



U.S. TREASURY DEPARTMENT OFFICE OF PUBLIC AFFAIRS

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STATEMENT OF ASSISTANT SECRETARY CLAY LOWERY BEFORE THE SENATE FOREIGN RELATIONS COMMITTEE ON THE MULTILATERAL DEVELOPMENT BANKS AND THE FIGHT AGAINST CORRUPTION

Chairman Lugar, Senator Biden, Members of the Committee, I'm pleased to testify today on a critical imperative facing us at the multilateral development banks (MDBs). The Administration has one fundamental policy goal for the MDBs – to use programs, projects, and advice to assist countries in reducing poverty by increasing economic growth. There is no issue that undermines that goal more than that of corruption. Corruption compromises development like no other impediment, resulting in squandered resources and ineffective efforts to combat illiteracy, disease, high infant mortality, and a polluted environment. This has been a top priority from the first day of the Bush Administration, and we know it has been a top priority for you, Mr. Chairman, and your whole committee.

We see two great challenges. First, we must attack the corruption around the world that keeps nations poor. President Bush has launched a series of initiatives to tackle this problem – from crafting the Monterrey Consensus on Financing for Development, to creating the Millennium Challenge Account, to launching anti-corruption initiatives through the G8, to taking on money laundering, terrorist financing, and searching out and returning the stolen assets from the kleptocrats of the world.

The second challenge is reforming the MDBs to root out any corruption within the institutions themselves and to make them effective instruments for attacking corruption in borrowing nations.

We are advancing a comprehensive reform agenda at the MDBs to address both of these challenges. And we have a strong new ally at the World Bank in its new President, Paul Wolfowitz. He has made fighting corruption in all areas of the World Bank's engagement one of his primary goals since coming to the Bank. Examples of this commitment thus far include:

- **Chad** where the Bank has suspended disbursements in response to the government's recent unilateral amendments to the **Petroleum Revenue Management Law**, which was negotiated with the World Bank to improve transparency and ensure allocation of oil revenues to priority sectors such as health and education;
- **India** where the Bank has held up consideration of a health project due to concerns about procurement irregularities and has suspended disbursements of approximately \$400 million for transportation projects due to safeguard violations;

- **Republic of Congo**, where concerns about allegations of corruption in the state-owned oil company resulted in President Wolfowitz's insisting on the **significant strengthening of conditions** for debt relief under the HIPC initiative;
- **Uzbekistan** where consideration of the **Country Assistance Strategy** has been delayed due to good governance concerns;
- The Bank's **Department of Institutional Integrity (INT)**, which President Wolfowitz has reinvented and restructured to make its authority clear and its operations more effective.

The United States supports President Wolfowitz's leadership on corruption and his progress to date. We also sought and continue to support the recent commitment of all MDB Heads to harmonize their strategies in the fight on corruption. But the job is far from finished, and we will continue to work with all the MDBs to advance the anti-corruption agenda as our highest priority.

Progress Made and the U.S. Plan to Further the Anti-Corruption Agenda

Only 10 years ago did the discussion of corruption begin in earnest at the MDBs, thanks in large measure to James Wolfensohn, former president of the World Bank. But U.S. leadership also played an important role in focusing the discussion and providing support for efforts on anti-corruption reform. The result is that each MDB has recognized the importance of fighting corruption and, with varying degrees of success, has taken on reforms at both the country and the institutional level.

Fighting corruption is not easy, however, even in the United States, where there are high fiduciary standards, well developed legal systems, and a relatively open and transparent society that demands accountability. For countries where institutions and standards are weak, where the political system is neither accountable nor transparent, and where individuals may have been beaten down and become resigned to corruption as a way of life, fighting this scourge is an extremely daunting challenge. Although the MDBs have developed and mobilized a variety of tools to focus on the quality of public-sector institutions, the World Bank's Review of Development Effectiveness for 2004 indicates that there is "little evidence that governance is improving and corruption decreasing." Because of corruption's pervasive nature, deep institutional changes are necessary across the multilateral development banks in order to make real progress in the fight.

