

**MULTILATERAL DEVELOPMENT BANKS:
PROMOTING EFFECTIVENESS
AND FIGHTING CORRUPTION**

HEARING

BEFORE THE

**COMMITTEE ON FOREIGN RELATIONS
UNITED STATES SENATE**

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

—————
MARCH 28, 2006
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Printed for the use of the Committee on Foreign Relations



Available via the World Wide Web: <http://www.access.gpo.gov/congress/senate>

U.S. GOVERNMENT PRINTING OFFICE

33-727 PDF

WASHINGTON : 2007

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
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C O N T E N T S

	Page
Lugar, Hon. Richard G., U.S. Senator from Indiana, opening statement	1
Easterly, Dr. William, Professor of Economics, New York University	26
Prepared statement	29
Lerrick, Dr. Adam Director, the Gailliot Center for Public Policy, Carnegie Mellon University	39
Prepared statement	41
Levine, Dr. Ruth E., Director of Programs, Center for Global Development	33
Prepared statement	35
Lowery, Hon. Clay, Assistant Secretary For International Affairs, Department of the Treasury, Washington, DC	3
Prepared statement	5
Perry, Hon. Cynthia Shepard, U.S. Executive Director, the African Development Bank, Washington, DC	10
Prepared statement	13

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TUESDAY, MARCH 28, 2006,

U.S. SENATE,
COMMITTEE ON FOREIGN RELATIONS,
Washington, DC.

The committee met, pursuant to notice, at 9:34 a.m. in room SD-419, Dirksen Senate Office Building, Hon. Richard G. Lugar [chairman] presiding.

Present: Senators Lugar and Martinez.

**OPENING STATEMENT OF HON. RICHARD G. LUGAR,
U.S. SENATOR FROM INDIANA**

Chairman LUGAR. This meeting of the Senate Foreign Relations Committee is called to order. The Foreign Relations Committee meets to continue our review of the United States policy toward the multilateral development banks, the MDBs. This is the fifth in a series of hearings on the MDBs that began in 2004. Those earlier hearings contributed to this committee's understanding of both the value of the MDBs' work and problems with their operations that were in need of correction.

In 2005, building on these hearings, I introduced Senate Bill 1129, the Development Bank Reform and Authorization Act. Through the cooperation of many Members of Congress, most of the provisions of this bill were enacted into law in November 2005. With passage of this legislation Congress made a strong statement that it recognizes the critical role of the MDBs in achieving developmental goals around the world, but also that the operations of these banks must be transparent, efficient, and free of corruption.

The legislation authorizes funds for three of the MDBs and contains provisions designed to ensure greater transparency and accountability in the banks' operations. It requires the Secretary of the Treasury and the United States Executive Directors to the MDBs to support clear and public anti-corruption procedures that are coordinated all across the MDBs. Among many provisions, it promotes staff financial disclosure procedures, whistle blower protections and the establishment of independent ethics and auditing offices. It also encourages transparent budget processes for countries that receive budget support from the MDBs, and additional disclosure requirements for natural resource extraction projects.

The need for oversight did not end with the passage of the MDB reform legislation, which is why we're here today. The United

States has strong national security and humanitarian interests in alleviating poverty and promoting progress around the world. The MDBs can help leverage the resources that we devote to advancing international development. Since 1960, the United States has provided more than \$42 billion in direct contributions to the MDBs. In addition, the United States has provided more than \$1.7 billion for debt relief.

The United States Government must work hard to ensure that this money is spent efficiently, both because of our responsibility to American taxpayers and because inefficiency and corruption undermine the basic humanitarian and foreign policy objectives of our participation in MDB financing.

World bank economists Craig Burnside and David Dollar asserted in the American Economic Review that, and I quote, "in the presence of poor policies . . . aid has no positive effect on growth," end of quote. Similarly, the World Bank Web site identifies corruption as quote, "the single greatest obstacle to economic and social development." Corruption associated with MDB loans not only squanders development funds and enriches dishonest officials and contractors, it leaves impoverished nations with the burden of the resulting debts.

At the World Bank, President Paul Wolfowitz has continued and expanded the anti-corruption policies initiated by his predecessor, James Wolfensohn. President Wolfowitz has reportedly suspended loans in Argentina, Bangladesh, Chad, India, Kenya, and perhaps others because of corruption concerns. Although some of these actions may stimulate controversy, nations receiving World Bank loans must do everything in their power to provide confidence that loans and the projects that they fund are free of corruption.

In Chad, for example, the World Bank has set up a model revenue management program to ensure that money generated by the Chad/Cameroon oil pipeline would be spent for the good of the people. But after the oil pipeline had been built, the government of Chad unilaterally reneged on its commitment to work under these anti-corruption procedures. The government also withdrew its pledge to direct the bulk of the revenue to health, education, and rural development. The World Bank had little choice but to suspend lending to Chad.

The importance of getting loans right from the start is demonstrated by the case of the Congo. Recently the World Bank and the International Monetary Fund agreed to grant debt relief to the Republic of Congo, a country that has flouted past anti-corruption conditions. According to Global Witness, there is evidence that hundreds of millions of dollars are unaccounted for in Congo's budget. Congo is receiving debt relief despite earning billions from oil sales in 2005.

