think it is acceptable in the institutions.

So I think that you have to approach it from two points of view. One, you are trying to build capacity in the education ministry because when you eventually leave, you want to leave that ministry better capable of carrying on on its own than when you started with them. You are not only providing money for construction, you are providing money for institutional betterment with respect to processes and you are demanding that as a part of your financing. Once you stop lending to that institution, you lose whatever leverage you may have had.

But in my experience, the institutions now look at the totality of what they are financing. They do not just look at building schools. They want to know the schools are going to be staffed. They are then looking at what is the output in terms of literacy. They then conduct joint evaluations to see what went wrong, what went right. They demand, in some cases that I used to know of, that the bidding process be subject to approval, which elicited enormous resistance because that is the way in which you took care of your friends.

As you point out, there is a tension between the sovereignty of the institution and of the country and the demand of the international financier, that if we are putting up the money, we want to be sure the money is going for the purpose that we claim. I think you have to see it as a whole.

The CHAIRMAN. Dr. Winters.

Dr. WINTERS. Yes. With regard to sovereignty issue, no country in the world has a right to multilateral development funds, and there is a fundamental difference between public sector lending and commercial lending. A commercial lender will look at loan conditions on the front side. It will assess ability to repay and whatever you do with money is up to you. It is very different with the case of a multilateral development bank. Because the money is in part coming from taxpayers, your responsibility as a representative of those taxpayers is to safeguard that money. And you are quite right that there is a lot of anger associated with it being stolen.

I think we also need to understand that the corruption issue is not an on/off switch. It is a dimmer switch issue. Those of us who live in the city of Chicago know this very well, a famously corrupt city, and we struggle very hard to make sure that our public money is watched.

I think the reason I differ somewhat with some of the comments that others have made here, especially about the relationship between governance at the broader societal level and specifically how these resources by public sector lenders are handled is because I am actually much more modest in my objectives. I believe a modest, but solid foundation needs to be laid for the resources that flow through this particular channel, and while accepting that we are probably talking about a multi-decade process of getting the governance institutions in place, controlling excessively powerful people and getting them to submit to rule of law in their own countries, this is a very long-term process. And I do not think that the operations of the MDBs should wait multiple decades in order to safeguard, as a best practices element within a broader context of theft, to basically have a hands-off policy on these particular resources.

I differ also slightly with the idea of the fungibility problem. When we do make payments directly into the Treasury for broad support, it is not unreasonable to ask that those funds be earmarked for specific projects and that followup be done to make sure that funds are spent for the ways that they were intended to be spent. It is possible actually to track and trace money, and if the government wants to steal the rest of the money from its treasury, if officials want to do that, fine, they can, but make sure that money that is allocated for specific purposes gets used for it.

Finally, on the question of what I am calling criminal debt and the scale of it. I stand behind the figures of $100 billion for the World Bank and $200 billion for all the MDBs, and it is because the problem is not in the bidding process on the front side. The problem is in how the funds are actually used on the back side, and that is an auditing and supervisory issue. I can give you a concrete example.

The bidding may be for a $300 million toll road to be built. Roads have been built for thousands of years. The technology of building roads has not changed much. One can put in a $200 million road with substandard sand, cement, materials, rocks, and when you are all done, it is going to look like a nice road. It cost $200 million instead of $300 million and $100 million was lost in the process. There is nothing about the front side bidding process that would ever detect this or catch it, and the problem is within 3 years that substandard road now needs a second World Bank reconstruction loan because it has deteriorated rapidly. And this kind of thing goes on over and over and over.

I conclude by saying we cannot ask the World Bank and we cannot expect the multilateral development banks to self-report and to self-monitor entirely. We need an independent multilateral agency that has the right to go into every country and on a spot basis audit projects as a condition for accepting multilateral loans. If you do not want MDB money, go to the commercial market.

The CHAIRMAN. Mr. Bapna.

Mr. BAPNA. I would like to touch upon two of the issues that have been raised recently. The first one has to do with this concern about infringing national sovereignty, which I think is a very important question to ask and something to be very clear about.

I think that what these institutions have and can do appropriately is to set clear, open, and transparent international standards that are consistent with their own missions on how they lend their funds. This is how I think one tries to ensure that one does not get into the World Bank forcing or coercing national governments on issues that are oftentimes considered sovereignty or within kind of a domestic context.

This is similar to the environmental and social standards that the institutions have put in place where there is oftentimes a higher standard or a difference of opinion on, for example, how to resettle individuals that are affected by a particular investment project. The World Bank has a resettlement policy that is at least superior than other countries in terms of dealing with this, and I think similarly for corruption, the idea of setting some open transparent standards that reflect the international communities approach to dealing with this issue can help address this issue.

The second point has to do with respect to adjustment lending. Adjustment lending is an increasing percentage of the total portfolio of these institutions. Since 1998, it is approximately 35 percent of World Bank total lending, and in one year I think it actually was 53 percent. So this is an important type of operation for conveying development aid.

Often, though not always, these resources are attached to a particular policy framework that sets out specific policy goals and triggers that need to be achieved in order for subsequent tranches of the operation to be released.

The rationale for adjustment lending is in part the recognition that investment projects can only go so far in addressing some of the underlying development challenges facing countries today, that one needs to put in place an appropriate policy and institutional framework. Moreover, questions of country ownership, questions of sustainability also have led organizations to recognize the importance of budgetary support.

What perhaps I find more controversial are the actually policy conditionalities that the institutions are putting in place. The type of operation itself I am a little less concerned about because perhaps from a slightly different point of view, I do believe resources are fungible. I do believe that the institutions can do some on their own through internal controls to address corruption, but if one really wants to look at addressing corruption in a more systemic way—and granted, this is a bit more of an ambitious goal—I think one needs to deal with corruption throughout the country and that really calls upon the international donor community to focus on supporting good governance.

The CHAIRMAN. Ms. Boswell, do you have a contribution to this round?

Ms. BOSWELL. Well, I would only ask the fundamental question why so much money is being shifted toward this budget support area if it is so controversial and so difficult. I think it is something that should be looked at. I think the amounts, as I understand it, are over what they were supposed to be at the bank. I do not have more specific figures, but I think it ought to be something we look into.

I wanted to go back to some of the comments you made earlier about the temerity of the committee in looking at this. From the perspective of the various chapter representatives I talked to in preparing for today, they welcome this inquiry. They welcome visits by congressional delegations to their country because it sheds light and it gives them information that they otherwise might not have. So it is an open invitation to continue.

I would like to comment that governments have already made commitments to take a lot of these steps that we are talking about today. They are signatories to anti-corruption conventions. If the bank takes up those commitments and makes sure that they are actually acted upon, then I think the issue of sovereignty may be less of an obstacle.

Finally, I think business attitudes are shifting as well. You go back to 1977, when the FCPA was enacted. Certainly for the last 25 years it has been terribly difficult to get laws on the books outside the United States. We now have 35 signatories where those laws are on the books. It is now a crime to pay a bribe to a foreign official to get a deal. Those payments are no longer deductible. However, we do not have any cases to point to. We simply have to make progress on that. The monitoring process at the OECD is terribly important to make sure that cases are brought.

The bidder requirement that the banks could impose can go a long way toward helping those companies that really want to do the right thing. And we have companies not just in the United States now but in Europe. We have been working in construction and energy and other problematic sectors. There are companies that would like to operate with integrity, but they need a level playing field, and I think a bidder requirement could help do that.

The CHAIRMAN. Let me ask a question. This is in an entirely different field, but there may be some transference of situations. At the time the Soviet Union collapsed, Russian officials came to some of us and said, we have got a mutual problem; namely, our nuclear weapons and our chemical weapons and what have you, might be at risk of misappropriation, proliferation, people stealing them or cashing in and so forth. So we think this ought to be of interest to you. It is of interest to us in terms of our own security. Nuclear accidents might occur in Russia, quite apart from missiles being shot inappropriately.

We came up with the Nunn-Lugar Act, a cooperative threat reduction program. But this was not to be budget support. The Russians said we have no money. We can sign the Chemical Weapons Convention, and we did, but there is no way we can destroy the 40,000 metric tons of chemicals we have because we have no money. Our budget is very small.

The Nunn-Lugar money came in the form essentially of paying American contractors, when it comes down to it, 85 percent of it, to go to Russia and to work with Russians there, at very modest sums, to get the job done.

Now, this is an extreme case. Obviously, it is counterintuitive. A great power enlists another power to disarm itself.

The fungibility question always came up, in this case, in a defense context. If you give money to the budget of Russia, how do you know what the money might be spent for? Granted, 85 percent or 90 percent goes to American contractors. How about the other 10 percent? Is it being spent developing new missile or submarines or what have you? The indications are that it has not been, but this is still a valid question. It is important to address the fungibility problem, if you are dealing government to government.

Some of the issues we are talking about today do not involve nuclear weapons or chemical destruction, but many countries are involved in some very vital activities.

I think you make a very good point. Why do the banks go into so much budget support? Why do we not have criteria for looking for roads or schools or various development situations, in which you define what this is all about, as opposed to what seems to be almost a propping up of somebody's failed economic system, or one that is on the tenterhooks of disaster?

Yes, Professor Levinson.

Dr. LEVINSON. The structural adjustment and sector adjustment lending, you are quite right, were designed to deal with emergency financial situations. You will recall after the Mexican devaluation in 1994 when Secretary Rubin and the IMF put together that major bailout, which really was not of Mexico but was of the creditors that had loaned the short-term——

The CHAIRMAN. Money for the worldwide financial system.

Dr. LEVINSON. Right. So what did they do? If you will recall, Rubin came to the Congress. The leadership said, yes, this is important, but the majority of both parties in the Congress said, hey, wait a minute. We are not going to appropriate $20 billion to pay off the creditors who bought these short-term bonds from Mexico.

So what did they do? They turned to these multilateral financial institutions, probably the only source of immediate liquidity at the time, and they invented this whole structural adjustment/sector adjustment lending. So that became part of the program.

Now, Professor Winters says, well, that money should be used for specific purposes. That would defeat the whole purpose for which they invaded the funds of these institutions which was to provide liquidity to enable the country to use the funds for any purpose. That was linked to reform, to an overall austerity reform program, as it is in every case.

