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on behalf of

**Bank Information Center
Environmental Defense
Government Accountability Project
Public Services International**

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Combating Corruption in the Multilateral Development Banks

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).

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 evaluations².

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 operations⁴ 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 Box 1 for an example from Thailand, p. 10)

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 Box 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

Box 2
<p><u>World Bank Extractive Industry Review</u> <u>Recommendations on Core Governance</u></p>
<p>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:</p> <ul style="list-style-type: none"> • 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. <p><i>The above is taken directly from Striking a Better Balance, the Final Report of the Extractive Industries Review, December 2003</i></p>

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 country⁵. Experiences to date (for example, see Box 3 on the Chad-Cameroon Pipeline Project, p. 11) 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 (PL 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 transparency⁹.

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.

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 Klong 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 Klong Dan community, its Special Review Mission found no evidence of any irregularities. When the community asked the ADB 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.

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.

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.