That is why we appreciate the added attention to these efforts that this committee has provided in recent years. We fully support the implementation of the policy goals laid out in the FY06 appropriations legislation, and in particular -- we endorse the aim of the legislation to improve transparency of operations, link project results to staff performance, strengthen procurement standards, and enhance coordination across the MDBs on definitions of fraud and corruption and cross-debarment procedures. These are important, necessary, and logical steps in eliminating corruption. In support of these goals, each U.S. Executive Director has developed an action plan for implementation, including time lines.

To make inroads on corruption, there must be a system of mutual accountability in place. To strengthen the system of accountability, the most critical areas of focus for the anti-corruption campaign involve four key policy objectives: strengthening institutional transparency and accountability, promoting good governance in recipient countries, improving fiduciary safeguards, and advancing the results agenda.

Institutional Transparency and Accountability

To protect against internal corruption, it is essential to ensure that each MDB has its own house in order. This committee has held a series of hearings over the last few years about progress -- or the lack thereof -- in fighting corruption in these institutions. Instead of recapping all of that, I thought it would be most

valuable to highlight where, with strong backing from the United States, the MDBs have made specific progress in the areas related to the legislation you passed last year, with particular emphasis on the areas of harmonizing anti-corruption and procurement efforts, strengthening whistleblower protections, increasing transparency, and building internal mechanisms to ensure accountability.

In order to strengthen the operations of the internal investigative function in each institution, the MDBs must move forward to standardize their definition of corruption and to ensure that compliance and enforcement actions taken by one institution are supported by all others. To this end, we welcome the recent announcement by the Heads of MDBs to establish a task force to develop a uniform Framework for Preventing and Combating Fraud and Corruption for agreement by the September World Bank Annual Meeting. This is the first step in harmonizing the MDB response to corruption. A working group will continue to refine these definitions and work toward harmonizing other aspects of the sanctioning of fraud and corruption at the MDBs. In fact, the Inter-American Development Bank (IDB) has already adopted the current definitions agreed to by the working group, including a common cross-debarment policy.

The MDB's whistleblower policies also bear reviewing, as it is critical that employees feel they can report abuse without reprisal. We see the strengthened INT operations at the World Bank as one way of supporting whistleblower protections, but all the MDBs need to continually update their whistleblower policies to reflect best practices in the public and private sectors. The Asian Development Bank, for example, has recently implemented measures to protect the identity of whistleblowers, including secure phone lines, emails, faxes and confidentiality procedures and is planning further enhancements.

Another way to improve accountability is through increasing transparency of operations at the MDBs. The U.S. insistence on institutional transparency over the last several years has led to revised disclosure policies at virtually all the development institutions. Just last month, for example, the Board of Directors at the International Finance Corporation (IFC) approved a new policy that includes the presumption of disclosure of non-proprietary information about IFC activities and the release of Board minutes.

Internal audit departments can play a key role in strengthening the accountability of the institutions themselves. We are encouraged that the World Bank's Internal Audit Department (IAD) is implementing a strong audit work program. IAD, reporting regularly both to President Wolfowitz and the Board's Audit Committee, is making significant contributions to risk management of the World Bank Group and to increasing the efficiency and effectiveness of the Group's operations. It is important that internal audit function in all the MDBs be given appropriate status by management and be provided adequate staff and resources to conduct audits and to follow up to ensure the implementation of recommendations. The progress to date at all institutions is commendable, and it is encouraging that the MDBs are taking action on these issues, thanks in no small part to the advocacy of the U.S. government on these issues.

Good Governance in Recipient Countries

In order to make inroads on corruption at the country-level, however, the MDBs need to help countries improve accountability by increasing country capacity and advocating good governance. This is an area in which the MDBs have committed significant resources, but unfortunately projects focusing on governance have had mixed success. To really be effective in the fight on corruption, the MDBs need to continue their work on building governance and institutional capacity, but with a better eye to ensuring ownership and results.