But the fact of the matter is your question is perfectly valid as to whether or not it is desirable to continue this form of lending. I think if you look at it in perspective, you will find that the great majority of it was a response to the debt crisis of the 1980s, post 1985, and the successive financial crises of the 1990s. The question now is so many of the countries have gotten, if you will, addicted to this free use of money, that they do not want to go back to financing infrastructure and specific programs and projects where the money is used for identifiable purposes.

There is a tension that is going on right now. At the last IDB annual meeting, this was a central issue. Some of the larger countries said, just give us the money, which is what you did during the decade of the 1990s. Well, you know, politically that is not viable.

When I made a trip to Brazil, I would say show me the debt. I want to see the debt. They would say, OK, we will pick you up in the morning in a carryall. And they would take me out to see a steel mill or transmission lines or a road. This is what we borrowed for. This is what we used it for.

I asked the same question in Argentina, and they thought I was out of my mind because the money all went for current consumption. There was nothing to show for it. It just went into the central bank and then went out the back door of the central bank.

I think Ms. Boswell raises a very legitimate question. Does it make sense any longer to go on with this type of lending? And if these institutions are to be politically viable over the long term, I suspect that it does not make any sense.

The CHAIRMAN. Ms. Boswell.

Ms. BOSWELL. I would just like to take advantage of your posing this question to raise something that may be a little bit delicate, but you mention situations with the nuclear weapons and the urgency justifying the support at the time. We have a situation in Iraq with great urgency. We have raised the question of whether or not time is being taken to build the kinds of institutions and leaders that after handover, will have the mind set of accountability and transparency and responsibility for the resources that will flow through them. So I just put that on the screen as an issue that I do not think we really have an answer to yet.

The CHAIRMAN. Well, we do not. I would say in an ideal world we might have a better one, but in the real world in which we are operating presently, it would appear that sovereignty is going to be transferred to people that are non-elected, although they will fashion some elections, some legitimacy. In this kind of an atmosphere, the kinds of standards that we are talking about today just do not exist. People who have become the Iraqi statespersons understand that you cannot be totally irresponsible. They may fashion some institutions, but clearly, I think, it is going to be an incremental, day-by-day experience for them. The negotiating skills of Ambassador Negroponte on behalf of the thousand Americans and 15 agencies that will be working to help in those situations will be tested. It is a very good question, and it probably is not the last time that it may be raised.

We had the hearing on Afghanistan yesterday, for example. Now, there a finance minister and others have fashioned very responsible activities in which they are asking the world community for aid, and the world community has responded with a certain amount of pledges. The money has not come yet. There is a certain slowness of payment and the cash-flow and what have you. But at least the institutional aspects look a lot more solid in terms of a transition state which still is trying to have its elections, still having road-building, just so people can get around to register the voters.

These are valid questions. We have been talking about a world of the 1980s and this is would be bad enough for even the 1990s, let alone our current decade. We face a whole new train of situations involving transitional states and failed states.

Did you want to talk, Mr. Bapna?

Mr. BAPNA. Sure. Just to perhaps touch upon this issue in a little bit more detail on adjustment lending and corruption. As has been acknowledged it is becoming an increasing percentage of the portfolios of these institutions, but I think it is important to recognize adjustment lending is almost a term that is a catchall for many different types of lending. There is emergency lending at the country level. There is macroeconomic adjustment lending at the country level. There is sector adjustment lending. There is programmatic lending. All these different types of lendings are being kind of classified under this catchall of adjustment operations or budgetary support.

The CHAIRMAN. Good point.

Mr. BAPNA. It is important to recognize the nuances between these different types of lending.

For some of the lending, the rationale for adjustment lending is premised upon a recognize that focusing solely on physical investments in investment lending did not produce the impact and the sustainability of development objectives that people had initially hoped for. This is based on a fair amount of literature back in the 1980s and 1990s on these experiences that recognized that policy institutional reforms are critical to underpin the sustainability of the particular objectives that are being set forth.

Therefore, I have a slightly more nuanced perhaps interpretation of budgetary support. I think at times when the wrong policy framework is imposed, it can have disastrous consequences. However, if in certain cases the policy institutional framework which has cost to it, which is why adjustment operations are provided to help provide ministries with the cause to make such an adjustment, is complemented with useful investment projects, that that is the most effective way to ensure positive development impact and to ensure local ownership and sustainability of that impact. So I would like to make that point clearly.

Thank you.

The CHAIRMAN. A very good point.

Dr. Winters.

Dr. WINTERS. I think your question on the adjustment lending gets to a more fundamental question which is what first were these institutions designed to be, what have they become, and what ought they be. One of the reasons we entitled our book "Reinventing the World Bank" rather than "reforming" the World Bank is because we feel we are looking at a blue screen and it is time to reboot. A second Bretton-Woods would be a very good idea.

The computer analogy is one that is used intentionally. The World Bank and the other multilateral development banks have responded to criticisms over the decades and they have responded also to political pressures by adding to what they do. They have expanded out into all kinds of things which are not necessarily their core competence. The World Bank should not be the leader on environmental change in the world. The World Bank is not a knowledge bank. A good deal of its research is not cutting edge and so on and so on. The World Bank should not be promoting participation around the world. This is not what the World Bank in our view is good at.

What the World Bank should be doing is lending for purposes of direct development projects, things that they can watch funds. So I am actually against adjustment lending. I think the vast majority of adjustment lending has not produced very good results.

So one of the things we have to grapple with ultimately, quite apart from the technical aspects of how to watch money and what specific recommendations should be put forward, is the much broader question which is can we rethink and can we reinvent these institutions. I certainly hope, given the needs that have been expressed here today and the question of reducing poverty and so on, that that can be undertaken.

The CHAIRMAN. This is a different objective but an important one. As you say, perhaps we need to take a look at the sorts of institutions we have and, what is required, given the problems in the world.

I suspect something will come along again like the Mexican crisis, which I remember very well. I remember Secretary Rubin coming over here, and Alan Greenspan, hand in hand, as part of a small group of people meeting over in Senator Dole's office. It appeared as though the world was collapsing. We were getting communications from Asia and elsewhere of funds being transferred wildly. It was a crisis situation that in fact was met with the very obscure reserve fund of our government, leaving aside the banks, from nowhere. Some funds were found from readjustment from World War II, as I recall. Pragmatically, statesmen do this sort of thing in order to sort of save the world.

At the time of the long-term capital management situation, when things were unraveling as people tried to get their positions right, a meltdown appeared to be occurring in various ways. There were a lot of tense people. In that particular case, there was not a great deal of multinational lending from these institutions, as I recall, but on the other hand, there were suggestions there might be.

I am not certain what we will anticipate next. Last year there was a concern with China. Is there a bubble being created here? Is there something that is so big, given the enormity of the impact on all the surrounding nations, quite apart from our own debt structure, with the Chinese buying all the bonds from us and supporting our currency in these ways? A crisis has not happened, and we are not experiencing borrowing problems.

A hearing of this variety is important. First of all, we have encouraged transparency, a better sense of governance, a better sense of confidence. You have served as very constructive critics of the situation. When these crises do occur, there might be confidence on the part of the American people and their elected representatives in the institutions, as well as faith in the ability to form new ones, to have some sense of what sort of charters are really required given the financial requirements of an interdependent world.

We promised the hearing would come to an end at noon. The rollcall vote mercifully had been postponed until 12:10. I can do my duty and go vote. I appreciate your spending time both on the statements, which are helpful for our record, and also on your very forthcoming responses.

The hearing is adjourned.

[Whereupon, at 12:03 p.m., the committee adjourned, to reconvene subject to the call of the Chair.]

ADDITIONAL SUBMISSIONS FOR THE RECORD

THE WORLD BANK,
WASHINGTON, DC, 20433,
U.S.A., April 28, 2004.

The Honorable RICHARD G. LUGAR,
United States Senate,
Chairman, Committee on Foreign Relations,
306 Hart Senate Office Building,
Washington, DC 20510-1401.

DEAR CHAIRMAN LUGAR:

I am writing in response to the request from you, as Chairman of the U.S. Senate Foreign Relations Committee, to testify and provide the Committee with a status report on efforts to address corruption related to World Bank projects. I regret to advise you that I will not be able to testify, as further explained below. Nonetheless we are very enthusiastic about your enquiry and will use every other possible means to provide you and your colleagues with information to allow your enquiries to be complete and fully informed.

The World Bank, as an international organization, is accountable to all of its 184 member countries, through its internal governance structure in which all members participate. Consequently, the Bank and its officials provide information about the Bank's activities to each of its shareholding member governments, using channels agreed upon with the representatives of that government. The Bank recognizes the importance of parliamentary and Congressional processes in its member countries, and indeed, provides support to help strengthen these processes as part of its development work. As you are aware, the Bank regularly provides briefings to U.S. Congressional staff on topics of mutual interest.

Bank officials cannot provide information, however, through testimony before the legislatures of the Bank's shareholders. This long-standing policy respects the requirements under the Bank's charter to preserve the international character of the Bank, to avoid involvement in domestic political affairs, and to ensure that local legal processes are not inappropriately applied to the Bank.

Consistent with these policy and legal requirements, I am not able to accept the request to testify before the Committee. Yet, combating corruption is a topic of keen importance to the Bank and to me, so I have asked Suzanne Rich Folsom, Counselor to the President, to be in touch with Keith W. Luse and your staff shortly to arrange for our Bank experts to provide a full briefing and exchange of information on this topic.

Sincerely yours,

JAMES D. WOLFENSOHN,
President.

INTER-AMERICAN DEVELOPMENT BANK,
1300 NEW YORK AVE., N.W.,
Washington, DC 20577, May 4, 2004.

The Honorable RICHARD G. LUGAR,
Chairman, Committee on Foreign Relations,
United States Senate,
Washington, DC 20510.

DEAR MR. CHAIRMAN,

Thank you for your letter of April 22, 2004, in which you invite me to testify at the hearing on "Combating Corruption in the Multilateral Development Banks", to be held on Thursday, May 13, 2004.

I want to commend you for this initiative and assure you of our fullest cooperation. You may be aware, however, that due to the policies governing international organizations such as the Inter-American Development Bank, Bank officials are unable to provide testimony to the parliaments of any of the member countries of the institution.

