

**“COMBATING CORRUPTION IN THE MULTILATERAL DEVELOPMENT BANKS”**

**TESTIMONY**

**BEFORE THE**

**SENATE FOREIGN RELATIONS COMMITTEE**

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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 & 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 & 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.



