

ASIAN DEVELOPMENT BANK

R-PAPER

ANTICORRUPTION

POLICY

**Strategy and Policy Office
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ABBREVIATIONS

ADB	-	Asian Development Bank
BPMSD	-	Budget, Personnel & Management Systems Department
COSO	-	Central Operations Services Office
CRS	-	Congressional Research Service
DMC	-	Developing Member Country
GDP	-	Gross Domestic Product
IBRD	-	International Bank for Reconstruction and Development
IFI	-	International Financial Institutions
IMF	-	International Monetary Fund
MDB	-	Multilateral Development Bank
NGO	-	Nongovernment Organization
OAS	-	Office of Administrative Services
OAS	-	Organization of American States
OECD	-	Organization for Economic Cooperation and Development
OGA	-	Office of the General Auditor
OGC	-	Office of the General Counsel
SPO	-	Strategy and Policy Office
TA	-	Technical Assistance
TI	-	Transparency International
UNDP	-	United Nations Development Programme
USAID	-	United States Agency for International Development

NOTE

In this Report, "\$" refers to US dollars.

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EXECUTIVE SUMMARY

The problem of corruption, here defined as the misuse of public or private office for personal gain, is an ancient one that can be found in every government. It can also be found in the private sector, and in the interactions between the public and private sectors. A balanced approach to combating corruption must address both sides of the equation, and make it more difficult and risky for those who would give bribes as well as those who would receive them.

Recently, a powerful combination of factors has emerged in donor and recipient countries that is providing momentum to the global anticorruption effort. At the same time, the latest empirical analysis is demonstrating that although the effects of corruption are complex and varied, it clearly exerts a negative impact upon development. As a result, the environment in which multilateral development banks (MDBs) operate has changed. Pressure for more active measures against bribery and graft is no longer likely to be isolated and sporadic, but will remain an important element of the broader debate over good governance and sound development management.

As a major multilateral development institution and one of the leading sources of development funding in the Asian and Pacific Region, the Asian Development Bank (ADB) welcomes this emphasis on anticorruption initiatives as part of its broader work on governance issues. The Bank's Board paper, *Governance: Sound Development Management*, recognizes the importance of accountability for public officials, and transparency and predictability in government operations—critical principles in the fight against corruption.¹

At the broadest level, the Bank's anticorruption policy is intended to reduce the burden that widespread, systemic corruption exacts upon the governments and economies of the region. More specifically, the Bank's policy is centered upon three objectives:

- (i) supporting competitive markets, and efficient, effective, accountable, and transparent public administration as part of the Bank's broader work on governance and capacity building;
- (ii) supporting promising anticorruption efforts on a case-by-case basis and improving the quality of the Bank's dialogue with its developing member countries (DMCs) on a range of governance issues, including corruption; and
- (iii) ensuring that the Bank's projects and staff adhere to the highest ethical standards.

The bulk of the Bank's effort will be directed toward broader measures to improve the quality of governance in the DMCs. This effort will have two components. The first will seek to reduce the scope of direct government intervention in the economy, in the belief that markets should be efficient, competitive, and have as few barriers to entry and exit as possible. This will reduce the opportunity for firms or officials to take advantage of artificially restricted markets or suboptimal pricing to demand monopoly rents.

The second component will focus upon supporting improvements in public administration and public sector management. Efforts to strengthen management information systems, for example, should enhance transparency and accountability, and strengthen the capacity of governments to monitor their expenditures. Measures to strengthen audit functions or to ensure adequate control over disbursements can play the dual role of helping to improve performance while making theft and embezzlement more easily detected. Procurement reform, which the Bank is already pursuing in a number of the DMCs, can reduce costs while making fraud and abuse more difficult to perpetrate. Steps to strengthen civil service establishment management will help to eliminate "ghost employees," and efforts to decompress pay scales and improve employment conditions will lower the incentive for illicit behavior. Measures to improve procedures for recruitment and promotion should help avoid abuses of patronage, nepotism, and favoritism, and help foster the creation of an independent, meritocratic civil service. The reengineering and streamlining of business processes can improve the efficiency and effectiveness of the public sector while simultaneously reducing opportunities for corruption.

In advancing such initiatives, the Bank affirms its desire to adopt a proactive and not a reactive stance. Most priority governance initiatives will have significant positive externalities that will make corrupt behavior more difficult to engage in and more readily detected once it occurs. Over the longer term, the Bank is likely to be much more effective if it focuses its anticorruption efforts upon measures for prevention and not on short-term efforts aimed at prosecution.

The Bank may also be called upon to assist the DMCs in pursuing an explicit anticorruption program. Bank assistance will be guided by three considerations: (i) the extent to which Bank assistance is requested by the DMC; (ii) the degree to which the request is consistent with the Bank's broader country operational strategy and ongoing efforts in the field of governance and capacity building; and (iii) the extent to which the request falls in an area where the Bank has expertise. Under this element of the policy, the Bank may also support regional anticorruption initiatives or anticorruption-related research.

ADB staff should exercise caution in addressing several sets of initiatives that will typically remain beyond the Bank's scope of involvement. They include efforts to influence the domestic debate within the DMCs regarding an anticorruption strategy or set of anticorruption initiatives; anticorruption programs that are highly politicized in nature and targeted at a particular individual or political party; and initiatives that are largely cosmetic and designed to foster the illusion of progress without the substance. To ensure consistency with the Bank's Charter, any anticorruption initiatives supported by the Bank must be apolitical in nature and motivated solely by essential economic considerations or concerns about the probity of Bank operations.

The Bank has several mechanisms for engaging in dialogue with the DMCs on issues of governance (including corruption), ranging from the country operational strategy and the country assistance program discussions, to country portfolio review missions, to project appraisal, implementation, and review missions. Bank staff charged with country strategy and program formulation, including the drafting of the country operational strategy and country assistance program documents, as well as staff responsible for loan or TA projects, should address corruption in the context of broader governance and capacity building issues. They should be knowledgeable about issues of corruption and its impact within their particular geographic and/or sectoral sphere of operations. They will use these mechanisms to discuss

and recommend ways in which the Bank can help advance the principles of sound development management, including measures that would help to combat corruption, in any country where corruption affects Bank projects and the country's general prospects for economic growth.

Country portfolio review missions and project review missions may provide a useful venue for discussing the policies and practices that impede the efficient implementation of Bank projects. Under most circumstances, staff who suspect that corruption may have occurred or be occurring within a given Bank project should follow the procedures outlined in paragraph 64 of this document and report the matter to the Office of the General Auditor, who will determine the optimal course of action. In rare cases where rapid follow-up actions may be needed, staff can address such issues explicitly with the relevant company, executing agency or appropriate investigative agencies after clearance from their director and Office of the General Counsel (OGC). Any discussion with a given firm or government agencies should, however, be limited to a specific Bank operation or set of operations.

If the Bank's efforts to reduce illicit behavior among its DMCs are to be credible, it is essential that Bank staff be beyond reproach and the Bank's internal regulations and procedures support the highest ethical standards. Toward this end, the third pillar of the Bank's anticorruption policy calls for more robust internal measures to enhance the integrity of Bank operations along five dimensions: (i) maintaining the integrity of Bank lending and TA operations; (ii) strengthening the Bank's procurement policy; (iii) updating the Bank's Code of Conduct and creating independent internal reporting mechanisms to address allegations of corruption among Bank staff or within Bank operations; (iv) improving the quality of oversight for Bank loans and TA grants; and (v) ensuring that all Bank staff are familiar with the anticorruption policy and act in a manner consistent with both the letter and the spirit of the policy.

If there is credible evidence of corruption in a Bank-financed loan or TA grant, the Bank will address the issue in dialogue with the DMC. Breaches of specific loan regulations or covenants could result in a decision by Management to blacklist the firm involved, suspend disbursements, or cancel the loan.

In keeping with the evolving practice of IMF and the World Bank, Management and staff will consider issues of corruption more explicitly in the formulation of the country operational strategy and the country assistance program. Cases may occur in which corruption has reached such proportions that it poses a significant impediment to the probity of Bank operations or the attainment of a country's fundamental development objectives. Under such circumstances, Management could elect to lower or suspend Bank lending and TA operations to that country after consultation with the country and the Board.

Conversely, situations may also exist where a given country has made significant progress in improving the efficiency, effectiveness and integrity of its public and private sectors. Under such circumstances, Management may elect to accelerate the lending program or provide additional TA resources to ensure sustainability for the reforms.

In light of the complex and highly differentiated nature of corruption, it is important that Bank Management and staff be granted some degree of flexibility in dealing with individual cases within the parameters laid out in this policy. While acknowledging the need for fairness and consistency in its operations, and strongly affirming the importance of a "zero

tolerance" policy when credible evidence of corruption exists among Bank staff or projects, the Bank notes that different types of corruption will require different responses. There is a need for careful judgment based on accurate information and the specifics of the situation. The Bank's anticorruption effort will place particular emphasis upon the implementation of practical and cost-effective prevention control measures, in a fashion consistent with the Charter principle of "economy and efficiency."