Nevertheless, I hope that we will have the opportunity to inform about our longstanding commitment to help fight corruption in the Latin American and Caribbean region and of efforts to greatly improve our institution's own internal and external controls. To this effect, senior staff of the Bank dealing with these matters would be available, preferably before the scheduled hearing, to provide all necessary information. I also will be only too willing to meet with you at a later date to discuss this and other issues of interest to you and the Committee.

Yours sincerely,

ENRIQUE V. IGLESIAS
President.

IDB EXPANDS INFORMATION DISCLOSURE, TRANSPARENCY

BANK AT FOREFRONT OF PROVIDING GREATER ACCESS TO DOCUMENTS, POLICY PROCESS

The Inter-American Development Bank's new Information Disclosure Policy, which entered into effect on Jan. 1, 2004, places the institution at the forefront of action by multilateral institutions to provide greater and more timely access to documents and information.

For the first time the policy includes not only operations-related information, but also financial statistics and legal documents. Approved by the Board of Executive Directors in late 2003, the new policy is the first for a multilateral institution to include access to minutes of the deliberations of the Board.

In the realm of projects, the extent of information published under the new policy has been expanded considerably. Information on operations is first provided when a project has newly entered the Bank's pipeline. As the proposed operation becomes more complex and detailed, a project concept document is posted on the IDB Web Site, which is later complemented by the full-text publication of the loan proposal, the document used by the Board in its deliberations as to whether or not to approve a financing package sent forward to it by the management of the Bank.

In another new development for 2004, the public now has access to information on the status of disbursements for all projects. The Statement of Approved Loans, updated monthly on the Web Site, contains a rundown of all loans approved in more than 44 years of Bank operations, including information on repayments. Coordinated by the Bank's Office of External Relations, the IDB Web Site also provides access to two other operations-related products: the Country Strategies, which lay out in broad terms the rationale for the Bank's collaboration with borrowing member countries in Latin America and the Caribbean and Country Program Evaluations, prepared by the IDB's Office of Evaluation and Oversight, which reviews both Bank and country performance in comparison with the programs as originally mapped out. Individual Bank-financed operations with significant environmental and social implications are required to publicly document those impacts—and the Bank and borrowers' proposed remedial actions—in a timely manner. All documents considered by the Board are available in both English and Spanish. Documents in Portuguese are available for operations for Brazil, and French language documents are available for those in Haiti.

ZERO TOLERANCE FOR CORRUPTION

The IDB's adoption of a progressive new information disclosure policy fits alongside a number of other significant steps taken by the institution to raise questions of governance—both In Bank operations and among member countries. Dating back to the Bank's Annual Meeting in Milan, Italy, in March 2003, IDB President Enrique V. Iglesias emphasized the need to maintain a policy of "zero tolerance" for fraud and corruption. To that end, late in 2003, the Bank assembled a number of its most important investigative functions under the umbrella of a new Office of Institutional Integrity. The secretariat of the Bank's Oversight Committee on Fraud and Corruption resides in the new office, as do investigators charged with looking into alleged violations of the Bank's Code of Ethics and matters related to conduct in the workplace.

Within the past year, the Bank has implemented a new staff rule on protection for whistleblowers. A policy providing for the debarment of firms accused of improper actions related to Bank-financed procurement is in the final stages of clearance by the Bank's management. In the area of procurement more generally, the Bank hired two leading firms to conduct top-to-bottom reviews of the Bank's procurement policies and procedures—both for purchases made in connection with projects in borrowing member countries (operational procurement) and for the acquisition of goods, services and works directly by the Bank (corporate procurement).

In addition, a Corporate Governance Committee was established and submitted recommendations, for implementation by the Board of Executive Directors and management, on enhancing auditing, internal controls, institutional reporting and rules consistent with the procedures of the Sarbanes-Oxley Act of 2002 adopted in the United States and similar international initiatives.

These recommendations include the realignment and enhancement of the Audit Committee's responsibilities, enhanced disclosure mechanisms and procedures, tighter rules against conflict of interest and measures to ensure greater independence and effectiveness of the Bank's external auditor.

AFRICAN DEVELOPMENT BANK GROUP,
13 AVENUE DU GHANA,
ANGLE AV. HEDI NOUIRA ET PIERRE DE COUBERTIN,
BP.323—1002TUNIS BELVEDERE,
Tunisia, May 11, 2004.

The Honorable RICHARD G. LUGAR,
United States Senate,
Committee on Foreign Relations,
Washington, DC, 20510-6225.
United States of America

DEAR SENATOR LUGAR,

I am pleased to acknowledge receipt of your letter dated 22 April 2004, wherein, in your capacity as Chairman of the United States Senate Foreign Relations Committee, you have invited me to testify on 13 May 2004, and provide information to your Committee on the efforts of the African Development Bank to address corruption in the Bank's projects.

Regrettably, I will be unable to testify. However, I would like to express appreciation for your letter of invitation. The Bank would, of course, through other possible means be able to provide you information on the subject of the Committee's interest. We have been informed that the Committee hearing on 13 May 2004, is expected to discuss in particular, with respect to Africa, the Lesotho Highlands Water project in Southern Africa. If this information is correct, you will please note that the African Development Bank did not participate in financing that project.

The African Development Bank is an International Institution governed by the Agreement Establishing the Bank (the Bank Agreement) and is accountable, through its internal governance structure, to its member countries. The Bank, therefore, provides information about its activities to each of its member countries through the Board of Governors and the Board of Directors of the Bank, on which Boards all member countries are represented. The Bank also maintains a public information center, through which, and consistent with the Bank's policy of transparency and information disclosure, information about the Bank's activities are made available. Officials of the Bank do not testify before the national legislatures of its member countries. Nevertheless, the Bank fully recognizes and supports parliamentary inquiries by its member countries as evidence of good governance within the member countries. The inability of Bank officials to testify before the legislatures of its shareholders stems from the Bank Agreement that, among other things, requires officials of the Bank to preserve the international character of the Bank, avoid involvement in domestic political affairs of member countries and ensure that the Bank is not subjected to the national legal processes of its member countries or have these processes inappropriately applied to the Bank.

Consistent with these policies, and legal requirements, I am unable to respond favorably to the invitation of your Committee. I would, however, like to assure you and members of your esteemed Committee that the Bank is keenly interested in weeding out corruption from Bank projects and has worked towards that end. Please have your staff contact the General Counsel of the Bank, Mr. Adesegun Akin-

Olugbade, who could furnish available information for the benefit of your Committee.

OMAR KABBAJ,
President.

PREPARED STATEMENT OF AMBASSADOR CYNTHIA S. PERRY

ANTI-CORRUPTION EFFORTS OF THE MULTILATERAL DEVELOPMENT BANKS (MDBS)
AFRICAN DEVELOPMENT BANK GROUP (AFDB)

Mr. Chairman, Members of the Committee, I welcome your invitation to discuss the efforts of the African Development Bank Group (AfDB or "the Bank") to address corruption.

Fueled by poor governance, corruption in much of Africa remains widespread and pervasive. Far-reaching change will be necessary to reduce it dramatically. The African Development Bank is keenly aware of the challenges involved, and has placed itself at the forefront of efforts to promote good governance and combat corruption on the continent.

The Bank's anti-corruption efforts aim to mitigate the risk of corruption in its operations and increase the level and quality of assistance to its borrowing member countries in support of good governance. By virtue of its African character and the priority it has placed on promoting good governance, I believe the African Development Bank is well placed to continue to enhance its leadership role in the area of governance and in the fight against corruption.

The Office of the U.S. Executive Director at the AfDB has advocated strongly for greater transparency and improved governance at all levels of the AfDB's operations, and will continue to do so. While the Bank has made significant progress in terms of institutional accountability, transparency, and operational control, further efforts are needed. My remarks today will focus on the AfDB's efforts to combat corruption and strengthen governance on three fronts: at the institutional level, the project level, and the country level. The Bank is also actively promoting good governance through a number of partnerships with regional and international organizations.

Institutional Efforts

The AfDB's 1999 *Policy on Good Governance* emphasizes combating corruption as one of the pillars of the Bank's mandate to promote good governance in member countries. The Bank's *Strategic Plan for 2003-2007* also underscores the linkages between good governance, including combating corruption, and the Bank's poverty reduction mandate. To strengthen these linkages, the Bank has put in place effective internal controls and procedures intended to deter, detect and punish corrupt practices.

Most notably, in the past year, the Bank developed a *Code of Conduct* for Bank staff, *Guidelines for Preventing and Combating Corruption,* and an *Information Disclosure Policy.* The AfDB maintains strict recruitment procedures and is strengthening internal capacity to combat corruption and promote good governance through staff training programs.

The *Code of Conduct* for staff is a statement of basic ethical principles to guide Bank staff in fulfillment of their duties. Failure to abide by the Code of Conduct results in sanctions, as specified in the Bank Staff Rules. During the past year, the Bank has disciplined, in some instances terminated, the services of staff after determining their involvement in corrupt or unethical practices related to Bank operations.

Building on the Bank's good governance policy, the *Guidelines for Preventing and Combating Corruption* outline where and how corruption and fraud may occur in the Bank's operations, modalities for its prevention, and procedures on how Bank staff should respond to incidents of corruption and fraud in Bank operations.

One of the key features of the Guidelines is the Bank's *zero tolerance position* with regard to fraud and corruption. In line with the Code of Conduct for staff, the zero tolerance position means that staff proven to have engaged in corrupt or fraudulent practice in fulfillment of their duties will be disciplined in accordance with Bank Staff Rules.

With regard to transparency, the Board of Directors recently approved a new *Information Disclosure Policy,* which will significantly enhance the transparency of the Bank's operations by making a wide range of Bank documents publicly available. The Office of the U.S. Executive Director has been the strongest advocate in the Board for greater transparency, and will continue to lead this effort in order to achieve the goals specified in Section 581 of the FY2004 Consolidated Appropriations Act that are germane to the AfDB.

In the area of *recruitment,* the Bank's procedures explicitly forbid nepotism or favoritism on the basis of nationality or group identification. Staff members who fail to comply with these rules are subject to reprimand, dismissal, or legal sanction.