Assistance to help countries build successful and accountable public-sector institutions continues to be substantial, with the World Bank alone providing over \$2.83 billion in FY 2005. When adding sectors of law and justice, the assistance to improving governance and building capacity equates to roughly 25

percent of total commitments of both IBRD and IDA in 2005. Spending on governance projects increased by one-third at the Asian Development Bank (AsDB) to 14 percent of all lending in 2005 and accounted for 15 percent at the IDB. The assistance is directed to a wide range of governance issues, such as judicial reform to strengthen the rule of law, tax policy and revenue collection measures aimed at ensuring tax compliance and accountability, fiscal transparency and accountability, and procurement reform to help remove incentives for government corruption.

Despite the challenges in developing countries, there are projects that are helping countries make important strides to improve governance. In the Philippines, for example, the Supreme Court adopted recommendations arising from a recently completed AsDB technical assistance project on reforms to the judicial system. These recommendations will be implemented under a World Bank loan. In Bolivia, the IDB has a project to strengthen capacity in the Finance Ministry to develop an e-government procurement program. The program will have an additional indirect effect of permitting greater public accountability for the Ministry's funds. Recognizing that building capacity can be significantly more challenging sometimes than building a road or school, we are nevertheless troubled that building governance and capacity has produced mixed results.

Reasons for the mixed results were presented in a recent internal AsDB review of the implementation of its anticorruption and governance policies. The AsDB concluded that the Bank has not yet completed the process of mainstreaming governance and anticorruption throughout the institution. Challenges included inadequate identification of governance and corruption risks in country strategies, too many small projects covering too many areas, thinly-deployed staff resources, and insufficient emphasis on public financial management systems. While the review identified a number of weaknesses, the candidness of the report and management's decision to prioritize strengthening its anticorruption and governance efforts under the next Medium Term Strategy illustrate the AsDB's enhanced commitment to fight corruption.

Despite these challenges, there are promising steps to improve governance through the MDBs because of the changing incentives. For example, indicators in the World Bank/IFC *Doing Business* report highlight where countries need to dedicate resources to improve the business environment. Increasingly countries are asking how they can improve their rankings, with the recognition that through improved efficiency and systems, there is less government waste, fewer opportunities for corruption, and more opportunities for investment.

At the institutional level, the World Bank has embraced good governance as a key area in the focus of its Country Assistance Strategies because of its importance to development sustainability. The World Bank and IFC, supported by other donors, have developed indicators to measure and track country performance in public financial management. Finally, the country incentives for good governance are driven by the performance-based allocation (PBA) systems, which allocate resources of the concessional windows across the MDBs on the basis of performance. Scarce resources should go where they will be used most effectively, and the PBA systems serve as a critical part of this incentive structure. For instance, the AsDB's weighting on governance factors in terms of measuring country performance has increased from 30 percent to 50 percent in just the last year. And in IDA, in the mid 1990s, the best performers received roughly 40 percent more on a per capita basis than the worst performers; today that figure is over 350 percent.

Strengthening Fiduciary Safeguards

When we think about corruption it is easy to have a picture of cases of grand-scale corruption, such as those of former Liberian leader Charles Taylor or the late Nigerian dictator Sani Abacha. The most egregious cases are often much easier to identify than the much smaller abuses, but it is the smaller scale mishandlings that can really add up, unless the appropriate fiduciary safeguards are in place. Thus,

effective MDB project supervision and rules for procurement, disbursement, and audit are essential for protecting development resources, as well as for achieving and sustaining development results.

Unfortunately, on one key aspect of international standards the U.S. is finding itself increasingly at odds with the donor community. The harmonization agenda of the OECD Development Assistance Committee (DAC) is encouraging development assistance providers to use countries' own procurement systems rather than internationally agreed standards. The appropriate direction of harmonization should be upward and to a widely accepted international standard.