An Anticorruption Task Force under the leadership of the Project Coordination and Procurement Division was recently convened to examine Bank procurement policy. Having taken into account the advantages of harmonizing the anticorruption effort among the MDBs with regard to procurement and the engagement of consultants, the Bank will introduce anticorruption provisions effectively identical to those adopted by the World Bank in respect of rejection of proposals, loan cancellation, declaration of ineligibility and inspection rights. The Bank will also introduce an optional "no bribery pledge" in the bid form that will be similar to that of the World Bank. It will also introduce a mandatory clause that, when the contract is to be financed wholly or partly by the Bank, the contract documents shall include an undertaking by the contractor that no fees, gratuities, rebates, gifts, commissions or other payments, other than those shown in the bid, have been given or received in connection with the procurement process or in the contract execution. Following the adoption of the anticorruption policy paper by the Board, provisions to this effect will be incorporated in the Bank's *Guidelines for Procurement* and the *Guidelines on the Use of Consultants by the Asian Development Bank and its Borrowers* and submitted to the Board for approval. The *Guidelines* will be supplemented by provisions in the Bank's loan regulations allowing the Bank to cancel loans where there is evidence of corruption or fraud in connection with the award of a contract being financed by the Bank.¹

With regard to the Bank's internal policies and procedures, several measures are necessary to ensure that they are consistent with those of other MDBs and evolving best practice. Currently, there are no independent channels whereby Bank staff can report possible incidents of corruption and have them investigated. Under this policy, OGA will serve as the initial point of contact for allegations of fraud and corruption among Bank projects or staff. In consultation with Strategy and Policy Office (SPO), OGC, Budget, Personnel, and Management Systems Department (BPMSD), Central Operations Services Office (COSO) and other relevant departments, OGA will consider appropriate measures to be adopted under this policy to ensure that all Bank staff and projects adhere to the highest standards of ethical conduct.

In May 1998, Management approved revisions to Administrative Order No. 2.02; Section 4 that contains the Code of Conduct outlining staff ethical duties, rights, and responsibilities in greater detail than was previously the case.

The Bank will undertake a number of measures to improve the quality of project monitoring and audit. The capacity of OGA will be strengthened to enable it to address anticorruption issues effectively. Specialized training in forensic accounting and other investigative techniques will be provided, which will also be extended to select financial analysts and project implementation officers. Ongoing OGA efforts to streamline internal work procedures to free up greater resources for audits of high-risk and high-impact areas will

¹ Office of the General Counsel. 1986. *Ordinary Operations Loan Regulations*. ADB.
Office of the General Counsel. 1982. *Special Operations Loan Regulations*. ADB.

continue. OGA will devote more time to conducting audits of project procurement-related activities, which will help prevent and detect corruption or other forms of fraud. OGA will strengthen its exchange of information with supreme audit institutions in the DMCs, and—working in collaboration with other Bank departments—it will play an active role in assessing the need to upgrade the audit capability of such institutions.

The relevant sections in the *Project Administration Instructions* and the *Loan Disbursement Handbook* will be revised to require that qualified accountant(s) be recruited by the executing or implementing agency, and that robust internal control systems and accounting systems be in place for a project before loan disbursement can be made. Greater resources will be made available for upgrading the quality of project monitoring and implementation missions. Consideration will be given to the design of appropriate efficiency indicators, which will be utilized in monitoring financial and physical progress on a quarterly basis. The quality of the Bank's management information systems will be enhanced to provide managers with more timely information for monitoring project processing, loan administration and the status of mission budget utilization.

These measures will be ineffective if Bank staff are unfamiliar with the provisions of the Bank's anticorruption policy and Code of Conduct or fail to exercise due diligence in the performance of their duties. While it is not the intention of this policy to turn Bank staff into "police officers," or to make the objective of reducing corruption paramount over other development goals, all departments and staff have a strong obligation to ensure the integrity of Bank operations within their respective areas of responsibility. Bank staff should familiarize themselves with the content of this policy and staff guidelines, and be prepared to respond appropriately as required.

In conclusion, this paper recommends a number of concrete actions to establish the Bank's anticorruption policy. These measures can be broken down along three lines: recommended revisions of Bank policy and staff guidelines, new programming initiatives, and administrative changes.

I. INTRODUCTION

1. The problem of corruption, here defined as the misuse of public or private office for personal gain, has been one of the most enduring dilemmas confronting governments throughout history. Although differences may exist in the nature and scope of corrupt behavior, and the extent to which anticorruption measures are enforced, the phenomenon can be found at all times and within virtually every political system. It can also be found within the private sector. Indeed, the linkage between public and private sector corruption is an area of particular concern for both developed and developing countries in the Asian and Pacific Region.

2. Historically, concern about corruption has tended to run in cycles, in which revelations of official abuses prompted anticorruption campaigns and administrative countermeasures that subsequently faded from view until the next round of scandals provided further impetus for reform. The desire to reduce or eliminate corruption was at the core of many enduring innovations for good governance. The major public administration reforms of the late nineteenth and early twentieth centuries—such as the introduction of a meritocratic civil service system, and professional management of government ministries and departments, or the creation of more formalized budget, procurement, and audit processes and agencies—had their roots in the desire to avoid earlier abuses of graft and political patronage.

3. Recently, the effort to combat corruption has moved to the center of the debate about good governance and economic growth. The impetus behind this move has come from many sources. On the donor side, the end of the Cold War has reduced the willingness of countries providing aid to overlook financial improprieties in light of broader geopolitical interests. Donor fatigue has placed increasing pressure upon foreign assistance agencies to demonstrate that they are delivering maximum value for the money. Many multinational corporations have come to believe their interests are better served by open and transparent competition. At the extremes, the negative example of a handful of "kleptocratic" regimes has underscored the danger of political and social collapse if widespread corruption is allowed to fester unchecked.

4. On the recipient side, in countries throughout the Asian and Pacific Region, the citizenry has served notice that it is no longer willing to tolerate gross abuses of the public trust for private gain. The liberalization of the press in many parts of the world has enabled journalists to write more freely about official indiscretions. Improvements in education and increased information flow between countries have made their public more aware of anticorruption efforts in other countries and less willing to tolerate systematic abuses at home. The rise of new global nongovernment organizations (NGOs) dedicated to fighting corruption has helped to bring and keep the issue in the spotlight in both the developed and the developing world.

5. Many of these dynamics are likely to exist for at least the next decade or more, resulting in a fundamental change in the context within which multilateral development banks (MDBs) operate. Pressure for more active measures against graft and corruption is no longer likely to be isolated and sporadic. Like questions relating to the environment or women in development, influential and well-connected constituencies both within and outside of the MDB community will press hard to ensure that issues of corruption and good governance remain an important and ongoing element of the development debate.

6. In response to these pressures, many international organizations are adopting more robust anticorruption measures:

- (i) At a Summit of the Americas in May 1994, the Organization of American States (OAS) pledged to outlaw cross-border bribery and the "illicit enrichment" of officials in the hemisphere. In March 1996, 21 member states of the OAS signed the Caracas Convention, which calls for energetic collective action in four principal areas: preventative measures and international cooperation, transnational bribery, illicit enrichment, and extradition. The Caracas Convention is now in force between the countries that have ratified it: Bolivia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, and Venezuela.
- (ii) The Organization for Economic Cooperation and Development (OECD) Ministerial Council approved a resolution encouraging its member states to end the tax deductibility of foreign bribes and commissions for their multinational corporations in May 1996. A year later, it approved a full set of recommendations for criminalizing transnational bribery, enacting stricter accounting requirements and external and internal audit controls, tighter public procurement, and enhanced international controls. In December 1997, the OECD ratified a convention making the bribery of foreign officials a criminal offense, on a par with the bribery of local government officials in the country where the corporation is based.
- (iii) The International Chamber of Commerce recently approved revised rules of conduct that prohibit bribes and recommended that its member associations around the globe, and their member corporations, adopt and apply these tighter rules.
- (iv) In December 1996, the United Nations General Assembly passed the Declaration Against Corruption and Bribery in International Commercial Transactions.

7. One of the most forceful proponents of a tough stance on anticorruption issues is the World Bank's president, James Wolfensohn. At the annual meetings of the World Bank and the International Monetary Fund (IMF) in October 1996, Wolfensohn characterized corruption as a "cancer" on the global economy and emphasized that it was time to "put teeth" into the World Bank's efforts to address it. The managing director of the IMF, Michel Camdessus, was equally blunt, noting that Fund officials will henceforth regard it as their duty to press for anticorruption reforms in countries seeking to borrow money. In the wake of the annual meetings, a working group was established under the Development Economics Vice Presidency of the World Bank to develop an integrated anticorruption strategy. The final report, along with accompanying staff guidelines, was endorsed by the World Bank's Board of Executive Directors on 2 September 1997.

8. The World Bank's approach envisions a balanced strategy to combat corruption resting upon four pillars: (i) preventing fraud and corruption in World Bank-financed projects; (ii) helping countries that request World Bank support in their efforts to reduce corruption; (iii) taking corruption more explicitly into account in country assistance strategies, policy dialogue,

analytical work, and the choice and design of projects; and (iv) adding voice and support to international efforts to reduce corruption.¹

9. In August, the IMF took the unprecedented step of suspending the second tranche of an Enhanced Structural Adjustment Facility when one of its member countries failed to demonstrate that it was pursuing adequate measures to reduce the problem of corruption. The World Bank has strongly supported the IMF's move and warned that its own lending will be "substantially reduced" failing decisive action on the part of that government.² At the annual meetings of the World Bank and IMF in Hong Kong, China in September 1997, the commitment of both institutions to combat corruption was strongly reaffirmed.

10. The 1997 summit of the Group of Seven industrial nations, in Denver, United States, placed particular emphasis upon the role of the MDBs in combating corruption. The communiqué from the preliminary meeting of finance ministers and central bankers in April maintained, "in view of the corrosive effects of bribery and corruption generally on the achievement of sustainable economic development, growth, and stability, we welcomed the increased attention to these problems on behalf of international financial institutions and the OECD." In June, the final summit statement urged the IMF and the MDBs to strengthen their activities to help countries fight corruption, including measures to ensure the rule of law, improve the efficiency and accountability of the public sector, and increase institutional capacity and efficiency. The international financial institutions were also encouraged to promote good governance in their respective areas of competence and to collaborate fully with the World Bank's effort to establish procurement guidelines that meet the highest standards for transparency and rigor.

