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Anti-Corruption Efforts of the MDBs

Mr. Chairman, members of the Committee, I am extremely pleased to be here today to discuss efforts of the Inter-American Development Bank to address corruption and increase transparency. Although I have not been in my current position for very long, I hope I can answer the Committee's questions and shed light on how the IDB operates.

One of my primary concerns is development effectiveness; by effectiveness I mean that the development efforts of the IDB can only have their intended impact if projects and policies are implemented transparently and free of corruption from inception to completion. When the bank provides loans and technical assistance grants to the most vulnerable populations of the Western Hemisphere, guaranteeing the efficacy of those resources is critical. While multilateral development banks are accountable to all shareholders, they can be important vehicles to transmit US policy interests.

I would like to focus my remarks today on three levels of anti-corruption efforts by the IDB: within the institution, by project, and by country, and provide you with a U.S. view of the Bank's progress in each of these areas. The IDB has accelerated its progress in these areas recently, but still has much work to do. The Office of the US Executive Director has been, and will continue to be, a strong advocate for reform at the IDB. I am aware of the considerable challenges facing the IDB in the area of anti-corruption. My focus in the US Executive Director's Office will continue to be on critical areas that impact the Bank's core development mandates. Among my current priorities are: an overhaul of the IDB's corporate and country project procurement systems, creation of a separate audit committee of the Board and adoption and implementation of an internationally recognized framework of internal controls, and further work on disclosure and transparency in IDB projects and policies.

Institutional Efforts

The IDB has made significant strides with respect to institutional anti-corruption issues. Progress is being made on creating an institutional culture which promotes transparency. The new Information Disclosure policy, adopted late last year, contains a strong statement on the presumption of disclosure. As a result of strong U.S. advocacy, the policy, including release of the Minutes of Executive Board meetings, advances the IDB beyond many of the standards in other MDBs and includes several of the objectives of the transparency language in Section 581 of the FY 2004 Appropriations Legislation on which the Treasury Department worked closely with this Committee. As part of the IDB policy, an annual review of implementation will be conducted. I will use this opportunity to advocate for additional measures to enhance disclosure.

As you may know, President Iglesias has made a strong commitment to fight against corruption within the Bank and in the Bank's member countries. To strengthen his pledge to fight corruption at the IDB, the Office of Institutional Integrity was created in 2003, and is now responsible for pursuing allegations of impropriety through three different Bank committees -the Oversight Committee on Fraud and Corruption, the Conduct Review Committee and the Ethics Committee. Allegations may be reported anonymously, via a toll-free hotline, with full whistleblower protections afforded as the result of a new policy in 2003. Semimonthly reports on the activities of the Oversight Committee on Fraud and Corruption are available on the IDB's public website. Since its inception in April 2002 through April of this year, 183 allegations have been received, averaging 7 per month. The OCFC/OII has opened 92 investigations during the past two years. Also in 2003, the Board of Executive Directors adopted for the first time its own Code of Ethics as distinct from the Code of Ethics for Bank Management.

These are important steps, but they need to be strengthened by encouraging participants in IDB projects to come forward with allegations, and for those allegations to be vigorously prosecuted.

There are two additional transparency-enhancing mechanisms at the IDB which I would like to highlight: the inspection panel and the Office of Oversight and Evaluation. The IDB's independent inspection mechanism was established in 1994 as part of the implementation of the Eighth General Increases in Resources of the Bank. During the negotiations for the Eighth Replenishment, the Governors of the Bank expressed a desire to increase the transparency, accountability and effectiveness of the Bank's performance by the introduction of an inspection function, to be performed independently of Management, which would investigate allegations by affected parties that the Bank had failed to apply correctly its own operational policies. To date there have been five requests for inspections and information on the activities of the inspection mechanism are available on the Bank's website.

The Office of Evaluation and Oversight reports directly to the Board of Directors and is independent of Bank management. The office undertakes independent and systematic evaluations of the Bank's strategies, policies, programs, activities, delivery support functions and systems. The evaluation office provides the Board of Directors with a vehicle for obtaining independent views of the effectiveness of the Bank's operations, policies, and programs. The Auditor General performs audits, reviews, and investigations designed to help assure management of the adequacy, effectiveness and efficiency of the Bank's internal controls and resource utilization.

The US Chair has been a strong advocate for reform of the IDB's corporate and project procurement systems. We pushed for a review of both systems by external consultants and management is expected to recommend concrete reforms in the near future. The US will continue to drive the agenda on this issue with the objective of creating a best-practice, transparent and accountable project procurement system at the IDB which is fully harmonized with that of the other MDBs.

Going forward, in addition to Section 581 reforms, I see three areas of focus to improve institutional transparency efforts at the IDB: mandatory disclosure of financial information for IDB employees, creation of an audit committee of the Board, and adoption and implementation of an internationally recognized framework of internal controls. To avoid conflicts of interest at the staff level, financial disclosure is a key component. The establishment of an audit committee and the adoption of a formal internal controls framework are consistent with US policy.