The Bank continues to take steps to build its institutional and human capacity. Internal *staff training* has been organized to promote the Bank's good governance policy and to familiarize operations staff with new diagnostic assessments such as the Country Governance Profile. Enforcement of the Bank's zero tolerance position will require strengthening the Bank's institutional capacity to deter, investigate and sanction corrupt activities. The Bank intends to increase the number of staff experts assigned to anti-corruption activities, and enhance the technical skills of Bank staff through specialized training in areas such as forensic auditing, detection of money laundering and financial investigation techniques. In the Board of Directors and in dialogue with AfDB management, I will continue to stress the need for strengthening the capacity of staff working on governance and anti-corruption activities in the Bank.

Project-Level Efforts

The African Development Bank has instituted a range of controls to mitigate the risk of corruption in its projects. These controls include auditing, supervision, the use of special accounts for higher risk lending, due diligence on private sector borrowers and co-financers, strict procurement procedures and a soon to be established inspection mechanism. The AfDB requires annual audits of its projects and enforces contractual audit provisions in its loan and grant agreements. My office is active in the review by the Board's Audit and Finance Committee of internal audit reports dealing with the results of audits of the implementation of Bank projects.

The Bank's *Internal Audit* department safeguards the Bank's assets, certifies compliance with its policies, and ensures auditing standards are met. The Internal Audit department also assesses the strength of internal controls and institutional arrangements in borrowing member countries and assists national audit institutions with outsourcing audit functions until adequate national audit capacity can be developed. The AfDB's Operations and Internal Audit departments evaluate the quality of independent audits of Bank projects, and fully enforce the Bank's audit policy, which may include suspension of disbursements to some projects. While no disbursements have been suspended in the last three years due to fraud or corruption, at least *two projects are currently being investigated for fraud and corruption.* Preliminary assessments have revealed some improvements in the submission of annual audit reports of Bank funded projects, but the Bank needs to remain vigilant in its oversight to ensure project audit reports are completed consistently across projects in a timely manner.

Supervision missions focus on good financial management of projects as a way to eliminate opportunities for corruption. When compliance with financial management standards is not adhered to, the Bank proposes corrective measures and may impose sanctions. The Bank's ability to conduct supervision missions was significantly impaired by the temporary relocation of the Bank's operations to Tunis in 2003. The Bank is now fully operational at the temporary relocation site and supervision missions have resumed.

The AfDB's *procurement regulations* have been modified to be more explicit in their treatment of corruption. As a result, the Bank will now cancel at least part if not the entire loan or grant if the procurement process was tainted by acts of fraud or corruption. Firms proven to engage in corrupt or fraudulent practices can be declared ineligible from participating in future Bank funded activities indefinitely or for a period determined by the Bank. Over the past few years, about thirty tenders have been canceled, companies sanctioned, and together with their affiliates, barred from participating in Bank projects. The Bank maintains a list of sanctioned or blacklisted firms and shares the information with other MDBs.

The Bank's *Procurement Review Committee* of senior managers appointed by the President receives and investigates complaints from bidders who are not satisfied that their bid was handled in accordance with *Bank Rules of Procedure for Procurement of Goods and Works.* The committee is an independent body whose decisions, which can include cancellation of a procurement process, are final and binding.

The experiences of other MDBs show that efforts to prevent, detect, investigate and sanction fraud and corruption in MDB operations is most effective and credible where a high-level single oversight body is designated as a focal point for managing all matters relating to corruption and fraudulent practices. As such, the Bank plans to establish a high-level *Oversight Committee on Corruption & Fraud.* The Bank is also working to develop a formal *whistleblower protection* program designed to protect the identity of those disclosing information or allegations concerning fraud or corruption.

To address issues of corporate governance, particularly in private sector projects, the Bank is finalizing a *Strategy and Plan of Action on Corporate Governance.* The Bank conducts due diligence assessments on potential borrowers to ensure full compliance with corporate governance principles for Bank-supported projects. The Bank also provides direct assistance to private sector investors to endorse and implement corporate governance principles as a pre-condition for Bank financing.

Within the overall framework of promoting good governance, the Bank has proposed the creation of an *Inspection Function,* a combined compliance and problem-solving mechanism. The proposal was posted on the Bank's website for several months to invite comments from interested stakeholders. Bank management will submit a final proposal to the Board of Directors in June 2004. My office has been at the forefront of the effort to establish an inspection mechanism at the AfDB, which will reinforce the Bank's accountability for the impact of its project operations.

Country-Level Efforts

The African Development Bank provides financial and technical assistance to regional member countries in their fight against corruption. Requests for assistance are determined on a case-by-case basis and subject to a clear and credible demonstration of commitment to principles of good governance and combating corruption.

Since 2001, the AfDB has approved $925 million in loans and grants for governance-related activities for 25 member countries. Following the 10th replenishment of the African Development Fund (ADF), the number of Bank-financed governance projects is expected to increase significantly.

Good governance is a key factor in determining the ceilings on allocations of ADF resources for eligible ADF borrowing countries during a given replenishment cycle. The *Country Performance and Institutional Assessment* (CPIA) and Country Risk Assessments are based on formulas that place a 40% weight upon the quality of governance in ADF-eligible borrowers.

The *policy-based loan for governance* (PBLG) is a key instrument that the Bank will use to support institutional reforms to consolidate macroeconomic stability and a favorable environment for sustained growth in its borrowing member countries. PBLGs will be used to support governance-related reforms in areas such as judicial and legal frameworks, trade policy, public finance, fiscal and monetary policy, public sector management, financial sector policy, and competition policy. The Office of the U.S. Executive Director provided substantial input into the PBLG Guidelines that were recently approved by the AfDB's Board of Directors. Going forward, my office will monitor the Bank's use of this instrument very closely.

The AfDB collaborates closely with the World Bank in conducting various diagnostic assessments of public financial management systems and recommends actions for implementation. To date, this collaboration has produced eleven *Country Financial Accountability Assessments* (CFAAs) in Burkina Faso, Chad, Gambia, Malawi, Mali, Madagascar, Mauritania, Senegal, Tanzania, Uganda and Zanzibar. Since 2002, the AfDB has also collaborated with the World Bank to carry out six *Country Procurement Assessment Reviews* (CPARs) in Benin, Senegal, Côte d'Ivoire, Angola, Togo, and Guinea.

The Bank also conducts its own *Financial Management Review* of its projects. The Financial Management Review is an AfDB innovation designed to improve the financial management and audit functions of specific projects. The Bank has successfully carried out Financial Management Reviews in five countries (Cameroon, Madagascar, Malawi, Uganda, and Zambia), covering four key sectors (agriculture, transport, public utilities, and the social sector).

Another important and innovative diagnostic tool employed by the Bank since 2002 is the *Country Governance Profile.* Country Governance Profiles are used to identify key governance issues in borrowing member countries, including corruption, and to develop a common understanding of the strengths and weaknesses of country governance arrangements. These profiles allow the Bank to better assess risks to Bank funds and to develop governance reform and capacity building programs with its borrowing member countries. The Country Governance Profile is the key instrument for mainstreaming governance priorities into Bank operations. The new cycle of Country Strategy Papers for 2005-2007 will address governance issues based on the governance profiles. Currently five Country Governance Profiles have been completed (in Nigeria, Ghana, Mauritania, Malawi, and Zambia) and an additional 10 Country Governance Profiles are scheduled for completion in 2004.

Borrower institutional capacity is critical for effectively combating corruption and compliance with the anti-corruption safeguards in the loan agreements with the Bank. For countries ranked low in the CPIA governance factors and where the risk for corruption is deemed high, the Bank will undertake more rigorous assessments through Country Governance Profiles, CFAAs, and CPARs, and propose corrective measures. Government officials will benefit from selective and specialized governance- and corruption-related training organized through the Joint Africa Institute housed at the AfDB. Such training will be country specific and based on areas of weakness identified through assessments.

Partnerships

The AfDB is actively engaged in partnership with a number of institutions to combat corruption on the continent. The Bank is an active member of the MDB Harmonization Working Group on Financial Management, Procurement, and Environment. The Bank is also collaborating on good governance promotion activities with the Economic Commission for Africa, and has conducted a series of workshops on developing national strategies and action plans for combating corruption in collaboration with Transparency International, the World Bank Institute, and the Global Coalition for Africa.

The Bank was the lead institution involved in developing the standards and benchmarks for banking, financial regulations, and corporate governance for the New Partnership for Africa's Development (NEPAD) initiative and is providing technical assistance to the African Peer Review Mechanism component of the NEPAD. The AfDB was also a key partner of the African Union in finalizing the Africa Convention on Combating Corruption.

Responding to the call to tighten anti-money laundering controls after the September 11, 2001, the Bank is actively supporting existing institutions such as the Financial Action Task Force (FATF), Africa regional FATF-style bodies and specialized sub-regional anti-money laundering taskforces. In addition, an internal Bank working group is exploring how the AfDB can help member countries develop appropriate legal and regulatory systems and regimes to address the problem.

Conclusion

Despite these significant and ongoing efforts to combat corruption and improve governance at the institutional, project, and country levels, the African Development Bank itself recognizes that additional efforts are required, particularly with regard to implementation and enforcement of existing policies and procedures, and strengthening the Bank's internal capacity. As the Bank works to build the appropriate skills mix to carry out its good governance promotion initiatives, I will continue to press the Bank to periodically review its organizational arrangement, procedures, and policies to ensure an appropriate enabling environment and strategy for combating corruption.

The Office of the U.S. Executive Director will continue to challenge and support the Bank to further strengthen its anti-corruption efforts, enhance the transparency of its operations, and realize its objective of becoming the lead institution on good governance in Africa.

Thank you.

Prepared Statement of Patricia Adams

I appreciate the opportunity to submit this written statement to the Senate Committee on Foreign Relations regarding its investigation of corruption in multilateral development bank (MDB) projects. As an economist and the executive director of Probe International, a Canadian non-profit research group, I have researched the environmental, financial, and social effects of MDB projects over the past 20 years. In 1991, I published a book, "Odious Debts: Loose Lending, Corruption, and the Third World's Environmental Legacy," which exposes how corruption led to unrepayable debts, environmental harm, and the demise of democracy throughout the Third World. I submit a copy for your reference.

I have followed the case of corruption in the Lesotho Highlands Water Project, and especially the trial of Acres International—the first corporation to be convicted—since before the indictments were issued in 1999. I have read many of the court documents and my organization makes these widely available to the public and press around the world by posting them on our Web site <www.odiousdebts.org>.