11. Many of the developing member countries (DMCs) of the Asian Development Bank (ADB) have played an integral role in the growing anticorruption movement. In East Asia, several countries that have enjoyed high growth rates in the past have expressed concern that perceptions of corruption can hamper their ability to attract future investment. In 1995, the People's Republic of China passed legislation requiring leading Communist Party cadre levels above the country level to declare their income. Thailand's Prime Minister pledged in January 1997 to clean up the Customs Department, which was creating numerous "hidden costs" for foreigners seeking to do business in Thailand. That same month, the President of the Philippines characterized "the nightmare of corruption in public service" as one of the country's most persistent afflictions and ordered all government departments to submit monthly progress reports on their fight against corruption within their offices.

12. On the South Asian subcontinent, the problem of corruption has become one of the most pressing issues confronting government leaders today. In Pakistan, the Prime Minister has made the effort to clean up government one of the key goals of his new administration. India's President recently characterized corruption as one of the greatest challenges now confronting his country.³

¹ See World Bank. 1997. *Helping Countries Combat Corruption: The Role of the World Bank*, Washington D.C.
² Cited in Oxford Analytica. 1997. *Asia Pacific Daily Brief*, 14 August. Other problems cited by IMF include the failure to prosecute the perpetrators of a multimillion dollar financial fraud; irregularities surrounding the award of contracts for two power projects; and the use of extrabudgetary funds to purchase a presidential jet and build an international airport in the president's home town.
³ K.R. Narayanan. 1997. "Next an India for All, Tolerant and Uncorrupt," editorial, *International Herald Tribune*, 13 August.

II. THE ADB'S RESPONSE

13. As a major multilateral development institution and one of the leading sources of development funding in Asia, the ADB welcomes this emphasis on combating corruption as part of its broader work on issues of governance and capacity building. The Bank's Board paper, *Governance: Sound Development Management*, recognizes the importance of accountability for public officials, and transparency and predictability in government operations—critical principles in the fight against corruption.¹ The policy's emphasis upon strengthening the essential prerequisites for effective public administration is designed to ensure that the fundamental building blocks for transparent, predictable, and accountable administration are in place. These building blocks include an appropriate legal framework and effective enforcement mechanisms; a professional, competent, motivated, and meritocratic civil service; transparent procurement practices; effective internal control systems; and a well-functioning independent audit office. Participation, the fourth major principle in the Bank's governance policy, is also of relevance. The experience of Hong Kong, China and Singapore demonstrates that public support is a critical asset in the long-term struggle against official malfeasance.

14. At the broadest level, the Bank's stance on anticorruption issues is intended to reduce the burden that widespread, systemic corruption exacts upon the governments and economies of the region. More specifically, the Bank's approach is centered upon three objectives:

- (i) supporting competitive markets and efficient, effective, accountable, and transparent public administration as part of the Bank's broader work on good governance and capacity building;
- (ii) supporting promising anticorruption efforts on a case-by-case basis and improving the quality of our dialogue with the DMCs on a range of governance issues, including corruption; and
- (iii) ensuring that Bank projects and staff adhere to the highest ethical standards.

15. Sections III and IV will set the stage for the discussion of these objectives by addressing the definitional questions that have surrounded the topic and the costs that corruption imposes upon development. The remainder of the paper will consider the nature of the Bank's response. Section V outlines the Bank's position on anticorruption issues and describes current Bank programs with significant anticorruption components. It also highlights the implications of the Bank's anticorruption policy for current Bank operations. Section VI concludes by highlighting specific next steps for the Bank to take in implementing this policy.

¹ R151-95: *Governance: Sound Development Management*, 17 August.

III. DEFINITIONS OF CORRUPTION

16. The term "corruption" is used as a shorthand reference for a large range of illicit or illegal activities. Although there is no universal or comprehensive definition as to what constitutes corrupt behavior, the most prominent definitions share a common emphasis upon the abuse of public power or position for personal advantage. *The Oxford Unabridged Dictionary* defines corruption as "perversion or destruction of integrity in the discharge of public duties by bribery or favor." *Webster's Collegiate Dictionary* defines it as "inducement to wrong by improper or unlawful means (as bribery)." The succinct definition utilized by the World Bank is "the abuse of public office for private gain." This definition is similar to that employed by Transparency International (TI), the leading NGO in the global anticorruption effort: "Corruption involves behavior on the part of officials in the public sector, whether politicians or civil servants, in which they improperly and unlawfully enrich themselves, or those close to them, by the misuse of the public power entrusted to them."¹

17. These definitions are useful but, in the Bank's judgment, they do not give adequate attention to the problem of corruption in the private sector or to the role of the private sector in fostering corruption in the public sector. As a shorthand definition, the Bank defines corruption as "the abuse of public or private office for personal gain." A more comprehensive definition is as follows:

Corruption involves behavior on the part of officials in the public and private sectors, in which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed.

18. A list of illicit behavior typically referred to as "corruption" is presented in Box 1. This catalogue is not exhaustive and is intended to illustrate the areas of greatest interest and concern to the Bank. Some types of corruption are internal, in that they interfere with the ability of a government agency to recruit or manage its staff, make efficient use of its resources, or conduct impartial in-house investigations. Others are external, in that they involve efforts to manipulate or extort money from clients or suppliers, or to benefit from inside information. Still others involve unwarranted interference in market operations, such as the use of state power to artificially restrict competition and generate monopoly rents.

¹ See World Bank 1997, p. 8. See also Transparency International. 1996. *The TI Sourcebook*, edited by Jeremy Pope. Berlin: TI, p.1. The World Bank definition includes the activities of private agents who subvert public policies and processes for competitive advantage.

Box 1: An Illustrative List of Corrupt Behaviors

1. The design or selection of uneconomical projects because of opportunities for financial kickbacks and political patronage.
2. Procurement fraud including collusion, overcharging, or the selection of contractors, suppliers and consultants on criteria other than the lowest evaluated substantially responsive bidder.
3. Illicit payments of "speed money" to government officials to facilitate the timely delivery of goods and services to which the public is rightfully entitled, such as permits and licenses.
4. Illicit payments to government officials to facilitate access to goods, services, and/or information to which the public is not entitled, or to deny the public access to goods and services to which it is legally entitled.
5. Illicit payments to prevent the application of rules and regulations in a fair and consistent manner, particularly in areas concerning public safety, law enforcement or revenue collection.
6. Payments to government officials to foster or sustain monopolistic or oligopolistic access to markets in the absence of a compelling economic rationale for such restrictions.
7. The misappropriation of confidential information for personal gain, such as using knowledge about public transportation routines to invest in real estate that is likely to appreciate.
8. The deliberate disclosure of false or misleading information on the financial status of corporations that would prevent potential investors from accurately valuing their worth, such as the failure to disclose large contingent liabilities or the undervaluing of assets in enterprises slated for privatization.
9. The theft or embezzlement of public property and monies.
10. The sale of official posts, positions, or promotions; nepotism, or other actions that undermine the creation of a professional, meritocratic civil service.
11. Extortion and the abuse of public office, such as using the threat of a tax audit or legal sanctions to extract personal favors.
12. Obstruction of justice and interference in the duties of agencies tasked with detecting, investigating, and prosecuting illicit behavior.

19. More narrow definitions of corruption are often necessary to address particular types of illicit behavior. In the area of procurement fraud, for example, the World Bank defines corrupt practice as "the offering, giving, receiving, or soliciting of any thing of value to influence the action of a public official in the procurement process or in contract execution." Fraudulent practice is defined as "a misrepresentation of facts in or to influence a procurement process or the execution of a contract to the detriment of the Borrower, and includes collusive practices among bidders...designed to establish bid prices at artificial, noncompetitive levels and to deprive the Borrower of the benefits of free and open competition."¹

20. It is often useful to differentiate between grand corruption, which typically involves senior officials, major decisions or contracts, and the exchange of large sums of money; and petty corruption, which involves low-level officials, the provision of routine services and goods, and small sums of money. It is also useful to differentiate between systemic corruption, which permeates an entire government or ministry, and individual corruption, which is more isolated and sporadic. Finally, it is useful to distinguish between syndicated corruption in which elaborate systems are devised for receiving and disseminating bribes, and nonsyndicated corruption, in which individual officials may seek or compete for bribes in an ad hoc and uncoordinated fashion.

IV. THE COSTS OF CORRUPTION

21. Corruption has not always been perceived as having a negative impact upon development. In earlier decades, arguments were advanced that it could have beneficial effects. In countries where public sector wages are often low and in some cases may not even be enough to live on, some maintained that it was natural for civil servants to augment their salaries by other means. It was alleged that corruption could advance economic efficiency by helping to restore artificial and administratively determined prices to market-clearing levels. Others maintained that corruption played a useful redistributive role, transferring resources from wealthy individuals and corporations to those of more modest means, or that it could serve as a tool of national integration by allowing ruling elites to entice or co-opt fractious political, ethnic, or religious groups. Finally, some scholars have argued that corruption is a natural stage of development. They note that it was generally widespread in many advanced countries until recently, when it was reduced (but not eliminated) through the gradual imposition of public sector reforms over the last century.

22. Robert Klitgaard, one of the most astute students of the problem of corruption in development, notes that these arguments have several common features.² First, they often refer to the benefits stemming from specific illicit acts and do not consider the systemic impact of corruption. Although a given incident or transaction may have positive results, it may also generate negative externalities that degrade the performance of the system as a whole and compromise the economy's long-term dynamic efficiency.

¹ In the movement to harmonize ADB procurement standards with those of the World Bank on the topic of corruption, these definitions may also be adopted by the Bank. See Section VI.

² Robert Klitgaard. 1988. *Controlling Corruption*. Berkeley and Los Angeles: University of California Press, p. 32.

23. Second, many of the alleged benefits from corruption, such as streamlining government transactions or enhancing civil service pay, only appear as such against the background of a public sector that is failing to perform effectively. The experience of economies such as Singapore indicates that patient and persistent efforts toward improved public sector management, by streamlining customs procedures or by paying wages that are competitive with the private sector, for example, are likely to result in greater benefits over time than tolerating relatively high levels of corruption to compensate for these deficiencies.