IDB Financed- Projects

To address corruption in the execution of bank-financed projects, the IDB has a supervision system of reviews and evaluations during the project cycle. The IDB's independent evaluation office recently completed a study of this system and found it to be deficient. Bank-wide, not all supervision requirements are met on a consistent basis, and there is no centralized authority in the Bank responsible for monitoring compliance on all of the supervision instruments. The US Chair was supportive of the evaluation's recommendations for reform, and has urged the Management to immediately address flaws in the current system. By reducing the number of reporting requirements to key reports at the beginning, mid-term, and end of a project's implementation and at the same time strengthening the consistency and quality of reporting, we expect to see improved project supervision. I intend to hold IDB management accountable for addressing the weaknesses identified by the evaluation.

Another fundamental area where the IDB can play a role in improving governance at the project level is through reform of the project procurement system. This Chair has urged the IDB to work with the other MDBs to agree on a best-practice set of procurement and consultant guidelines, standard documents and processes. Updated project procurement and consultants policies must be available to the public and referenced in all IDB investment loan agreements with Borrowers and must mandate the use of appropriate standard documents.

With respect to the private sector, the IDB Group's new private sector development strategy will promote best practices for corporate governance and social responsibility. The US has been a strong advocate of the MDBs working exclusively with those private sector firms committed to corporate governance. We have also encouraged the IDB to promote capacity building and best-practice awareness among smaller firms so that they might improve competitiveness along with governance and safeguards.

The IDB representation in each of the borrowing member countries is a key factor in improving project performance. The IDB needs to focus additional energy and resources, if necessary, on properly staffing and training the country offices so that they are capable of providing project supervision, exercising fiduciary oversight over procurement processes, and reporting back to the Bank when participants in local projects are unsatisfied with any of the fiduciary or governance aspects of IDB projects.

Anti- Corruption Efforts at the Country Level

I would like to highlight to the Committee that the Treasury Department prepares an annual report on the anti-corruption efforts of all of the Multilateral Development Banks. The report focuses on the country impact of MDB actions to improve governance.

The IDB's institutional strategy explicitly prioritizes modernization of the state as an area of Bank action. Before projects are developed, the country strategy which defines IDB's engagement will consider anti-corruption, governance, and institutional strengthening in the strategy. Public sector reform and modernization of public administration are key components in virtually every country strategy paper the IDB adopts.

In 2003, the IDB financed 19 projects for a total of \$772 million for public sector reform and modernization. These projects ranged from strengthening internal controls in Brazil's Federal Court of Accounts to promoting fiscal reform in Bolivia and Peru. In 2004, the IDB has financed several projects of note: \$7.8 million for capacity building of municipal governments in Panama; \$25 million in concessional finance to Honduras to improve bank supervision; and a grant of \$150,000 to Paraguay to improve management between the Executive and Legislative branches.

Through the Multilateral Investment Fund, the IDB also makes extensive use of grant financing for demonstration projects to show the benefits of politically difficult commitments that benefit the private sector, such as strengthening auditing and accounting standards in the Caribbean, and developing benchmarks to combat money laundering across the region. The MIF focuses on innovative private sector projects with large demonstration effects. Recent areas of activity include: accounting and auditing standards, financial sector reform and supervision, and improving regulatory frameworks.

To encourage market forces to provide a strong positive demonstration effect, the IDB has created its Business Climate Initiative, which will draw on the work of the World Bank and other multilateral institutions. The initiative will fund a diagnostic assessment of the weaknesses in country business climates, and then propose a program to target these weaknesses.

Results from early governance and anti-corruption elements of larger loans have shown that conditions for disbursement related to anti-corruption efforts such as sub-national financial reporting and investigation of financial crimes have largely been met. We need to capitalize on these incentive mechanisms and enhance the Bank's ability to achieve improvements in anti-corruption activities.

In my view, a critical area for further reform at the country level is building the capacity of project executing agencies in the country, usually Ministries or coordinating bodies of the executive branch. Executing agencies are subject to tremendous political pressures and a governing culture which often does not lend itself to full transparency. The IDB, through its long relationship with countries, is well-placed to dig deeper into the

institutional culture and improve the government's use of IDB resources for the benefit of civil society.

Conclusion

In conclusion, while the pace of institutional reforms to combat corruption has accelerated recently, I recognize that the IDB still has much work to do. Because the bank is a leader in the region, a strong signal of the importance of anti-corruption and transparency initiatives in the Bank's institutional culture will have exponential effects in the countries of the region. This is an aggressive agenda, but as the largest shareholder in the Bank, the US is working aggressively on the need for further reform.

In his address to the IDB Board of Executive Directors last July, Secretary Snow remarked on the critical need to improve the investment climate in Latin America, saying that "capital is a coward" and only goes to places where it feels adequately protected. It is our job to enhance anti-corruption and transparency activities at the IDB to create the conditions for capital to flourish and for our development assistance to be effective.