I first wish to correct the record regarding testimony you received on May 13, 2004 from Professor Jerome I. Levinson of the Washington College of Law at the

American University. He is incorrect in stating that corruption did not occur in the award of a World Bank Lesotho Highlands Water Project contract.

In his statement to the Committee on Foreign Relations, Professor Levinson states:

> A recent project in Lesotho, Africa illustrates the issue. The Director of the Lesotho Highland Water Authority was convicted in the courts of that country of corruption in the award of contracts in connection with the project. Part of the project was financed by the World Bank. *There is no allegation of corruption in the award of contracts on that part of the project financed by the World Bank.* (Emphasis added)

The Lesotho High Court transcripts, which are available at <http://www.odiousdebts.org/odiousdebts/index.cfm?DSP=subcontent&AreaID=12> and the World Bank's own "Notice of Debarment Proceedings," dated March 21, 2001, which is available at <http://www.odiousdebts.org/odiousdebts/publications/DebarmentProceedings.pdf>, show Professor Levinson to be mistaken. These documents show that Acres International was convicted in the Lesotho High Court (later upheld by the Appeal Court) for bribery payments to the former head of the Lesotho Highlands Development Authority in order to secure Contract 65, a World Bank contract signed in 1991 with a base value of CAD$16,986,413.

This conviction regarding the award of a Bank contract is important because, according to the World Bank's self-defined guidelines, only those who have committed fraud or corruption in the procurement or execution of Bank-financed contracts will be subject to the Bank's debarment proceedings. Indeed, the World Bank acknowledged that Acres' crime did involve a World Bank contract when it reopened its debarment proceedings against Acres International in March, 2004.

Under World Bank anti-corruption guidelines, a contractor that commits fraud or corruption in the procurement or execution of Bank-financed contracts will be barred from receiving future World Bank contracts. World Bank contracts are the bread and butter of many multinationals. As the world's largest development agency, and the standard setter for the world's other agencies, a World Bank blacklisting could be the death knell for a corrupt company. No more effective deterrent exists to corruption in international development projects than a World Bank debarment.

I understand this principle drives the sanctions against bribery under the U.S. Foreign Corrupt Practices Act which includes, among other sanctions, fines, imprisonment, and being "barred from doing business with the Federal government." Indeed, according to the U.S. Department of Justice's Web site, "Indictment alone can lead to suspension of the right to do business with the government." The Foreign Corrupt Practices Act, which has been in place since 1977, "was intended to have and has had an enormous impact on the way American firms do business," says the Justice Department. This is consistent with my own anecdotal experience: Relative to firms in other countries, American companies are acutely alert to the serious consequences of a conviction for corruption. This may explain why, of the 19 individuals and firms from nearly a dozen countries that were indicted in the Lesotho Highlands Water Project corruption scandal (many of them Organisation for Economic Co-operation and Development members), none of them was from the United States.

Jeremy Pope from Transparency International described the importance of tough consequences for corrupt acts when he said, "If executives see they can be prosecuted, humiliated and jailed, their firms barred from work and their names damaged, they will conclude bribery is not worth it." [1]

If the World Bank does not debar those companies convicted of corrupt acts in the Lesotho Highlands Water Project trials, corporations will get the message that a bribery conviction is an affordable irritant, and that they can counter bad press with promises to adopt new internal corporate anti-corruption management systems. In the absence of meaningful deterrents, bribery will continue to pay and firms will have an incentive to look for more devilishly inscrutable ways to hide their crime.

Also, if the World Bank does not debar those companies convicted of corrupt acts, Third World governments will learn that the OECD convention against bribery [2] is meaningless, and that those who repeatedly lecture them on the need to adopt good governance and the rule of law—OECD member governments and the World Bank alike—are hypocrites.

The Lesotho bribery trials, involving over a dozen of the world's most prominent engineering firms, is the most important case of corruption in the history of inter-

[1] "The end of swag?" by Rich Thomas and Stefan Theil, *Newsweek*, July 1/2002.

[2] OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions available at <http://www.oecd.org/document/21/0,2340,en__2649__34855__2017813__1__1__1__1,00.html>

national development. For the first time, multinational firms have been brought to trial by a Third World government. Two of the firms have been convicted and one has been fined after pleading guilty to bribery in connection with their contracts on the $8 billion Lesotho Highlands Water Project dam-building scheme. In the international development business, this case is being closely watched by engineering companies around the world, as well as by companies in other sectors, as a bellwether that will indicate the World Bank's tolerance of corruption.

Lesotho and other Third World countries that are confronting corruption deserve western government support and respect for courageously tackling this cancer. And they deserve to have western governments follow up their extraordinary, precedent setting trials with action, not business as usual. As Lesotho's Attorney General Fine Maema said, "The attitude has always been that Africans are corrupt. But it takes two to tango, and we want rich world corporations and countries to acknowledge their role."[3] It is time for western governments and all the international funding institutions, such as the MDBs, to stop awarding contracts to individuals and corporations that engage in corrupt acts.

THE U.S. CONGRESS'S INVESTIGATIONS INTO THIS MATTER ARE ESPECIALLY IMPORTANT

To my knowledge, apart from the U.S. Congress, no northern governments or legislatures have worked to make the World Bank crack down on corruption. Indeed in Canada, in contrast to the U.S. Congress's attempt to root out corruption and expose it to the light of day, the Canadian government has been lobbying the World Bank not to debar Acres. A Canadian official in our Executive Director's office at the World Bank, for example, has told me that the Canadian government would resist Acres' debarment because "there is corruption with courts in the Third World."[4] Other Canadian government agencies have also disparaged, without any evidence, the judicial process in Lesotho. A spokesman from Export Development Canada, Canada's counterpart to the Export-Import Bank of the United States, stated: "Had the case been heard in an Ottawa courtroom, there might have been a different outcome."[5] Indeed, EDC and other Canadian agencies recently announced that they will continue to favour Acres with taxpayer-funded programs. [6]

Also disturbing, Acres agent in Lesotho, the person who arranged Acres bribery payments for which it was later convicted, was a Canadian federal cabinet appointee. The person in question was Mr. Zalisiwonga Bam, Canada's Honorary Consul to Lesotho.

Bribery is a "corrupt and ugly offence, striking cancerously at the roots of justice and integrity," quoted the Court of Appeal in Lesotho in its judgment confirming the lower court's finding of guilt. Acres' "cynical exploitation" of Africa's largest international development project "motivated as it was by greed, is the more reprehensible."

Countries that are working against the odds to rid their countries of corruption, as is Lesotho, deserve honesty and integrity from those of us in the West. Many of Probe International's supporters have written compelling and principled letters to Mr. Wolfensohn, urging him to resist pressure from the Canadian government. They ask him not to "derail the course of justice" and to follow through on Bank policy to debar Acres and any other company that is convicted of bribing a Third World official.

The developed countries have long lectured Third World nations to clean up their corruption. In Lesotho, we have a little country that has found the courage and fortitude to do just that. Now it is the western countries and western institutions like the World Bank, long on lip-service to corruption but short on action, that must muster their courage. We appreciate the efforts of the U.S. Congress to make that case to the World Bank.

Thank you.

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[3] "The end of swag?" by Rich Thomas and Stefan Theil, *Newsweek,* July 1/2002.

[4] June, 2003 meeting with Francois Pagé, Senior Advisor to Canadian Executive Director. Subsequently reported in the press, including in "Acres' partners in crime," *Financial Post,* August 23, 2003.

[5] "Groups fear Canadian funding for Romanian mine," by Stephen Leahy, Inter Press Service News Agency, November 16/2003.

[6] For example, Patti Robson in the Media Relations Office of the Canadian International Development Agency stated in a February 6, 2004 email to me that, "We have reviewed the issue carefully and we have discussed it with a number of key stakeholders including international institutions and donor countries. Acres has agreed to pay the fine, and we are satisfied that Acres has implemented an Integrity Management System designed to protect itself and its clients from future risks. This was one of the determining factors in our decision. We will continue to fulfil existing contractual agreements with Acres and will consider new proposals when submitted."

PREPARED STATEMENT OF BRUCE M. RICH

I. INTRODUCTION

Environmental Defense is a national environmental organization with over 300,000 members and supporters nationwide. The International Program of Environmental Defense has been involved in research and advocacy concerning the environmental and social impacts of Multilateral Development Bank (MDB) lending for twenty years, and has made numerous submissions to Congressional authorization and appropriations committees regarding these institutions. Our concern regarding the quality of MDB lending led us a number of years ago to examine the issue of institutional incentives and controls in these institutions, particularly in the World Bank.

This submission examines the institutional issues concerning massive corruption in World Bank lending over the past thirteen years, as documented in internal World Bank memoranda and reports. Based on this record, we question the adequacy of current World Bank management efforts to address major management and institutional problems that are conducive to corruption.

We would first like to comment on why organizations such as Environmental Defense, which are primarily focused on promoting environmentally sustainable lending policies at the international financial institutions, are so concerned about corruption. The "culture of loan approval" and "pressure to lend" that has been documented in the World Bank and other MDBs for more than a decade has often meant that policies designed to mitigate adverse environmental and social impacts of MDB lending are not implemented. Our research has led us to World Bank internal documents that state clearly that the culture of loan approval has also undermined the implementation of basic financial auditing and reporting requirements. These findings themselves are rather astounding for any public international financial institution, let alone one like the World Bank, which proclaims itself to be a leader. Nevertheless, the excerpts and conclusions from internal World Bank documents speak for themselves.

We believe that the same measures that would address the institutional problems relating to corruption in the MDBs would also go a long way towards improving overall project quality with respect to environmental and social impacts. For this reason we wish to submit additional information for the record to supplement the information presented in the testimony of the witnesses on May 13th, particularly the statements of Mr. Manish Bapna of the Bank Information Center (to which we contributed) and the statement of Dr. Jeffrey Winters.

Our major concern is that the statement of the U.S. Executive Director Carole Brookins and the announced anti-corruption measures of the World Bank do not credibly address the most serious, endemic problem embedded in MDB lending operations; namely, the systematic, across-the-board diversion of MDB lending by whole governments or government ministries in the Bank's borrowing countries.

As was noted in Mr. Bapna's statement, World Bank anti-corruption actions have focused on specific procurement, bribery and kickback abuses, as well as selected general governance programs, rather than on the much larger and more serious public sector, country-wide level of corruption of Bank loans. This latter problem is at the root, however, of by far the largest portion of corruption in MDB lending.