24. Third, corruption encourages people to avoid both good regulations and bad. There is no guarantee that an importer who bribes a customs official to expedite the clearance of badly needed medication one week will not bribe the official to expedite the clearance of illegal narcotics the next.

25. The task of evaluating the practical impact of corruption upon a country's development is a complicated one that is now being subject to increasing scholarly attention. Although there are instances when illicit acts can improve the economic rates of return, the bulk of the evidence indicates that corrupt actions typically generate far more costs than benefits. A study of corruption in one African country, for example, concluded that corruption intensified ethnic conflict, ruined the efficiency of municipal government and federal agencies, crippled the merit system of hiring and promotion, and generated an "atmosphere of distrust which pervades all levels of administration." A study of an Asian country found that in none of the cases under consideration was the money raised through corruption "directly and productively invested."¹ An extensive study of corruption in another Asian country concluded:

Graft and corruption has strongly affected development efforts negatively, belying the so-called "revisionist hypothesis" prevalent in the West which considers corruption as either a necessary step in the development process or a means of speeding it up. Instead [our research] found that corruption leads to the favoring of inefficient producers, the unfair and inequitable distribution of scarce public resources, and the leakage of revenue from government coffers to private hands. Less directly, but no less perniciously, corruption leads to loss of confidence in government.²

26. Upon closer inspection, many of corruption's alleged distributive, efficiency, and political benefits turn out to be illusory. Rather than enhancing a more equitable distribution of income, corruption distorts the allocation of social resources away from those who are legally entitled to them and toward the rich, the powerful, and the politically well connected. Rather than compensating civil servants for poor pay, corruption undermines the merit system and compromises service professionalism and esprit de corps. At times, it can even foster addi-

¹ The African citation is from Herbert Werlin. 1979. "The Consequences of Corruption: The Ghanaian Experience," in Monday U. Ekpo, ed. *Bureaucratic Corruption in Sub-Saharan Africa: Toward a Search for Causes and Consequences*. Washington D.C.: University Press of America, p. 253. The second citation is from Kang Sintaek. 1978. "Conclusions and Recommendations," in a paper prepared for the Fourth Working Meeting on Bureaucratic Behavior and Development, Hong Kong, August, cited in Klitgaard. 1988. p. 37.

² Ledvina V. Carino and Josie H. de Leon. 1983. *Final Report for the Study of Graft and Corruption, Red Tape and Inefficiency in Government*, cited in Klitgaard. 1988. p. 38.

tional inefficiencies within the public sector.¹ Instead of cementing political loyalties, corruption more often breeds public cynicism and resentment toward the political process and those associated with it.

27. Many studies of the cost of corruption in individual cases paint a disturbing picture of resources lost, squandered, or devoted to suboptimal uses:

- (i) Some estimates calculate that as much as \$30 billion in aid for Africa has ended up in foreign bank accounts. This amount is twice the annual gross domestic product (GDP) of Ghana, Kenya and Uganda combined.²
- (ii) Over the last 20 years, one East Asian country is estimated to have lost \$48 billion due to corruption, surpassing its entire foreign debt of \$40.6 billion.³
- (iii) An internal report of another Asian government found that over the past decade, state assets have fallen by more than \$50 billion, primarily because corrupt officials have deliberately undervalued them in trading off big property stakes to private interests or to international investors in return for payoffs.⁴
- (iv) In one South Asian country, recent Government reports indicate that \$50 million daily is misappropriated due to mismanagement and corruption. The Prime Minister stated publicly recently that the majority of bureaucrats and the administrative machinery from top to bottom are corrupt.⁵
- (v) In one North American city, businesses were able to cut \$330 million from an annual waste disposal bill of \$1.5 billion by ridding the garbage industry of Mafia domination. A particular problem was the permeation of regulatory bodies by organized crime.⁶
- (vi) Studies of the impact of corruption upon government procurement policies in several Asian countries reveal that these governments have paid from 20 to 100 percent more for goods and services than they would have otherwise.⁷

¹ In one African country, for example, each imported container shipment is inspected three times by custom officers because of the opportunity for graft and speed payments, rather than conducting a spot check based upon the previous history of the importer, as is the practice in many other countries.

² P.E. Pedersen. 1996. "The Search for the Smoking Gun," *Euromoney* (September): 49.

³ Philippine Government estimate, cited from *Reuter Newswire*. 1997. "Philippines Corruption a 'Nightmare' — Ramos," 11 January. See also *Philippine Star*. 1997. "Commission on Audit: P1.2 B Lost to Graft Each Year," 12 June.

⁴ Internal report, cited from *Business Week*. 1993. "The Destructive Costs of Greasing Palms," 6 December, p. 133.

⁵ *The News*. 1997. 28 March.

⁶ *The Financial Times*. 1997. 6 June.

⁷ Thinapan Nakata. 1978. "Corruption in the Thai Bureaucracy: Who Gets What, How and Why in Its Public Expenditures," *Thai Journal of Public Administration* 18 (January): 102-28; Clive Gray. 1979. "Civil Service Compensation in Indonesia," *Bulletin of Indonesian Economic Studies* 15 (March): 85-113; and Robert Wade. 1982. "The System of Administrative and Political Corruption: Canal Irrigation in India," *Journal of Development Studies* 18 (April): 287-328. Cited in Klitgaard. 1988. pp. 39-40.

- (vii) Corruption can cost many governments as much as 50 percent of their tax revenues. When customs officials in a Latin American country were allowed to receive a percentage of what they collected, there was a 60 percent increase in customs revenues within one year.¹
- (viii) Some estimates of the role of corruption in a European country concluded that it has inflated this country's total outstanding government debt by as much as 15 percent, or \$200 billion. In one city, anticorruption initiatives have reduced the cost of infrastructure outlays by 35-40 percent, allowing the city to significantly increase its outlays for the maintenance of schools, roads, street lamps, and social services.²

28. Although almost impossible to value accurately, the indirect costs of corruption can often dwarf its direct costs. Scarce resources are squandered on uneconomical projects because of their potential to generate lucrative payoffs, and priority sectors such as education or health suffer disproportionately. Legitimate entrepreneurial activity is hindered or suppressed. Public safety is endangered by substandard products and construction. Capital is redirected toward more transparent and predictable investment sites. Individuals who would not otherwise engage in illicit behavior decide they have no alternative, and intellectual energy is diverted from more productive pursuits to figuring out ways to "get around the system." In extreme cases, the legitimacy of the public sector itself is called into question, and governments may be confronted with political instability or collapse.

29. Although corruption is costly, its impact upon development is not uniform. Some countries can tolerate relatively high levels of bribery and graft and continue to maintain respectable rates of economic growth, whereas others cannot. Several factors influence the extent to which corruption serves as a brake upon the process of development. At the most basic level, a state's natural resource base and the sources of its comparative advantage play a critical role in its ability to attract investment.³ A second factor is the form in which corruption is practiced. In some countries, corruption is highly routinized. Payoffs are generally known in advance and concentrated at the top in a "one-stop" fashion. Such an approach may reduce transaction costs and add a measure of predictability to investment decisions, making the country inherently more attractive than others where many different officials can demand unspecified and unanticipated payments. Finally, the extent to which money remains in the country and is invested in productive economic activity, or flows abroad into foreign bank accounts, will also have an impact upon a nation's ability to tolerate relatively high levels of corruption and still enjoy decent rates of economic growth.

30. In spite of these caveats, the most recent and innovative empirical research demonstrates that—even correcting for variables such as bureaucratic efficiency—countries that tolerate relatively high levels of corruption are unlikely to perform as well economically as they would have otherwise. In a study of over 70 countries during the late 1970s and early 1980s, IMF economist Paolo Mauro found that corruption "is strongly negatively associated

¹ *Business Week*. 1993. "The Destructive Costs of Greasing Palms." 6 December, pp. 134-135.

² *Business Week*. 1993. "The Destructive Costs of Greasing Palms." 6 December, p. 135.

³ States with rare or valuable natural resources can generally attract more investment than those seeking to compete as a source of low wage, labor intensive manufacturing. Ironically, such resource-rich countries also often enjoy lower growth rates than their poorer counterparts. See Philip R. Lane and Aaron Tomell. 1996. "Power, Growth and the Voracity Effect." *Journal of Economic Growth*, 1 (June): 213-241.

with the investment rate, regardless of the amount of red tape." Mauro's model indicates that a one standard deviation improvement in the "corruption index" will translate into an increase of 2.9 percent of GDP in the investment rate and a 1.3 percent increase in the annual per capita rate of GDP growth.¹

31. This analysis is supported by other recent studies. Using data from 39 industrial and developing countries that controlled for income, education, and policy distortion, two World Bank researchers found that countries that were perceived to have relatively low levels of corruption were always able to attract significantly more investment than those perceived to be more prone to corrupt or illicit activity. This result held true for both countries where corruption was highly syndicated and predictable, and countries where it was not.² Another recent study, which utilized econometric analysis to examine the impact of corruption upon foreign direct investment in East Asia, found that perceptions of corruption had a strong and negative impact upon the flow of foreign investment. According to the study's findings, East Asia is no different from any other region in this regard.³

V. ADB'S POSITION ON ANTICORRUPTION ISSUES

32. In light of the discussion above, the Bank affirms that corrupt and illicit behavior is a serious brake upon the development process. The Bank rejects the argument that corruption's beneficial effects outweigh its negative consequences, or that it is inappropriate for international financial institutions to address such issues. The Bank notes that experience drawn from the Asian and Pacific Region and elsewhere demonstrates that significant progress can be made in the struggle against corruption if the proper legal, institutional and policy reforms are in place. The Bank welcomes the growing focus upon anticorruption issues as part of its broader effort to advance the principles of transparency, predictability, accountability, and participation under its governance policy.

33. At the broadest level, the Bank's stance on anticorruption issues is intended to reduce the burden that widespread, systemic corruption exacts upon the economies of the region and the development of the Bank's DMCs. In keeping with Article 36(2) of the Charter, Bank initiatives regarding corruption will be grounded solely upon economic considerations and concerns of sound development management. They will not involve interference in the political affairs of a DMC or be influenced by its political character.