We believe countries should use the World Bank's procurement standards – not only because they are the best in the business -- but also because the international business community is familiar with them and this promotes fair competition. At the other MDBs, we are trying to hold procurement standards to the highest-common denominator rather than the lowest. We have been urging all the MDBs to harmonize strong procurement standards by adopting the World Bank's procurement guidelines. The IDB did so last year. Unfortunately the AsDB failed to follow suit despite recent attempts to work with them on this. Strong procurement and disbursement guidelines create accountability and transparency, without which there is room for corruption.

Results Measurement and Performance

A critical win for the U.S. has been the acceptance in the donor community of the results agenda – embracing results measurement at the country and now increasingly at the institutional level. We believe this will improve accountability and effective use of scarce development resources. Results measurement is an integral aspect of the anti-corruption discussion because it is a way to ensure that resources are allocated on the basis of tangible outcomes. Focus on results demands country and institutional accountability for actions and hopefully can improve institutional efficiency as well.

The measurable results agenda supported by the U.S. has been broadly recognized in the donor community as an essential tool for ensuring effective aid delivery at the project level. The good news is that now all project documents considered by the Executive Directors of the World Bank, AfDB, AsDB, IDB, and EBRD identify project objectives, which are subject to subsequent evaluation. The World Bank and AsDB are now incorporating results frameworks in all their new country strategies. For example, the AsDB's recent Bangladesh country strategy, which was the product of extensive consultations with civil society groups, comprises detailed and time bound development targets, including those on critical structural reforms related to governance.

Incorporating a matrix of expected results in project planning is the first step; however, as a next step, the MDBs now need to ensure that effective oversight occurs during project implementation, allowing managers to recognize early on when a project is off-track and corrective action needs to be taken. The track record on this is improving, and one encouraging example of accountability is in Honduras where the community monitored all aspects of health and education projects and met regularly with World Bank staff. The community volunteers assessed the projects on an ongoing basis and were in a position to let staff know if things were off-track.

At the institutional level, the U.S. has pushed for stronger links between project performance, staff compensation, and budget allocations. The AsDB recently implemented a new performance management system that assesses staff on the basis of performance against development outputs and rewards the top 10 percent of achievers. The World Bank is currently preparing to implement fully an Operational Policy of Results Measurement, which will effectively codify the importance of results at the center of Bank operations.

However, despite their commitment to results, significant hurdles to the implementation of the results agenda within the institution remain. The World Bank needs to link the decision-making processes of

human resources, operations, and the budget, allowing the results agenda to have an impact in the form of allocation of resources. The IBRD and IDA have not yet fully tied program budgets to results, but Bank management anticipates completion of this project by the beginning of its 2008 fiscal year. Meanwhile, at all of the MDBs except the IFC, there is a missing link to the results agenda as there does not appear to be any move to directly link staff or management compensation to project performance. Bottom line: while there is progress on the results agenda across the MDBs, more needs to be done in terms of implementation of results measurement at the institutional level.

Making results measurement and strong fiduciary policies our priority in the MDB reform process serves a distinct purpose in the fight on corruption because it helps ensure accountability. In turn, accountability ensures that donor resources are used effectively and serves as an effective method to decrease the opportunities for corruption at the project and institutional level.

Conclusion

There is no easy fix or answer to corruption, and it remains a very serious impediment to growth, poverty reduction and improved living standards in the world's poorest countries. While we have made progress in focusing the MDBs on the fight against corruption, we are still a long way from victory. As I testify before you today I find reason for optimism in the recent steps taken by President Wolfowitz and other MDB Heads to intensify their efforts to tackle the problem both systematically and systemically. We will continue our intense efforts to push this agenda and look forward to our continuing cooperation and dialogue with Congress on the best ways to achieve concrete results. I can assure you that we will continue to pursue this cause tirelessly. Thank you for your time, and I look forward to answering any questions you may have.