II. EXTENT OF CORRUPTION IN WORLD BANK OPERATIONS: LESSONS AND IMPLICATIONS OF THE INDONESIA CASE

The World Bank has claimed that there is "no supporting evidence" and "no credible evidence and/or foundation" for Senator Lugar's statement (based on the testimony, *inter alia,* of Dr. Winters) that between 5% and 25% of the $525 billion the World Bank has lent since 1946 has been diverted and misused, the equivalent of between $26 billion to $130 billion.

Yet the Bank itself cannot provide any credible estimate of how much—or even a range of how much—is currently being stolen and diverted from Bank lending operations.

In the case of one major Bank borrower, Indonesia, Bank staff did prepare precisely such an estimate, with a detailed breakdown of how the money was being stolen from World Bank lending, including estimates of the extent of graft for each government ministry.

In the Indonesia case, American political economist Jeffrey Winters alleged in a July 1997 Jakarta press conference that shoddy accounting practices by the World Bank had allowed corrupt Indonesian officials to steal as much as 30% of Bank loans over a thirty-year period—a mind-boggling total approaching $10 billion.[1] At about the same time, Environmental Defense obtained a copy of an internal study of corruption in World Bank lending programs to Indonesia commissioned by the Bank's Jakarta Office. For well over a year, the findings and recommendations of the study—which confirmed many of Winters' charges—were not acted on by World Bank senior management, and World Bank President Wolfensohn learned of the existence of the report only in July 1998, a year after its completion.[2] This was nearly two years after Wolfensohn's 1996 declaration of "no tolerance" for corruption and the announcement that the Bank was "taking steps" "to ensure that [its] own activities continue to meet the highest standards of probity."[3]

The internal Bank report, known as the "Dice Memorandum"[4] (after the Bank staffer who authored it) directly contradicted the assertions of the Bank's Vice President for East Asia, Jean Michel Severino, who, in response to Winters' charges, stated that "this [systematic corruption in World Bank lending to Indonesia] is demonstrably untrue. We know exactly where our money is going."[5]

The Dice Memorandum is a critical document, for it provides an alarming blueprint—drafted by Bank in-country staff deeply familiar with the situation—of a problem which is likely endemic in other major MDB borrowers such as Russia, Bangladesh, Mexico, and most of sub-Saharan Africa. It notes the following:

> 1. "Documentation of procurement, implementation, disbursement and audits for Bank-financed projects are generally complete and conform to all Bank requirements; we have moved to resolve each and every irregularity for which we have documents (as well as many cases of preventive action and informal corrections of problems)."
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> 2. "Bank staff members have not been implicated in any form of misconduct; the Bank is widely regarded as one of the few 'uncorruptable' institutions in the Indonesian development process. . . ."

What follows indicates that even when "documentation of procurement, implementation, disbursements and audits are generally complete and conform to all Bank requirements," these requirements do not address massive problems of corruption and diversion of Bank loans.

Dice goes on to note that "In aggregate we estimate that at least 20-30% of GOI [Government of Indonesia] development budget funds are diverted through informal payments to GOI staff and politicians, and there is no basis to claim a smaller 'leakage' for Bank projects *as our controls have little practical effect on the methods generally used.*" (emphasis added)

Dice notes "one of the difficulties in attempting an analysis of the nature and magnitude of such diversions is the wide range of variations in operational methods among GOI organizations." Nonetheless, the memorandum goes on to give detailed estimates of percentage diversions of specific Bank funds, such as: "Pre-Project expenses (5-10% of project budget);" "Land Acquisition and Resettlement Costs—*numerous reports of diversion of 50-80% of funds. . . .*;" (emphasis in original); "Contract Procurement and Award Process (extremely variable, 5-35%;" etc. Most remarkable is a list of estimated corruption and diversion of funds for each Indonesian Government Ministry, ranging from "relatively low (less than 15%)" at the Ministry of Health, for example, to a "high (more than 25%)" at the Ministries of Home Affairs, Transmigration, Cooperatives and SMEs, and Forestry. Below, in italics, is the chart of estimated corruption directly taken from the Memorandum:

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[1] Jeffrey A. Winters, "Down With the World Bank," *Far Eastern Economic Review,* 13 February, 1997, p. 29; Keith Loveard, "The Dark Side of Prosperity: A World Bank critic alleges waste and graft," *Asia Week,* 15 August 1997.

[2] Personal communication, member of World Bank management (must remain anonymous), September 17, 1998.

[3] "Let's not mince words we need to deal with cancer of corruption . . . Let me emphasize that the Bank Group will not tolerate corruption in the programs we support, and we are taking steps to ensure that our own activities continue to meet the highest standards of probity." World Bank President James Wolfensohn, 1996. See: http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20190202-menuPK:34457-pagePK:34370-piPK:34424-theSitePK:4607,00.html

[4] Glenn R. Simpson, "World Bank Memo Depicts Diverted Funds, Corruption in Jakarta; Report Contrasts with '97 Denials," *The Wall Street Journal,* August 19, 1998, A14.

[5] World Bank New Release No. 98/1426/EAP, "Indonesia and the World Bank," July 28, 1997.

penses (5-10% of project budget);" "Land Acquisition and Resettlement Costs—*numerous reports of diversion of 50-80% of funds. . . .*;" (emphasis in original); "Contract Procurement and Award Process (extremely variable, 5-35%;" etc. Most remarkable is a list of estimated corruption and diversion of funds for each Indonesian Government Ministry, ranging from "relatively low (less than 15%)" at the Ministry of Health, for example, to a "high (more than 25%)" at the Ministries of Home Affairs, Transmigration, Cooperatives and SMEs, and Forestry. Below, in italics, is the chart of estimated corruption directly taken from the Memorandum:

"Classification of GOI Implementing Units by Estimated Magnitude of Development Budget Diversion

Estimated Diversions Agency/Ministry

Relatively Low (less than 15%)
** Relatively small percentages of very large numbers*
** Major problems with firms owned/related to senior GOI officials*

PLN
PGN
Telecoms
Jasa Marga
Min. of Health ?
Min. of Mines and Energy

Moderate (15-25%)
Min. of Public Works
Min. of Education
Min. of Agriculture
Min. of Housing/Perumnas
Min. of Environment
Min. of Communications ?
Min. of Religous Affairs ?
Min. of Tourism, Post & Tel. ?

High (more than 25%)
Min. of Home Affairs, including all provincial and local gov'ts.
Min. of Transmigration
Min. of Cooperatives & SMEs
Min. of Forestry"

In the fifteen months subsequent to the Dice Memorandum, the Bank committed and disbursed over $1.3 billion more to Indonesia without any effective measures to contain the "leakage" detailed in the memo. In October 1998, with plans to commit and disburse an additional $2 billion over the next nine months, a second Bank mission, headed by Jane Loos, recorded the following:

> Our mission confirms earlier reports on corruption in Indonesia: that it is pervasive, institutionalized, and a significant deterrent to overall growth of the economy and effectiveness of the Bank's assistance. . . . We cannot rely on probity of audits both from BPKP (Government internal audit agency) and local associates of international audit firms. . . . Despite apparent compliance with World Bank guidelines and documentation requirements for procurement, disbursement, supervision and audits, there is significant leakage from Bank funds. . . . Bank procedures/standards are not being applied uniformly . . . The [World Bank] auditing requirements have been allowed to deteriorate into a superficial exercise; even an agency with overdue audits was not excluded from receiving new loans.[6]

The full consequences of the inability to root out the "culture of approval" were spelled out in an unusually candid reevaluation of the entire thirty-year record of the Bank in Indonesia conducted by the Bank's Operations Evaluation Department

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[6] Jane Loos, Regional Manager, EAPCO, World Bank Office Memorandum to Mr. Jean-Michel Severino, Vice President, EAP, "Options to Reduce Negative Impact from Corruption on Bank-Financed Activities," October 19, 1998.

(OED) and circulated internally (and leaked to the press) in February 1999.[7] The OED "Indonesia Country Assistance Note" of February 4, 1999 presents a major revision of the Bank's evaluation of development effectiveness in Indonesia over the past three decades.[8] For years the Bank had touted Indonesia as one of its great success stories, "widely perceived within the Bank to be a miracle and a symbol of the Bank's success." However, the OED report concludes that reluctance to offend a major borrower, a refusal to address corruption, and a dysfunctional internal Bank culture that punishes staff for identifying problems that could slow down lending, all contributed to the propagation of what the original draft of the OED report called the "myth of the Indonesian miracle." (The final report omitted this phrase in response to the objection of the Indonesian Government.)[9] The OED report rates the Bank and the Indonesian government as only "marginally satisfactory" for the past three decades, contradicting numerous previous evaluations of Bank involvement in Indonesia as a leading example, at least relatively, of development effectiveness.[10]

One of the more revealing analyses in the report describes how the culture of approval and perverse Bank career incentives led to disastrous consequences in lending for the financial sector. As the Indonesian meltdown was brewing, supervision reports indicated the Bank's single biggest financial sector project, the Financial Sector Development Project, was riddled with problems. Then,

> A thorough supervision effort in August 1996 not only found the project outcome to be unsatisfactory on all counts, but concluded that Indonesia's State Banking Sector was in disarray, riddled with insolvency. . . . the Bank downplayed the evidence presented in the supervision report and rejected the proposed cancellation of the loan for several months (cancellation was postponed until a new Banking Reform Assistance project was approved in November, 1997), arguing that such action would do serious damage to the Bank-Government relationship. This process also triggered perceptions of unjustified penalties to career prospects of some Bank staff who had brought the issues to light. The staff proposals for in-depth [financial] sector work were shelved. . . . The Bank's readiness to address the subsequent financial crisis in Indonesia was seriously impaired.[11]

The World Bank 1999 OED Country Assistance Note also recounts how the 1997 reorganization of the Bank under Wolfensohn—through which Bank management claims that anti-corruption measures became a priority—further undermined the ability of the Bank to respond to the Indonesian crisis in 1997-98:

> An unfortunate combination of staff turnover, some of it the result of policy disagreements, and the 1997 reorganization complicated the ability of the Bank to respond to the crisis. . . . The far-reaching 1997 reorganization detracted attention from economic development issues.[12]