34. More specifically, the Bank's approach is centered upon three basic objectives:

- (i) supporting competitive markets and efficient, effective, accountable, and transparent public administration as part of the Bank's broader work on good governance and capacity building;

¹ Paolo Mauro. 1995. "Corruption and Growth." *Quarterly Journal of Economics*. 681 (August): 681-711. The citations are from pages 695 and 683, respectively. It should be noted that many of these cross-country econometric studies are based on levels of perceived (versus actual) corruption, and that such studies can have problems in desegregating corruption's effects from those of other variables related to the quality of governance.

² The analysis was conducted by Jose Eduardo Campos and Sanjay Pradhan in conjunction with the 1997 World Development Report. See World Bank. 1997. *World Development Report 1997*, Washington D.C.: World Bank, pp. 102-109.

³ Shang-Jin Wei. 1997. "How Taxing is Corruption on International Investors." *Working Paper 6030*, National Bureau of Economic Research, Cambridge, MA.

- (ii) supporting promising anticorruption efforts on a case-by-case basis and improving the quality of our dialogue with the DMCs on a range of governance issues, including corruption; and
- (iii) ensuring that Bank projects and staff adhere to the highest financial and ethical standards.

A. Objective No. 1: Supporting Competitive Markets, and Efficient, Effective, Accountable, and Transparent Public Administration

35. As a matter of policy, the major thrust of the Bank's anticorruption effort will address this problem as a part of its broader work on governance and capacity building. The Bank's approach seeks to be proactive and to place a premium upon continuous efforts to upgrade the efficiency of markets and the quality of the public sector as a whole. This focus upon prevention over prosecution reflects the belief that most priority governance initiatives have significant positive externalities in the struggle against corruption. Long-term success is more likely to come through patient and persistent economic, legal and institutional reform rather than short-term and largely reactive efforts to punish wrongdoers.¹

36. There are two priority areas where the Bank will concentrate its broader governance effort: policy dialogue directed toward economic liberalization and public administration reform. Regarding the former, the Bank can use its dialogue with the DMCs to advance policy recommendations that will help eliminate market distortions and reduce opportunities for rent seeking on the part of firms or officials. The liberalization of licensing regimes, the opening up of access to foreign exchange markets, the reduction of administered prices, the expansion of credit opportunities for small farmers and business people, the removal of subsidies and soft loans to favored companies, and the introduction of a clear distinction between production and regulatory functions are all ways in which policy changes can level the playing field and reduce opportunities for corrupt or illicit behavior. The Bank is already pursuing many of these initiatives in its dialogue with the DMCs (Box 2).

¹ The detection and prosecution of illicit activities has been an important part of successful anticorruption efforts. However, the most effective approaches have combined efforts toward prosecution with an even stronger emphasis upon prevention. The Bank's own experience and comparative advantage fall strongly on the side of prevention.

**Box 2: Examples of ADB Loans and Grants
Supporting Market Liberalization and Policy Reforms**

Loan 1444 and TA 2537: Kyrgyz Road Rehabilitation Project and Institutional Strengthening of the Road Sector: In June 1996, the Board approved a loan for \$50 million to the Kyrgyz Republic for road rehabilitation. A component of this project and its associated technical assistance (TA) were designed to open the transport sector to competition so that customers are free to choose between competing alternatives on the basis of price and quality of service, and there is no government discrimination (through regulations, price controls, discriminatory licensing practices or other interventions) between government-owned and private operators of transport services.

Loan 1506: Gujarat Public Sector Resource Management Program: In December 1996, the Board approved a loan of \$250 million and an additional TA grant to the Indian state of Gujarat to improve the quality of its public sector management, to support the divestment of selected state enterprises and to improve its infrastructure. A critical objective of the Bank's policy dialogue was to reverse the impact of past policies and regulations that discriminated against private sector participation in infrastructure, including a lack of transparency of the decision-making system, the absence of regulations governing entry, evaluation of bids, and tenders, problems related to pricing and regulatory issues in monopolistic conditions, and weakness of the legal system (dispute resolution and arbitration). The goal was to reduce the involvement of the public sector in the direct provision of certain goods and services, while redefining and strengthening its regulatory role in ensuring a level playing field for public-private sector operations.

37. There are several ways in which the Bank's work in enterprise reform and financial markets development, along with its private sector operations, are contributing to increased competitiveness, transparency and accountability. The Bank is supporting a range of policy-based reforms in many countries that are intended to amend banking regulations to allow greater competition and to reduce directed lending while strengthening the capacity of regulatory agencies. This is also true in the area of capital markets, where the Bank is seeking to enhance disclosure practices and improve market surveillance. Through its private sector operations, the Bank invests in catalytic projects such as ratings agencies, which provide transparency in the capital market by publishing independent judgments on the investment quality of debt instruments, thus helping investors make informed investment decisions. The Bank is also becoming increasingly involved in strengthening corporate governance in the private companies and investment funds where it has an equity interest. In the wake of the financial crisis that has affected many countries in the Asian and Pacific Region, these efforts are being rapidly expanded. The Bank is also considering providing support for new initiatives in areas such as money laundering.

38. Particular care must be taken in dealing with issues of privatization. There are often powerful financial and economic rationales for the state divesting from activities where it has little comparative advantage. Preliminary research also indicates that, when done properly, privatization can also help to lower the level of corruption.¹ However, in many countries the privatization process has often been fraught with allegations of bribery, theft, and embezzlement. To avoid this problem, it is critical that transparent, unbiased, and fully contestable procedures be utilized in the sale of state assets. When the sale involves a natural monopoly, it is also important that capable, independent regulatory agencies be established to provide adequate oversight prior to privatization. Issues of best practice involving corporate governance will also be an important component of Bank loans and TA grants addressing issues of privatization, corporatization and public enterprise management.

39. Many basic public administration reforms during the late nineteenth and early twentieth centuries came about in response to official malfeasance. By focusing as a first priority upon comprehensive public sector reform, the Bank can help its DMCs effect changes that will make corrupt behavior more difficult to engage in and more readily detected once it occurs. A breakdown of broader reform initiatives with significant anticorruption components is presented in Appendix 1.

40. Turning first to the executive branch, there are several priority areas where efforts to upgrade the quality of a country's public administration will pay significant dividends in the struggle against corruption. Efforts to strengthen information systems, particularly those relating to financial management, should enhance transparency and accountability, and strengthen the capacity of governments to monitor their expenditures. Measures to strengthen internal audit functions and to ensure adequate control over disbursements can play the dual role of helping to monitor and improve performance while making theft and embezzlement more easily detected. Procurement reform, which the Bank is already pursuing in a number of DMCs, can reduce costs while simultaneously making it more difficult to perpetrate fraud and abuse.

41. Another area where significant progress can be made is civil service reform. As the Bank's Board paper, *Governance: Sound Development Management* notes, the cumulative effect of poor salaries, low morale and productivity, uncertain prospects for career development, and insufficient linkage of merit to promotion can foster pervasive corruption among public officials.

42. The Bank can support a number of initiatives to redress these problems. Measures to strengthen establishment management and control for civil service positions will help to ensure that there are no "ghost employees" on the payroll. Efforts to decompress pay scales and improve employment conditions throughout the civil service will lower the incentive for illicit behavior. Initiatives to reduce the number of exemptions and special allowances will make remuneration more transparent. Measures to improve procedures for recruitment and promotion should help avoid abuses of patronage, nepotism, and favoritism, and help to foster the creation of an independent, meritocratic civil service. Efforts to draft and enforce a code of ethics will clarify what is expected of civil servants and ensure adherence to appropriate norms of behavior.

¹ Daniel Kaufmann and Paul Siegelbaum. 1996. "Privatization and Corruption in Transition Economies." *Journal of International Affairs* 50 (2): 419-458.

43. Finally, one can improve the efficiency and effectiveness of the public sector while simultaneously reducing opportunities for corruption by narrowing its scope for intervention. Within ministries, agencies, and departments, one of the best approaches is the re-engineering of business processes. As procedures are simplified and streamlined, the need for "speed money" payments to expedite services disappears. At a broader level, deregulation, commercialization, and privatization can, under appropriate circumstances, achieve similar objectives. As the sphere of state activity decreases, then as a general rule the opportunity for soliciting bribes will also go down.

44. Several "good governance" initiatives relating to the legislative and judicial branches can also help in the fight against corruption. One important means to enhance accountability is to strengthen the parliament's oversight function and improve the capacity of parliamentary institutions, such as supreme audit agencies, to function effectively. Measures for legal and judicial reform, such as efforts to reduce judicial backlogs through alternate dispute resolution techniques, or to improve courtroom management to ensure cases can be tried in a timely fashion, or to enhance the independence and professionalism of the judiciary, will all have positive externalities in the struggle against corruption. The same is true for efforts to reduce critical skill gaps in areas such as accounting and audit.

45. These initiatives are noncontroversial and widely recognized to be the building blocks of solid public sector management. The Bank is already pursuing a number of such initiatives within its existing portfolio of loans and TA grants (Box 3). They will serve as the core of the Bank's anticorruption effort as part of its broader program for strengthening governance and capacity building.

B. Objective No. 2: Supporting Promising Anticorruption Efforts on a Case-by-case Basis and Improving the Quality of Dialogue on Governance Issues

46. The Bank may also be called upon to assist its DMCs in pursuing explicit anticorruption programs. Such assistance could include efforts to develop a national anticorruption strategy; improve the ability of the courts to try corruption cases; respond to requests from legislators and government officials for legal or technical assistance (TA) in drafting anticorruption statutes or professional codes of conduct; strengthen the legal mechanisms for review of administrative action, e.g., the creation of an ombudsman or provision for judicial review; or improve the capacity of anticorruption agencies to detect or prosecute illicit behavior.

