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**TO THE SENATE FOREIGN RELATIONS COMMITTEE**

**CONCERNING RECOMMENDATIONS TO THE MULTILATERAL  
DEVELOPMENT BANKS TO REDUCE CORRUPTION IN THEIR  
OPERATIONS**

**FOR THE  
MDB ROUNDTABLE DISCUSSION  
OCTOBER 29, 2004**

Mr. Chairman and Members of the Committee, thank you for the opportunity to contribute to this important process, which we hope will result in legislative and other measures to address corruption in MDB lending. As a follow-up to the three hearings held by the Committee on corruption in the MDBs on May 13, July 21, and September 28, 2004, Chairman Lugar has asked us to provide three recommendations to enhance transparency and accountability in the MDBs in order to reduce corruption in their operations.

Many good recommendations were put forth in the statements of various witnesses in the three hearings held by the Committee over the past several months, as well as before the roundtable discussion on October 29, 2004. The hearings and the roundtable discussion elicited some common, overarching themes which many of the specific recommendations of the witnesses tried to address. Among the two most prevalent concerns are 1) the need for countervailing measures to address the ‘pressure to lend’ and ‘loan approval culture’ which is still prevalent in the MDBs and 2) the need for coherence, harmonization and coordination of efforts among the MDBs and other publicly supported financial institutions in addressing corruption.<sup>1</sup> We have chosen and prioritized our

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<sup>1</sup> Concerning harmonization, coordination and coherence, the International Conference on Financing for Development that took place in Monterrey, Mexico in March, 2002 set forth a commitment of donors and multilateral and bilateral aid institutions to deliver and manage aid more effectively to increase development impact. A key component of the “Monterrey Consensus” has been follow-up activities to harmonize bilateral and multilateral aid policies and guidelines, including in the areas of financial management and reporting, accounting and fiduciary standards, and procurement. Indeed, since 2003 efforts in these areas have been conducted through three major inter-agency entities: a Working Party on Aid Effectiveness and Donor Practices of the Organization for Economic Cooperation and Development Assistance Committee (OECD-DAC-WP-EFF), a MDB Technical Group on Financial Management including the MDB heads of procurement; and a MDB Roundtable of Policy Directors and Advisors in the MDBs. (World Bank, “Harmonization Follow-Up: Global Architecture and World Bank Activities, October 1, 2003, SecM2003-0387/1). Although a rather formidable bureaucratic apparatus appears to have been set up, in reality there appears to be little progress in strengthening actual measures to coordinate anti-

recommendations with these cross-cutting concerns in mind.

Based on our own analysis and that of the other witnesses, I will try to summarize three major priorities that the Committee can act on relatively soon to address corruption through enhanced accountability and transparency of the MDBs.

### **A. Increased Enforcement and Deterrence**

Many witnesses emphasized the need for **more effective and increased enforcement of existing anti-corruption policies in the MDBs**. The ADB is a prime example. For example its 1998 Anti-Corruption Policy and 2000 Anti-Corruption Operational Procedures require assessing corruption risk in country and project documents, yet a systematic examination of ADB Country Strategy Papers, project appraisal and audit reports conducted earlier this year by the Bank Information Center<sup>2</sup> exposed the total non-implementation of the policy and procedures.

**For deterrence** one of the most effective measures would be **Public Cross-Debarment of any company or individual found guilty of corruption in a project financed with public money in developing countries. Cross-debarment should be applied by all of the MDBs, as well as by donor bilateral aid and export-credit agencies**. It makes no sense for one MDB to do business with a company that another MDB has debarred because of corruption—indeed one could have the grotesque situation of a company obtaining business from a MDB in the same sector in the same country where a sister MDB had found evidence of corrupt practices. Similarly, given that the MDBs, bilateral aid agencies and export credit agencies are all supported by taxpayer funds and guarantees in the donor countries, it makes little sense for a company to be debarred from doing business with the MDBs for corruption, but then to receive taxpayer-backed loans or guarantees—sometimes in the same country and sector—from a donor country’s bilateral aid or export credit agency.