The major recommendations of the February, 1999 OED Indonesia study echo the conclusions of countless past reports, particularly the 1992 Morse Commission and Wapenhans reports. It argues that if country monitoring is to be effective, there must be "major changes in the Bank's internal culture." Once again,

> warning signals were either ignored or played down by senior managers in their effort to maintain the country relationship. Some staff feared the potential negative impact on their opportunities that might result from challenging mainstream Regional thinking.[13]

One of the biggest obstacles to improved development effectiveness, and a major factor in the culture of loan approval flagged in the Wapenhans report, is the chronic "clientitis" of the Bank—the desire to keep lending to maintain the "country relationship," often to the direct detriment of the poor the Bank purports to be trying to help. The 1999 OED Indonesia report makes clear that in many cases a choice has to be made: "Bank strategy should look at the importance of the issues to the

[7] Association France-Presse, "World Bank Rates Its Indonesia Performance as 'Marginal,'" February 10, 1999 (wire service story); David E. Sanger, "World Bank Beats Breast for Failures in Indonesia," *New York Times,* February 11, 1999.
[8] World Bank Operations Evaluation Department, *Indonesia Country Assistance Note,* February 4, 1998.
[9] Association France-Presse, February 10, 1999.
[10] OED, *Indonesia Country Assistance Note,* February 4, 1999, 25.
[11] Ibid., 20.
[12] Ibid., 9.
[13] Ibid., 26.

country's development, and not whether the country relationship may be jeopardized." [14]

It is worth summarizing the Indonesia case since it relates to the overall management and institutional culture of the Bank, and has major implications for all of the Bank's country lending programs. In the late 1990s in Indonesia, we had a "smoking gun;" namely, a number of internal World Bank memoranda and reports that document [15] the past, ongoing, and continuing diversion of an estimated 20-30% of Bank lending by one of its major borrowers. After the first alarm was sounded by the Dice Memorandum in 1997, nothing was done and another $1.3 billion was disbursed. The 1998 Loos Memorandum repeated the same findings regarding the systematic diversion of funds in even more alarming terms. Then the 1999 OED country note linked the pressures to keep disbursing funds to Indonesia and the associated corruption to a long-documented, Bank-wide institutional problem: the culture of loan approval that pressures staff to keep lending despite abuses.

Since 1999, the Bank claims that it has mounted an anti-corruption program in Indonesia, and has reduced lending levels to approximately $400 million annually. But the problems documented in Indonesia are endemic within many of the Bank's major borrowers that rank low on the Transparency International Corruption Perception Index. For example, in most of sub-Saharan Africa many estimate that the diversion of international loans by corrupt government practices occurs on an even more serious scale than in Indonesia. It is hardly idle speculation to ask whether in Russia, Bangladesh, and in much of Latin America the systematic diversion of World Bank loans is also on the scale documented in the Dice Memorandum.

For example, in the summer of 1997, *Business Week* alleged that "at least $100 million" from a $500 million Russian Coal Sector loan was either misspent or could not be accounted for. Noting that the Bank was preparing a new $500 million loan for the Russian coal sector, *Business Week* observed that "World Bank officials seem surprisingly unperturbed by the misspending. They contend offering loans to spur change is better than micromanaging expenditures." [16] A little over a year later, the *Financial Times* estimated the amount stolen in the coal sector loan to be much higher, as much as $250 million.[17]

We have no evidence from the Bank's public statements of any systematic inquiries or estimates of diversion of World Bank lending in other major borrowers taking place, nor of the elaboration of measures to address the systematic problem of country diversion and corruption of whole lending programs.

III. THE CULTURE OF CORRUPTION: ISSUES OF FINANCIAL REPORTING AND AUDITING

Apart from the Indonesia case, in the 1990s there was also alarming documentation of the long-standing failure of internal World Bank financial auditing and reporting, as well as the systematic non-enforcement of financial reporting and management loan conditions. This failure was again linked to the culture of loan approval. While we do not have recent documentation, the findings are so alarming—yet seemingly neglected—that one can only wonder how much has changed.

One of the most astounding aspects of the 1992 Wapenhans Report was the finding that the Bank's auditing and accounting system was in shambles. Indeed, Wapenhans reported that nearly 78% of the financial conditions in World Bank loans were not adhered to, a figure he characterized as "startlingly low." [18]

Then, in late 1993 a World Bank "Financial Reporting and Auditing Task Force" reported that "less than 40% of audited financial information is received by its due date, making it inconsequential for project management purposes." [19] It found that the format of the financial information that is received often does not allow for "1) comparison with information in the staff appraisal report and 2) linkage of physical achievements with project expenditures and reconciliation with Bank disbursement records." Moreover, "financial statements and reports rarely address specific re-

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[14] Ibid.

[15] "Document" is perhaps not the accurate term, since the memoranda and reports make educated speculations on the degree of corruption, since the Bank has no precise, reliable documentation of how much is actually being stolen—if it did, that would be a big step towards addressing the problem.

[16] Carol Matlack, "What Happened to the Coal Miners' Dollars? At least $100 million from a World Bank loan is lost," *Business Week,* 8 September 1997, 52, 54.

[17] John Lloyd, "A Country Where the Awful has Already Happened," *Financial Times,* Weekend October 24-October 25 1998, XXVI.

[18] Wapenhans et al., "Report of the Portfolio Management Task Force," ii.

[19] World Bank, Central and Operational Accounting Division, "Financial Reporting and Auditing Task Force" (internal report World Bank, Central and Operational Accounting Division, Financial Reporting and Auditing), October 8, 1993, 1.

quirements of the loan agreements and rarely make reference to accounting principles and auditing standards applied." Finally, the report found that the Bank "rarely 1) reviews the borrower country's reviewing and auditing standards and 2) reviews the auditors' independence and capabilities. Financial statements received by the World Bank frequently are not reviewed by Bank staff or are reviewed by staff without the necessary skills to identify significant problems and initiate appropriate action."[20] One reads with amazement the major conclusion of the report, coming as it does from the largest public international financial institution: "As a general principle the World Bank should promote the concept that accounting is the foundation of financial management." So as the Bank approached its 50th anniversary, and, at the time, $170 billion in outstanding loans, it had learned the following: "Without efficient accounting and financial auditing arrangements project management itself is not under control."[21]

One of the accountants (a former director of the World Bank Auditing and Anti-Corruption Unit) who had worked on a the 1993 "Financial Reporting and Auditing Task Force" publicly stated that Bank auditors prepared an earlier financial reporting and auditing report in the 1980s that documented the same systemic problems. The original draft of the 1993 report referred to the fact that the recommendations of the earlier report had been ignored. Bank management had simply removed the reference to the earlier report's existence and its findings—a convenient enough way of preventing accountability, since the average tenure of an Executive Director on the World Bank's Board is two to three years.[22]

Like the Wapenhans Report, the "Financial Reporting and Auditing Task Force" report disappeared in the bowels of the Bank bureaucracy with no effective follow-up.[23] ("It is perhaps noteworthy," Mr.Wapenhans wrote in 1994, "that the Bank's management response to the Wapenhans report does not yet address the recommendation concerning accountability. The 'cultural change' required is, however, unlikely to occur unless the performance criteria change."[24])

The questions of financial auditing and reporting on the ultimate end use of Bank loans are critical in examining the World Bank's efforts to address corruption. The specific, comprehensive questions and issues set forth in the 1993 "Financial Reporting and Auditing Task Force" report are ones that should be systematically reviewed by each MDB on a regular basis. However, we have do not have answers to these questions from any of the MDBs. While the World Bank has divulged the most information about its anti-corruption efforts, an examination of its most recent public descriptions reveal that the issues of systematic diversion of World Bank resources by its borrowers, of the kind documented in the Dice Memorandum, as well as of the need for effective, rigorous financial auditing and reporting systems for its own loans, have not been adequately addressed.

IV. "HOW THE WORLD BANK FIGHTS CORRUPTION"

An examination of the most recent public document outlining the Bank's anti-corruption efforts leaves more questions open than it answers. The document, the most recent brief of the Bank's External Relations Department, which was also distributed internally to World Bank staff in response to the May 13, 2004 hearing of the Senate Foreign Relations Committee, is entitled "How the World Bank Fights Corruption" (web link: http://web.worldbank.org/WBSITE/EXTERNAL/NEWS/0,,contentMDK:20040922-menuPK:34480-pagePK:34370-theSitePK:4607,00.html). It claims, among other things, that the Bank is "making anti-corruption efforts a key focus of the Bank's analysis and lending decisions for a country" and is "striving to prevent fraud in Bank-financed projects." However, many of the Bank anti-corruption initiatives listed do not get to the heart of the problems and questions outlined above from the Indonesia case and with financial auditing and reporting. For example, the Bank highlights that "in recent years [it] has lent an average of $5 billion a year to help countries build efficient and accountable public sector institutions" and that "more than 40% or the Bank's lending operations now include public

[20] Ibid.
[21] Ibid., 2.
[22] Public Statement by James Wesberry, Former Director, Auditing and Anti-Corruption Unit, World Bank, at Northwestern University Conference, "Reinventing the World Bank," May 14-16, 1999.
[23] The follow-up was, in 1993, an 87 step "action plan" entitled "Next Steps" which Bank management proclaimed within a year was "92 percent either . . . completed or at an advanced stage of completion." World Bank, "Progress Report on Next Steps," Report No. R94-154 (Washington, D.C.: World Bank, 26 July 1994), ii.
[24] Willi A. Wapenhans, "Efficiency and Effectiveness: is the World Bank Group Prepared for the Task Ahead," in Bretton Woods Commission, "Bretton Woods: Looking to the Future" (Washington, D.C.: July, 1994), note 22, p. C-304.

sector governance components." The "How the World Bank Fights Corruption" summary goes on to note that "the Bank runs a global 24-hour a day anti-corruption hotline: 1-800-831-0463," that "the Bank has strengthened its financial disclosure rules for its senior managers and Executive Directors of the Board," and that "the Bank is an active supporter of the United Nations Convention Against Corruption."

But can the Bank give any estimate of how much money continues to be diverted through corruption in its own lending operations? Has it made any serious effort, apart from the example of the Dice and Loos memoranda in Indonesia in the late 90s, to undertake such an effort for individual countries or across the board?