47. The Bank will give careful consideration to any request from a DMC for assistance in developing an anticorruption effort. Since these activities are likely to be politically delicate and require detailed knowledge of the particular circumstances surrounding each case, the Bank will provide staff with flexibility and discretion in pursuing such initiatives on a case-by-case basis. Bank assistance should be guided by three principles: (i) the assistance must be requested by the DMC government; (ii) the request must be consistent with the Bank's broader country operational strategy and ongoing efforts in the field of governance and capacity building; and (iii) the request should fall in an area where the Bank has or can provide relevant expertise.

**Box 3: Examples of ADB Loans and Grants
for Good Governance with Anticorruption Components**

RETA 5688: Regional Long-term Audit Training Program for Members of the Asian Organization of Supreme Audit Institutions. This initiative for \$10 million was approved by the Board in June 1996. It envisions a five-year program to strengthen regional training programs for supreme audit institutions and to upgrade the training and technical audit skills of individual audit institutions.

TA 2186: Strengthening the Legal Framework for Customs Administration in the People's Republic of China. This TA program for \$646,000 was approved by the Board in October 1994. Its objectives were to assist the Customs General Administration (CGA) in (i) proposing new effective legislation and regulations relating to border control of international property rights, anti-counterfeiting duties, anti-commercial fraud measures, and external auditing; (ii) establishing a legal information system for customs legislation and regulations; and (iii) training for CGA staff in implementing these measures.

TA 2616: Public Administration Reform in Sri Lanka. In July 1996, the President approved a grant of \$276,000 to the Government of Sri Lanka to help reverse a long-term decline in the quality and capability of the public sector. Two of the goals of this initiative were to rationalize public sector cadres and to enhance the accountability of government employees by introducing results-based management systems and procedures.

Loan 1513: Support for the Public Sector Reform Program in the Republic of the Marshall Islands. In January 1997, the Board approved a loan of \$12 million to support the implementation of a public sector reform program intended to stabilize the Government's financial situation, improve the efficiency of its public sector, and enhance its ability to provide an enabling environment for private sector growth. Among the conditions in the loan plan is a commitment upon making procedures for issuing business and foreign investment licenses more transparent and predictable. They also provide for the establishment of the Office of the Ombudsman to assure the fair and independent arbitration of disputes between the Government and public at large.

48. In a similar fashion, the Bank will consider supporting regional anticorruption efforts; workshops, seminars, conferences, and training activities; research and publications

dealing with anticorruption issues; and possible collaboration with local and international NGOs whose mission or work program advances such initiatives.

49. Staff should exercise caution in addressing several sets of initiatives that will typically remain beyond the Bank's scope of involvement. They include efforts to influence the domestic debate within the DMCs regarding a particular anticorruption strategy or set of anticorruption initiatives; anticorruption programs that are highly politicized and targeted at a particular individual or political party; and initiatives that are largely cosmetic in nature and designed to foster the illusion of progress without the substance. The Bank should not provide assistance to any anticorruption measures unless there is an understanding with the DMC over the nature and scope of these initiatives and their importance within that country's overall development strategy.

50. The Bank has several mechanisms for engaging in dialogue with the DMCs on issues of governance (including corruption), ranging from the country operational strategy and the country assistance program discussions, to country portfolio review missions, to project appraisal, implementation, and review missions. Bank staff charged with country strategy and program formulation, including the drafting of the country operational strategy and country assistance program documents, as well as staff responsible for loan or TA projects, should address corruption in the context of broader governance and capacity building issues. They should be knowledgeable about issues of corruption and its impact within their particular geographic and/or sectoral sphere of operations. They will use these mechanisms to discuss and recommend ways in which the Bank can help advance the principles of sound development management, including measures that would help to combat corruption, in any country where corruption affects Bank projects and the country's general prospects for economic growth.

51. The country portfolio review missions and project review missions provide a useful venue for discussing the policies and practices that impede the efficient implementation of Bank projects. Under most circumstances, staff who suspect that corruption may have occurred or be occurring within a given Bank project should follow the procedures outlined in paragraph 64 and report the matter to the Office of the General Auditor (OGA), who will determine the optimal course of action. In rare cases where rapid follow-up actions may be needed, staff can address such issues explicitly with the relevant company, executing agency, or appropriate investigative agencies after clearance from their director and the Office of the General Counsel (OGC). Any discussion with a given firm or government agency should, however, be limited to a specific Bank operation or set of operations.

52. Consistent with the Bank's *Media Guidelines*, the President, vice presidents, and heads of offices or departments can speak to the press about issues of corruption as they deem necessary in the conduct of Bank operations. Other Bank staff are free to discuss issues of corruption in general terms, provided they follow the procedures prescribed in the *Media Guidelines*. However, they should not speak to the press about either specific examples of corruption among Bank suppliers or in DMCs, or the general level of corruption within a company or nation without previously receiving clearance from the vice president concerned or, in his or her absence, the Bank's chief information officer.

C. Objective No. 3: Ensuring Bank Projects and Staff Adhere to the Highest Ethical Standards

53. If Bank efforts to reduce illicit behavior between its DMCs and suppliers and contractors are to be credible, it is essential that Bank staff be beyond reproach, and the Bank's internal regulations and procedures support the highest ethical standards. Toward this end, the third pillar of the Bank's anticorruption policy calls for more robust internal measures to enhance the integrity of Bank operations. These measures will take place along five dimensions: (i) maintaining the integrity of Bank lending and TA operations; (ii) strengthening the Bank's procurement policy; (iii) updating the Bank's Code of Conduct and creating independent internal reporting mechanisms to address allegations of corruption among Bank staff or within Bank operations; (iv) improving the quality of oversight and management of Bank loans and TA grants; and (v) ensuring that all Bank staff are familiar with the anticorruption policy and act in a manner consistent with both the letter and the spirit of this policy.

1. Maintaining the Integrity of Bank Lending and TA Operations

54. If there is credible evidence of corruption in a Bank-financed loan or TA grant, the Bank will address the issue in consultation with the relevant country during project review or country portfolio review missions. Breaches of specific loan regulations or covenants could result in a decision by Management to blacklist the firm involved, suspend disbursements, or cancel the loan.

55. In keeping with the evolving practice of IMF and the World Bank, Management and staff will consider issues of corruption more explicitly in the formulation of the country operational strategy and the country assistance program. Cases may occur in which corruption has reached such proportions that it poses a significant impediment to the probity of Bank operations or the attainment of a country's fundamental development objectives. Under such circumstances, Management could elect to lower or suspend Bank lending and TA operations to that country after consultation with the country and the Board.

56. Conversely, situations may also exist where a given country has made significant progress in improving the efficiency, effectiveness and integrity of its public and private sectors. Under such circumstances, Management may elect to accelerate the lending program or provide additional TA resources to ensure sustainability of the reforms.

57. In light of the complex and highly differentiated nature of corruption, it is important that Bank Management and staff be granted some degree of flexibility in dealing with individual cases within the parameters laid out in this policy. While acknowledging the need for fairness and consistency in its operations, and strongly affirming the importance of a "zero tolerance" policy when credible evidence of corruption exists among Bank staff or projects, the Bank notes that different types of corruption will require different responses. There is a need for careful judgment based on accurate information and the specifics of the situation. The Bank's anticorruption effort will place particular emphasis upon the implementation of practical and cost-effective prevention control measures, in a fashion consistent with the Charter principle of "economy and efficiency."

2. Procurement Reform

58. An Anticorruption Task Force chaired by the Central Operations Services Office was recently convened to examine Bank procurement policy. The Task Force considered various anticorruption measures adopted by the World Bank in July 1996, in which it is required that borrowers, bidders, suppliers, and contractors "observe the highest standard of ethics" during the procurement and execution of contracts.¹ In implementing this approach, the World Bank will:

- (i) reject a proposal for an award if it determines that the bidder recommended for the award has engaged in corrupt or fraudulent practices in competing for the contract in question;
- (ii) cancel the portion of the loan allocated to a contract for goods or works if it at any time determines that corrupt or fraudulent practices were engaged in by representatives of the borrower or a beneficiary of the loan during the procurement or the execution of that contract, without the borrower having taken timely and appropriate action satisfactory to the World Bank to remedy the situation;
- (iii) declare a firm ineligible, either indefinitely or for a stated period of time, to be awarded a World Bank-financed contract if it at any time determines that the firm has engaged in corrupt or fraudulent practices in competing for, or in executing, a World Bank-financed contract; and
- (iv) have the right to require that in contracts financed by a World Bank loan a provision be included requiring suppliers and contractors to permit the World Bank to inspect their accounts and records relating to the performance of the contract and to have them audited by auditors appointed by the World Bank.

59. Similar provisions were introduced in the World Bank's *Guidelines for Selection and Employment of Consultants*. On 2 September 1997, the World Bank's Board agreed to an amendment to procurement guidelines to accommodate a "no bribery pledge" in the bid form, which can be inserted into World Bank-financed projects at the request of the borrower and will obligate firms to observe local laws with respect to the bribing of government officials.

60. The Task Force considered these and other measures, which were discussed with Management. In line with the recommendation of the Group of Seven industrial nations, and having taken into account the advantages of harmonizing practice among the MDBs with regard to procurement and the engagement of consultants, the Bank will introduce anticorruption provisions effectively identical to those adopted by the World Bank for the rejection of proposals, loan cancellation, declaration of ineligibility, and inspection rights, as set forth in paragraph 58. The Bank will also introduce an optional "no bribery pledge" in the bid form which will be similar to that of the World Bank. Following the adoption of the

¹ R96-112/1: *Proposed Amendments in the Bank's Loan Documents for the Purpose of Making Them More Effective in the Fight Against Fraud and Corruption*, International Bank for Reconstruction and Development, 23 July 1996.