Cross-debarment is something the U.S. can initiate on its own. When a company is debarred by an MDB, or found guilty of corruption in contracting with U.S. AID, OPIC or the EX-IM Bank, it should be debarred for a reasonable amount of time from business with all U.S. taxpayer-supported projects and investments abroad. Finally, a strong argument can be made that when a company is found guilty of corruption in a country — even if an MDB or bilateral agency is not involved —the company should nevertheless be subject to cross-debarment at these publicly funded institutions for a period of time.

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corruption efforts. A framework for better coordination and harmonization of financial management, reporting and auditing among the MDBs has been developed as well as standardized master documents for international competitive bidding in procurement. (Ibid., pp. 21-22). But there is no reference to strengthening anti-corruption efforts; in fact the main driver behind the current harmonization, coordination and coherence agenda is streamlining and simplifying procedural requirements for aid recipients and borrowers—a worthy goal, but one that without strengthened and better coordinated anti-corruption efforts will in all likelihood inadvertently contribute to *weakened development effectiveness*.

<sup>2</sup> Steve Herz, “‘Zero Tolerance?’ Assessing the Asian Development Bank’s Efforts to Limit Corruption in its Lending Operations” (Washington D.C.: Bank Information Center, March 2004).

It should be emphasized that **systematic, public cross-debarment**, as described above, **would be a logical, necessary element of the Monterrey Consensus harmonization process** described in footnote 1, **completing the process of coherence, harmonization and coordination of policies and practices among bilateral and multilateral development agencies.**

An equally strong and important measure to promote increased enforcement and deterrence is the recommendation of Steve Berkman to **require MDBs to provide annual estimates of the amount of money that is illicitly diverted, as well as to report on the efforts made to recover stolen funds.** As Mr. Berkman pointed out, most major retailers have estimates of what percentage of sales is lost through employee theft and shoplifting, and how much this loss is reduced through increased security measures. The World Bank produces statistics and estimates of every conceivable economic indicator except arguably the most important one for the development effectiveness of its own operations: leakage of its own loans and credits through corruption. We note that the Bank's Indonesia Country staff prepared such an estimate—with breakdowns by government ministry—of how much money was being diverted in its Indonesia country lending in 1997 and 1998 (the "Dice" and "Loos" memoranda).

The second aspect of this reporting requirement is equally important, namely that MDB management should also require its borrowers to undertake legal proceedings to recover stolen funds. MDBs should report annually on the efforts made by each borrower and by the Bank as a whole. **The MDBs have talked a lot about helping to build capacity in borrowers for financial management and addressing corruption, but ignore the single most effective and useful measure they could undertake; namely, identifying the resources of their own which are diverted and demanding recovery of these funds from borrowers.**

*In its future authorization legislation for the MDBs, the Committee should require the U.S. Executive Directors of the MDBs to promote cross-debarment of companies and individuals, as well as the institution of these reporting requirements at each MDB. The legislation should set a future deadline after which the MDBs' failure to implement cross-debarment and produce country and Bank-wide aggregate reporting estimates for leakage and recovery of lost funds would require a reduction in U.S. funding for the institution, or require that U.S. EDs not support future loans until these requirements are met.*

## **B. Strengthening the Existing Anti-Corruption Units and Initiatives at the MDBs.**

A common recommendation of many witnesses focused on strengthening the existing anti-corruption units in the MDBs through measures to ensure **greater independence and autonomy, increased and better qualified staffing, additional resources, and an expanded mandate to undertake systematic pro-active spot audits and investigations**, rather than focusing only on reactive inquiries in response to specific allegations. The anti-corruption units in the MDBs should report directly to the President

of the institution, not through intermediary layers of management.