To the extent we find a public answer to these questions, it is the following: "To deliver real results in fighting corruption, the Bank relies on upon the Department of Institutional Integrity to investigate claims of fraud and corruption—inside and outside the institution—and a Sanctions Committee to adjudicate cases and assess penalties."

The Department of Institutional Integrity has some 50 staff, and "so far more than 180 companies and individuals have been debarred from doing business with the Bank, and their names and sanctions posted on the Bank's external web site." Moreover, "between July 2003 and March 2004, the Bank referred 18 cases of fraud or corruption to national justice authorities."

However, while these measures are a step forward, the Bank's record, and the record of the Department of Institutional Integrity so far is not especially encouraging. The 180 "companies and individuals" debarred from future Bank business are all relatively minor players, almost entirely smaller developing country companies and some international consultants. In the case of procurement corruption in the Lesotho Highlands Water Project, the Bank's corruption investigation has been unsatisfactory despite the high level of international publicity and attention that it has received. The Lesotho courts have already convicted the following companies for paying bribes to win contracts on the World Bank-financed multi-billion dollar project: Acres International Ltd., Canada; Lahmeyer International GmbH; Germany; Spie Batignolles (Schneider Electric SA), France. Acres and Lahmeyer have already lost their cases in the Lesotho Appeals Court. Concerning Acres, the World Bank commissioned a report from the prominent Washington law firm Arnold & Porter which found sufficient evidence to indicate that Acres had engaged in corrupt practice. However, none of these major international companies has so far been debarred from doing business with the Bank.

While the Lesotho investigations have been ongoing *for more than five years,* the Bank says its investigative unit is still studying the Acres case and will later transfer it to its Sanctions Committee.

V. CONCLUSION AND RECOMMENDATIONS

The initiatives of the Bank's anti-corruption unit are inadequate to address the scale, extent, and profoundly rooted institutional problems and *internal culture of the World Bank* described in the leaked internal reports and memos discussed earlier.

The Bank's most basic fiduciary duty is to ensure its funds are not misappropriated from their intended uses. If the Bank is serious about knowing—and changing—how its money is really used, much more is needed than Bank initiatives to date.

Therefore, we would suggest that the Committee pose the following questions:

1. Has the Bank undertaken, is it or will it undertake, country-wide surveys and reviews, along the lines of the Dice and Loos Memoranda in Indonesia, to begin to estimate how much "leakage" may be occurring from its lending programs in other major borrowers where problems of corruption and diversion of foreign loans and funds are well-known?

2. If the Bank disputes the estimate of Senator Lugar, based on the testimony of Dr. Winters and others, of as much as $100 billion or more having been diverted and stolen from World Bank lending, can it provide another figure or estimate? Surely the Bank would not deny that some amount of its funds are being diverted and stolen. The Dice and Loos Memoranda leave us to conclude that $8 to $10 billion was diverted from the World Bank's lending to Indonesia alone. Does the Bank dispute these estimates?

3. Given that no one disputes that *some* proportion of World Bank and MDB loans are diverted through corrupt means, the burden of proof should be on the Bank and other MDBs not only to come up with their own estimates but to explain how they plan to work with governments to recover the stolen amounts. If there is no systematic effort to recover the stolen amounts, then the people

of borrower countries and the taxpayers of donor countries ultimately bear the costs while the MDBs let the thieves not only succeed but continue. The people of the borrowing nations end up directly and indirectly subsidizing the repayment the stolen portions of MDB loans; the taxpayers of the donor nations directly (through soft-loan windows like IDA), or indirectly (through the callable capital of hard loan windows like the IBRD) support and/or guarantee MDB lending.

4. To what extent is World Bank management ready to implement the recommendations set out in the testimony of Mr. Manish Bapna, on behalf the Bank Information Center, Environmental Defense, the Government Accountability Project, and Public Services International? The recommendations would go a long way towards addressing some of these issues.

The World Bank's current statements regarding its anti-corruption measures also do not adequately answer all the questions and issues raised in the 1993 "Financial Reporting and Auditing Task Force" report. We do not have access to later reports, but former Bank accountants and Task Managers who have been involved in the more recent Wolfensohn era anti-corruption initiatives allege that the problems persist. There are basic questions relating to financial reporting and auditing that should be posed to all the MDBs since it is likely that whatever the problems with World Bank financial management and auditing, the situation in some of the regional development banks, for example the Inter-American Development Bank and the Asian Development Bank, may be more serious.

1. At the World Bank, as well as at the other MDBs, how often are detailed, Bank-wide financial auditing and reporting surveys, that examine the reporting, auditing, and use of funds linked to project disbursements, conducted?

2. What percentage of World Bank and other MDB financial covenants are now being complied with?

3. What percentage of audited financial information for World Bank and other MDB loans is received by due dates?

4. To what extent and degree (percentage estimates) does: a) financial and audit information received by the World Bank and other MDBs from borrowers allow for comparison with information in Staff Appraisal Reports; b) information from MDB projects transparently and clearly link discrete physical construction and specific physical improvements with project expenditures and MDB disbursement records?

5. To what extent and how often do the World Bank and the other MDBs: a} review each borrower's auditing standards; b) review borrowing country auditors' independence and capabilities?

6. To what extent are financial statements and reports received by the World Bank and other MDBs actually reviewed by staff? In cases where staff reviews financial statements, how often do they possess or lack appropriate accounting and financial management skills to identify significant problems?

KARACHAGANAK FIELD, KAZAKHSTAN: THE WORLD BANK CONTRIBUTES TO POOR ENVIRONMENTAL HEALTH AND SUPPORTS CORRUPT LOCAL OFFICIALS

The World Bank's mission, as chiseled in the entryway of its headquarters in Washington, DC, is to create a world without poverty. Loans provided by the World Bank's private lending arm, the International Finance Corporation (IFC), are bound by the same mission, and should, "promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives."

In 2002, the IFC provided $150 million in loans to LUKoil, a member of Karachaganak Petroleum Operating BV (KPO), the consortium working at the Karachaganak oil and gas condensate field in western Kazakhstan. Karachaganak is one of the largest petroleum fields in the Caspian region, and is operated by British Gas, ENI/Agip, Chevron Texaco and LUKoil. Karachaganak is estimated to hold over 1200 million tons of oil and condensate and 1.3 billion cubic meters of gas. Not only is oil and condensate extracted from the field, but also refined on-site. The condensate is transported from the field through pipelines to Orenburg, Russia; the oil is piped to Aktau, Kazakhstan where it joins the Caspian Pipeline Consortium pipeline and is then carried thousands of miles to Novorossisk, Russia to be shipped by tanker to the west.

The village of Berezovka, which is home to 1,286 residents, is located 5 kilometers from the Karachaganak field. A former collective farm, the village is now home to many of the construction workers building the refinery and other parts of the facility at Karachaganak. According to Kazakhstani law, which stipulates a five-kilometer "sanitary protection zone," the villagers should be eligible for relocation from the site near Karachaganak because of exposure to toxic chemicals produced at the field. However, KPO has decreased the sanitary protection zone to 3 kilometers, effectively barring the Berezovka villagers from relocation, because of the consortium's claim of "superior technology" at the field.

Although independent testing shows that Berezovka suffers from dangerously high levels of lead, cadmium and vanadium, the IFC and KPO have failed to provide local residents with environmental monitoring data taken in the village. Villagers allege that the local police threaten individuals who speak out against the Karachaganak project. Svetlana Anosova, the leader of an initiative group in the village working to achieve relocation, was threatened by local police when she returned from Washington, DC last summer, where she met with World Bank and IFC officials about the plight of her village. Rather than receiving support from the Bank, Ms. Anosova was told by one executive director, "there are winners and there are losers in this world, and you ladies are losers." Repeated requests for additional environmental health information have been denied and the village doctor who gathered data about increasing medical problems in the community was fired after speaking with US environmental activists who traveled to the village in the winter of 2002. When questioned by Berezovka activists about their decision to lend $150 million to the project, IFC officials replied that they had not considered the effect on the village when they did their initial study of the environmental risks at Karachaganak.

An independent environmental health survey conducted by the villagers, indicates that almost 50 percent of the village population is chronically ill. The health study revealed that 688 members of the adult population suffer from headaches and memory loss. Five hundred and ninety-nine have muscular-skeletal problems, 423 suffer from significant hair loss and are losing their teeth; 413 suffer from vision loss; 401 have cardio-vascular difficulties; 375 have serious gastroenterological problems; 308 have upper respiratory illness; and 260 suffer from skin ailments.

The villagers, led by Ms. Anosova, also conducted a survey of 100 high school students in the village and discovered that 95 of them suffer from overall weakness, 83 regularly experience severe headaches, 77 suffer from memory loss and have frequent fainting spells, 67 have skin ailments, 49 experience feelings of aggression and 34 suffer from regular nose bleeds. Among 80 middle school children (ages 7 to 10) whom Ms. Anosova surveyed, 45 have frequent headaches, 38 suffer from frequent stomach aches and weakness, 29 have skin ailments, 24 suffer from memory loss, and 21 suffer from regular chest pains.

According to US environmental health specialists Linda Price King and Dr. Janette Sherman, many of the villagers' health problems are consistent with exposure to toxic chemicals, including hydrogen sulfide, carbon monoxide, carbonyl sulfide and other by-products of petroleum extraction and processing. Villagers who have sought treatment for their ailments report that when they leave the village, many of their symptoms decrease dramatically or disappear altogether, making diagnosis and treatment difficult. However, when they return to the village, their symptoms immediately recur.

Denial of access to the environmental data the villagers request from the World Bank, KPO and the Kazakhstani government is a violation of the Aarhus Convention, to which Kazakhstan is a signatory, and of the World Bank's own regulations requiring disclosure of environmentally relevant documents to the public. Corruption among local officials, including the village mayor, who is also on the payroll of KPO, has been ignored by both KPO and the World Bank. The World Bank should not provide public funds to governments and corporations engaged in activities that do not comply with World Bank standards and whose activities contribute to poverty and illness in local communities. The Extractive Industries Review has demonstrated time and again that World Bank financial support of oil, gas and mining only contributes to poverty, environmental degradation and increased corruption. Such is the case at the Karachaganak field.

For more information about the Karachaganak case, contact: Kate Watters, Executive Director, Crude Accountability, P.O. Box 2345, Alexandria, VA 22301. www.crudeaccountability.org