Anticorruption Policy Paper by the Board, changes to this effect will be incorporated in the Bank's *Guidelines for Procurement* and the *Guidelines on the Use of Consultants by the Asian Development Bank and its Borrowers* and submitted to the Board for approval. The text for these changes is provided in Appendix 2. The Guidelines will further be supplemented by provisions in the Bank's *Loan Regulations* allowing the Bank to cancel loans where there is evidence of corruption or fraud in connection with the award of a contract being financed by the Bank.¹ The text of these changes is provided in Appendix 3.

61. In addition to introducing these new measures, existing Bank guidelines will be applied more rigorously and systematically to ensure greater fairness and transparency in the procurement process. Particular attention will be devoted to eliminating delays and requests for extensions in the prequalification, bid evaluation, contract award, advance payment, project start-up, and progress payment phases. Greater effort will also be devoted to scrutinizing the number and scope of change orders, including the introduction of random audits, with the aim of ensuring the appropriateness of such requests. When the contract is to be financed wholly or partly by the Bank, the contract documents shall include an undertaking by the contractor that no fees, gratuities, rebates, gifts, commissions or other payments, other than those shown in the bid, will be given or received in connection with the procurement process or in the contract execution.

62. With regard to the Bank's private sector operations, procurement issues are most relevant in the financing of infrastructure projects. In a fashion consistent with the Working Paper, *Review of Private Sector Operations*, sponsors for infrastructure projects must have been selected by the host government in a transparent manner, preferably through competitive bidding. If it is a negotiated project, the engineering, procurement and construction contract for the project must be competitively bid.

3. Updating Code of Conduct and Creating Independent Internal Reporting Mechanisms

63. OGC, in consultation with the Budget, Personnel and Management Systems Department (BPMSD), drafted amendments of Section 4 of Administrative Order No. 2.02 to extend its scope to cover matters concerning business affiliations and private activities, financial interests, investments and trading activities, and the disclosure of financial and business interests. The purpose of these amendments was to prevent the occurrence of a conflict, or the appearance of such a conflict, among staff members between their personal interests, and their duties and responsibilities as staff members. On 28 May 1998, Management endorsed these changes, and Section 4 has now become a comprehensive Code of Conduct applicable to all staff members of the Bank.

64. Additional measures are necessary to ensure that the Bank's internal policies and procedures for addressing issues of corrupt or illicit behavior are consistent with those of the other MDBs and evolving best practice. Currently, there are no publicized independent channels whereby incidents of corruption can be reported for investigation. Under this policy, OGA will serve as the initial point of contact for allegations of fraud and corruption in Bank projects or among staff. In consultation with the Strategy and Policy Office (SPO), OGC, BPMSD, Central Operations Services Office (COSO), and other relevant departments, OGA

¹ Office of the General Counsel. 1986. *Ordinary Operations Loan Regulations*. ADB, Manila.
Office of the General Counsel. 1982. *Special Operations Loan Regulations*. ADB, Manila.

will consider appropriate measures to be adopted under this policy to ensure that all Bank staff and projects adhere to the highest standards of ethical conduct.

65. In the event that Bank staff or external parties are not satisfied by OGA's preliminary finding on a particular case, they can bring it to the attention of Management, who can determine if the case should be resubmitted to OGA for further review, sent to an independent investigator or audit firm for examination, or dismissed if no further action is warranted. A subset of potential cases could also qualify for consideration by the Inspection Committee, provided that they met the criteria for inspection outlined in *Establishment of an Inspection Function* and the *Inspection Procedures* approved by the Inspection Committee on 9 October 1996.¹

4. Improving the Quality of Oversight

66. The Bank will undertake a number of measures to enhance the quality of project monitoring and audit. These measures will improve the overall quality and effectiveness of Bank-financed projects, thereby ensuring the integrity of Bank operations and making corrupt or illicit behavior more difficult to perpetrate and more readily detected should it occur.

67. The capacity of OGA will be strengthened to enable it to address anticorruption issues effectively. Specialized training in forensic accounting and other investigative techniques will be provided, and be extended to select financial analysts and project implementation officers. Additional staff with specific skills in these areas will be recruited. Ongoing OGA efforts to streamline internal work procedures to free up greater resources for audits of high-risk and high-impact areas will continue. OGA will devote more time to conducting audits of project procurement-related activities, which will help prevent and detect corruption or other forms of fraud. In collaboration with supreme audit institutions in the Bank's DMCs, OGA will also begin a series of random audits of Bank projects to monitor financial compliance and physical progress. OGA will strengthen its exchange of information with supreme audit institutions in Bank DMCs, and—working in collaboration with other Bank departments—it will play an active role in assessing the need to upgrade the audit capability of such institutions. OGA will also consider ways in which project audit reports can be made more accessible and user-friendly to operations staff. The effectiveness of these measures will be evaluated after the first year and additional steps will be considered as needed.

68. In the context of the recommendations of the Task Force on Improving Project Quality, more resources are already being made available to improve the frequency, duration and quality of project administration missions.² Care will be taken to broaden the technical expertise of these missions and to ensure that staff with relevant qualifications participate, particularly in the financial, managerial, and policy areas. Although it may not be possible to upgrade the quality of supervision for all projects across the board, additional resources will be

¹ Doc. R225-95, *Establishment of an Inspection Function*. 10 November 1995. Since many areas where corruption is most likely to occur (such as procurement or the selection of consultants) fall beyond the Bank Inspection Committee's mandate, staff anticipate that relatively few cases of alleged corruption are likely to be brought before the Committee.

² Asian Development Bank. 1995. *Report of the Task Force on Improving Project Quality*. Manila, pp. 22-26.

directed toward upgrading the supervision of projects that are particularly at risk and to initiating a program of random audits to monitor project implementation.¹

69. The relevant sections in the *Project Administration Instructions* and the *Loan Disbursement Handbook* will be revised to require that qualified accountants(s) be recruited by the executing or implementing agency and that robust internal control systems and accounting systems be in place for a project before loan disbursement can be made. Consideration will be given to designing and utilizing appropriate efficiency indicators to monitor financial and physical progress on a quarterly basis, and any variances between targeted efficiency performance and actual performance must be justified. The quality of the Bank's management information systems will be enhanced to provide managers with more timely information for monitoring project processing, loan administration and the status of mission budget utilization.

70. When there is compelling evidence that corrupt or illicit activities have hampered the effectiveness of Bank projects or lowered their rate of return, this problem should be explicitly noted in Bank documentation, including project supervisory reports, project completion reports, project evaluation reports, performance audit reports, and other relevant documents so that appropriate remedial action can be considered. Managers and staff should avoid using opaque or euphemistic language that may obscure the nature of the problem.²

5. Advancing Staff Awareness

71. These measures will be ineffective if Bank staff are unfamiliar with the provisions of the Bank's anticorruption policy and Code of Conduct or fail to exercise due diligence in the performance of their duties. While it is not the intention of this policy to turn Bank staff into "police officers," or to make the objective of reducing corruption paramount over other development goals, all departments and staff have a compelling obligation to ensure the integrity of Bank operations within their respective areas of responsibility. Bank staff will be required to familiarize themselves with the content of this policy and staff guidelines, and be prepared to respond appropriately as required.

72. The integrity of the Bank staff is one of the institution's greatest assets, and staff violations of the Bank's Code of Conduct or other relevant guidelines will be dealt with severely. Any allegation of corrupt or illicit behavior by Bank staff should be turned over to OGA, who—in conjunction with the relevant Bank departments—will determine the credibility of the accusations and the need for further investigation. Credible claims will be investigated promptly, thoroughly, and confidentially by OGA and BPMSD, who can draw upon additional expertise within or outside of the Bank as needed. In accordance with the disciplinary procedures outlined in Administrative Order No. 2.04, staff found guilty of such behavior will be subject to a number of sanctions, including reassignment, demotion, suspension without pay, restitution and/or forfeiture of pay, termination and summary dismissal.³ These sanctions will

¹ Guidelines will be issued for implementation of the proposed Anticorruption Policy. Prior to this, staff will examine the ways in which Bank operations can be streamlined and cost-effective measures for strengthening project monitoring and supervision can be introduced.

² For an excellent example of how the topic of corruption can be dealt with candidly yet diplomatically in Bank documents, see Post Evaluation Office. 1997. *Special Study on Issues Pertaining to the Engagement of Consultants in Bank Loan Projects and Their Effect on Project Performance*. ADB, Manila.

³ Section 5 of Administrative Order No. 2.04 provides for appeals procedures to the Appeals Committee and ultimately to the Administrative Tribunal.

apply equally to situations in which staff improperly and unlawfully enrich themselves and/or those close to them, and circumstances in which they induce others to do so.

73. To advance staff awareness, SPO, OGC, OGA, and BPMSD will collaborate in producing a series of internal training workshops and seminars to inform staff about the Bank's policy and to address the issues and options involved in assisting the efforts of DMC governments, suppliers, and contractors to combat corruption.

VI. CONCLUSION AND RECOMMENDATIONS

74. This paper recommends a number of concrete measures for establishing the Bank's anticorruption policy. These measures can be broken down along three lines: revisions of Bank policy and staff guidelines, new programming and project management initiatives, and internal administrative changes.

75. The following policy recommendations are submitted for consideration and approval by the Board:

- (i) Adopt the approach and recommendations contained within this document as a policy paper and as a Management directive in the form of staff instructions.
- (ii) Approve the revisions to the Bank's guidelines for procurement and on the use of consultants and the proposed amendment to the Bank's ordinary and special operations loan regulations as set forth in Appendixes 2 and 3.
- (iii) Consider additional changes in the *Project Administration Instructions* and *Loan Disbursement Handbook* to strengthen financial controls and improve reporting requirements.

76. The paper recommends the following changes in Bank programming and project management:

- (i) Continue to expand the Bank's assistance on issues of governance and capacity building, with particular attention to promoting market liberalization and public administration reform.
- (ii) Give increased emphasis to strengthening key institutions for advancing transparency and accountability in the DMCs (such as supreme audit agencies, procurement agencies, regulatory agencies, ombudsman offices, etc.) as part of the Bank's broader emphasis upon governance and capacity building.
- (iii) Where appropriate, support regional initiatives and research on advancing accountability and transparency in the Asian and Pacific Region through TA grants.