In the case of the World Bank, for example, there has actually been a regression in the independence of the Department of Institutional Integrity (INT), which no longer reports directly to the Bank's President but rather to managing directors and the legal department. Every effort has to be made to ensure that the staff of the MDB anti-corruption units is not influenced by internal pressures to downplay sensitive investigations; career incentives in the anti-corruption units should be linked to bringing investigations to a successful conclusion. The staff should be recruited independently from the outside focusing on experienced investigators, forensic accountants, etc.

Additionally, the level of staffing in all of the anti-corruption units needs to be increased. For example, while the World Bank INT has a staff of about 55, the report undertaken by Richard Thornburgh and his associates in 2003 recommended still further increases.<sup>3</sup> The ADB anti-corruption staff numbers only five. To reach the same proportional level as the World Bank in relation to the volume of its lending, the ADB anti-corruption unit should have at least 14 professionals.

Finally, the anti-corruption efforts in the MDBs to date have been almost entirely reactive and focused on responses to specific allegations of corruption. Proactive and preventative measures, as the Thornburgh World Bank reports stress, are equally important.<sup>4</sup> The anti-corruption units of the MDBs should be given the resources and the mandates to carry out pro-active spot audits on a much larger scale, particularly in corruption-prone sectors such as the extractive industries, large infrastructure projects, and non-project lending. Additionally, as a minimum preventative measure in a high-risk sector for corruption, for all MDB-supported extractive industries' projects, companies should be required to publish the revenues they pay to governments and governments should publish the revenues they receive.

Some witnesses have suggested that the establishment of an external, independent auditing entity for the MDBs would be desirable and preferable. Over the longer term this may be true, but in the short and medium term it is essential—and more immediately practicable—to strengthen existing mechanisms.

*In its future authorization legislation for the MDBs, the Committee should require the U.S. Executive Directors of the MDBs to promote increased resources and staff for anti-corruption units, greater independence of these units, and a more pro-active investigative agenda. The MDBs should also require revenue transparency for disaggregated company payments and government receipts from all MDB-supported extractive industry projects.*

### **C. Conditioning Future MDB Replenishments and Capital Increases on GAO**

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<sup>3 3</sup> Dick Thornburgh, Ronald L. Gainer, Cuyler H. Walker, "Report Concerning the Proposed Strategic Plan of the World Bank's Department of Institutional Integrity, and the Adequacy of the Bank's Mechanisms and Resources for Implementing that Strategy," July 9, 2003. pp. 5-6.

<sup>4</sup> Ibid.

## **Audits of Lending Programs**

We support this recommendation made by former World Bank auditor and task manager Steve Berkman. It is true that the review conducted by the GAO several years ago was understaffed and had difficulty in obtaining information from World Bank staff and management. However, as the first such external audit of the MDBs, the GAO review set an important precedent. Part of the first investigation's difficulty lay in the inadequacy of resources that were allotted for the task.

We would recommend that greater resources be allocated for GAO investigations in this area, commensurate with the six areas for prospective audits that Mr. Berkman identified, viz.:

1. A representative sampling of completed project, sector, and adjustment lending operations to determine if the funds provided by the Bank had been used, as Article III, Section 5, para. (c) requires, for the purposes intended and with due consideration to cost effectiveness.
2. A review of tranche, Special Account, and Statement of Expenditure disbursements to determine if they had been properly accounted for in accordance with Article III Section 5 para (c) of the Bank's Articles of Agreement. Specific attention should be devoted to the eligibility of goods, equipment and services procured, value for money, and other anti-fraud related issues.
3. A review of the anti-corruption and fraud investigation program with due consideration for the confidentiality of ongoing investigations and any other sensitive matters.
4. A review of the amount of stolen funds recovered from individuals, companies, or other non-government entities, which are not to be confused with the cancellation of credits, or parts of credits.
5. A review of Trust Fund activities managed by the Bank.
6. A review of any other accountability issues that may be deemed appropriate.