- (iv) Upgrade the quality of supervision during project implementation and strengthen project review missions, with particular emphasis upon those projects most at risk.
- (v) Develop a series of training seminars, workshops, etc., on the Bank's anticorruption policy and how staff can best advance integrity within Bank operations and in collaborative work with the DMCs.
- (vi) Publish a simplified brochure and other information materials describing the Bank's anticorruption policy for public dissemination.

77. Finally, the paper recommends the following administrative changes in Bank operations at the department/office level:

- (i) Enforce current procurement guidelines more rigorously to avoid unnecessary delays, extensions, and excessive change orders.
- (ii) Designate OGA as the initial point of contact for alleged incidents of corruption among Bank projects and staff, and instruct OGA to work out appropriate procedures for performing this function in consultation with relevant Bank departments.
- (iii) In consultation with BPMSD, consider increasing OGA's staff complement to enable it to better fulfill its responsibilities under this policy.
- (iv) In consultation with BPMSD and COSO, consider cost-effective ways to strengthen project monitoring and supervision, and any additional resources that may be necessary to perform these tasks.
- (v) Direct OGA and BPMSD to collaborate in providing training in forensic accounting and other investigative techniques to select OGA staff, financial analysts, and project implementation officers.
- (iv) Direct OGC and BPMSD to conduct a series of seminars and/or other informational activities to inform Bank staff about the revisions to Administrative Order No.2.02; Section 4 regarding the staff Code of Conduct, which were endorsed by Management on 28 May 1998.

78. To monitor and coordinate the Bank's efforts with respect to anticorruption initiatives and programming, the departments and offices concerned will be requested to provide SPO, OGA and OGC (in respect of legal frameworks and legal issues of relevance to other areas of action) with periodic appraisals on ways in which they are implementing the policy's provisions.

79. After Board approval of the Bank's operational policy on anticorruption issues, a Board paper will be circulated in due course analyzing the Bank's experience with the anticorruption policy, proposing modifications to the operational approach as necessary, and indicating more specific budgetary and other resource implications.

APPENDIXES

Number	Title	Page	Cited On (page, para.)
1	Breakdown of Governance and Capacity Building Initiatives with Anticorruption Elements	26	14,39
2	Proposed Revisions to the Bank's Guidelines for Procurement Related to Anticorruption (Sections 2.14 and 2.15)	28	20,60
3	Proposed Amendment to the Bank's Ordinary and Special Operations Loan Regulations	30	20,60

**BREAKDOWN OF GOVERNANCE AND CAPACITY BUILDING INITIATIVES
WITH STRONG ANTICORRUPTION ELEMENTS**

Target Entity	Type of Intervention	Examples
Executive Branch Civil Service Commission	<ul style="list-style-type: none"> • Revise pay and benefits to ensure comparability with alternative employment opportunities • Strengthen measures for establishment monitoring and control • Develop and widely publicize civil service code of ethics 	TA 2616 to Sri Lanka for Public Administration Reform
Ministry of Finance/Ministry of Development	<ul style="list-style-type: none"> • Strengthen management control and information systems • Strengthen expenditure monitoring and control • Support for strengthening procurement guidelines 	TA 2538 Improved Budget Management in Micronesia Loan 1506 for India Gujarat Public Sector Resource Management Program TA 2701 Institutional Strengthening of the National Office of Procurement Evaluation in Vietnam
Various Executive Branch Ministries, Agencies and Departments	<ul style="list-style-type: none"> • Streamlining and Reengineering business processes to reduce opportunities for the payment of speed money • Institute measures to make the agency/citizen interface more transparent and user-friendly, such as name tags, document requirements, posted fee schedules, etc. 	TA 2186 Strengthening the Legal Framework for Customs Administration in the PRC TA 2459: Technical Assistance to Nepal for Efficiency Enhancement of Customs Operations

Target Entity	Type of Intervention	Examples
<p>Legislative Branch Supreme Audit Agency</p> <p>Parliamentary Research Institutions</p> <p>Ombudsman Office, etc.</p>	<ul style="list-style-type: none"> • Enhance capacity and independence of Supreme Audit Agency • Strengthen capacity of Parliament to serve independent watch-dog function • Strengthen access of citizens for independent redress of grievances 	<p>RETA 5688 Regional Long-Term Audit Training Program for Members of the Asian Organization of Supreme Audit Institutions</p> <p>TA 2463 for Institutional Strengthening of the Office of the Auditor General in Fiji</p> <p>USAID/CRS Efforts to Strengthen Parliamentary Capacity in Economies in Transition</p> <p>TA 2599 Civil Service Reform Implementation for Marshall Islands-</p> <p>UNDP Project on Policy Coordination and Governance in the South Pacific</p>
<p>Judicial Branch Reducing Judicial Backlog</p> <p>Strengthening Primary Institutions: the Judiciary and Ministry of Justice</p> <p>Strengthening Secondary Institutions: Law Schools and Local Legal Research</p>	<ul style="list-style-type: none"> • Developing mechanisms for alternative dispute resolution • Continuing education for judges and lawyers • Introduce updated court management systems and information systems 	<p>TA 2779 for Alternative Dispute Resolution in India</p> <p>TA 2727 Restructuring and Capacity Building in Mongolia's Ministry of Justice</p>
<p>Civil Society Business-Government Councils</p>	<ul style="list-style-type: none"> • Providing feed-back loops between business and government on general good governance issues 	

**PROPOSED REVISIONS TO THE BANK'S GUIDELINES
FOR PROCUREMENT RELATED TO ANTICORRUPTION ¹**

In keeping with evolving best practice among Multilateral Development Banks, Sections 2.14, 2.15 and 2.16 of the Bank's *Guidelines for Procurement* will be modified as follows:

Fraud and Corruption

2.14 It is the Bank's policy to require that borrowers (including beneficiaries of Bank loans), as well as bidders/suppliers/contractors under Bank-financed contracts, observe the highest standard of ethics during the procurement and execution of such contracts. In pursuance of this policy, the Bank:

- (a) defines, for the purposes of this provision, the terms set forth below as follows:
 - (i) "corrupt practice" means behavior on the part of officials in the public or private sectors by which they improperly and unlawfully enrich themselves and/or those close to them, or induce others to do so, by misusing the position in which they are placed, and it includes the offering, giving, receiving or soliciting of any thing of value to influence the action of any such official in the procurement process or in contract execution; and
 - (ii) "fraudulent practice" means a misrepresentation of facts in order to influence a procurement process or the execution of a contract to the detriment of the borrower, and includes collusive practices among bidders (prior to or after bid submission) designed to establish bid prices at artificial, non-competitive levels and to deprive the borrower of the benefits of free and open competition;
- (b) will reject a proposal for award if it determines that the bidder recommended for award has engaged in corrupt or fraudulent practices in competing for the contracts in question;
- (c) will cancel the portion of the loan allocated to a contract for goods or works if it at any time determines that corrupt or fraudulent practices were engaged in by representatives of the borrower or of a beneficiary of the loan during the procurement or the execution of that contract, without the borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation;
- (d) will declare a firm ineligible, either indefinitely or for a stated period of time, to be awarded a Bank-financed contract if it at any time determines that the firm has engaged in corrupt or fraudulent practices in competing for, or in executing, a Bank-financed contract; and

¹ Similar provisions will be inserted into the Bank's *Guidelines on the Use of Consultants by the Asian Development Bank and Its Borrowers*.

- (e) will have the right to require that, in contracts financed by a bank loan, a provision be included requiring Suppliers and Contractors to permit the Bank to inspect their accounts and records relating to the performance of the contract and to have them audited by auditors appointed by the Bank.
- 2.15 With the specific agreement of the Bank, a borrower may introduce, into bid forms for large contracts financed by the Bank, an undertaking of the bidder to observe, in competing for and executing a contract, the country's laws against fraud and corruption (including bribery), as listed in the bidding documents. A footnote should also be inserted into documents where such a pledge has been inserted noting that it has been placed there at the request of the borrower.
- 2.16 When the contract is to be financed wholly or partly by the Bank, the contract documents shall include an undertaking by the contractor that no fees, gratuities, rebates, gifts, commissions or other payments, other than those shown in the bid, have been given or received in connection with the procurement process or in the contract execution.

**PROPOSED AMENDMENT TO THE ORDINARY
AND SPECIAL OPERATIONS LOAN REGULATIONS**

Section 8.03 of the Ordinary Operations Loan Regulations and the Special Operations Loan Regulations will be amended to read as follows. The relevant revisions have been underlined:

Section 8.03. Cancellation by the Bank. If (i) the right of the Borrower to make withdrawals from the Loan Account shall have been suspended with respect to any amount of the Loan for a continuous period of thirty (30) days, or (ii) at any time the Bank determines, after consultation with the Borrower, that any amount of the Loan will not be required for the purposes of the Project, or (iii) at any time the Bank determines, with respect to any contract to be financed out of the proceeds of the Loan, that corrupt or fraudulent practices were engaged in by representatives of the Borrower or of a beneficiary of the Loan during the procurement/consultant selection or the execution of such contract, without the Borrower having taken timely and appropriate action satisfactory to the Bank to remedy the situation, or (iv) at any time, the Bank determines that the procurement of any contract to be financed out of the proceeds of the Loan is inconsistent with the procedures set forth or referred to in the Loan Agreement, or (v) by the date specified in the Loan Agreement as the closing date for withdrawals an amount of the Loan shall remain unwithdrawn from the Loan Account, the Bank may by notice to the Borrower and the Guarantor, if any, terminate the right of the Borrower to make withdrawals with respect to such amount or contract. Upon giving of such notice, the amount of the Loan or the relevant portion thereof shall be canceled.