I'm optimistic about the G-8 agreement for 100 percent debt relief for highly indebted poor countries that implement policies to foster growth and to reduce poverty. The cycle of indebtedness of these poor countries must end. But we will not fully achieve this important goal unless we establish an anti-corruption culture throughout the international lending process.

Everyone involved must understand that the history of the MDBs includes well documented and unacceptable cases of waste,

fraud, and abuse. We know that billions of dollars that could have helped some of the poorest people in the world have been siphoned off or squandered. We all wish this was not so, but such facts place extra burdens on both the banks and the nations receiving the loans. And those of us in Congress who care about international development and like-minded people around the world must shine a light on these programs, not to undercut their missions, but rather to ensure that these missions succeed.

We are living in an era when threats posed by terrorism, weapons proliferation, international communicable diseases, increasing competition for energy supplies and other factors have enlightened many of the world's people to the need to ensure that poor nations are not left behind. But these same threats also place competing demands on national budgets. If development projects are transparent, productive, and efficiently run, I believe they will enjoy broad support. If they are not, they are likely to fare poorly when placed in competition with domestic priorities or more tangible security related expenditures.

Today we are pleased to be joined by two distinguished panels. First we will hear from Mr. Clay Lowery, Assistant Secretary of the Treasury for International Affairs, and Ambassador Cynthia Perry, U.S. Executive Director to the African Development Bank. They will testify regarding U.S. efforts to support the anti-corruption strategies of the development banks. On the second panel, we will hear from Dr. William Easterly of New York University, Dr. Ruth Levine from the Center for Global Development, and Dr. Adam Lerrick from Carnegie Mellon University. We welcome our expert witnesses, and we look forward to their insights.

Let me mention before I ask them to commence their testimony that I want to acknowledge the presence of a large group of State Department Foreign Service Officers who are here in this hearing today. They're in the midst, I'm advised, of a year-long economics training program at the Foreign Service Institute. I understand that they've been studying the works of some of our witnesses today and therefore will be acute observers. We're delighted that they are here because they will be in the field soon making a difference.

I welcome both of you. You are good friends of the committee. Let me say that your full statements will be made a part of the record, so you need not ask for permission that that occur. I'll ask you to proceed with a summary or the full text as you may wish. And then we will have questions from our committee members. Secretary Lowery?

**STATEMENT OF HON. CLAY LOWERY, ASSISTANT SECRETARY
FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE
TREASURY, WASHINGTON, DC**

Mr. LOWERY. Thank you sir. Chairman Lugar and Senator Martinez I want to thank you very much for the opportunity to testify today on the critical imperative facing us at the multilateral development banks, and that's the fight against corruption. I'm very pleased to be joined at the table by Ambassador Perry, the U.S. Executive Director at the African Development Bank, who will address the African Banks' efforts to combat this affliction.

The administration has one fundamental policy goal for the multilateral development banks, and that is to help poor countries reduce poverty by increasing economic growth. The world has made major gains against poverty in recent decades. In the past 40 years, life expectancy in developing countries has increased by over a quarter. In the last 30 years, illiteracy has fallen by half, and in the last 20 years over 400 people have been lifted out of absolute poverty.

While these statistics are impressive, I posit that many more tens of millions of people would have been lifted out of poverty if it wasn't for corruption. In other words, corruption still remains one of the major impediments to meeting the challenge of extreme poverty.

Corruption nefariously compromises development by squandering resources vital to combating illiteracy, disease, high infant mortality, and a polluted environment. Corruption, in and of itself, is immoral, illegal, and intolerable. In short, stealing from the poorest people is appalling. Fighting corruption and building strong governance and accountability structures in developing countries has been a top priority from the first day of the Bush administration, and we know that has been a top priority for you, Mr. Chairman, and the 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 head on, from crafting the Monterrey Consensus on Financing for Development, creating the Millennium Challenge Account, working to build a consensus to provide debt relief to the poorest countries, launching anti-corruption initiatives to the G-8, to taking on money laundering, terrorist financing, and searching out and returning the stolen assets from kleptocrats around 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. As we continue to advance our comprehensive reform agenda at the MDBs to address these challenges, 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. His leadership, together with this committee's, has put even more wind in our sails.

This committee has held a series of hearings over the last few years about progress, or the lack thereof, in fighting corruption in and through the multilateral development banks. The legislation enacted last year reflects our agenda in both fighting corruption and enhancing development results. In our view, the core of this agenda is to provide the right incentives to individuals, countries, and institutions, build the capacity and structures to have strong checks and balances, and hold those individuals, countries, and institutions accountable for their actions.

Examples of progress in advancing this agenda include something that you mentioned in your statement from the Burnside and Dollar study, which is rewarding performance. In the mid-1990s, the World Bank provided roughly 40 percent more of—on a per

capita basis, to the best performers than it did to the worst performers. Today that number is approaching 400 percent. In terms of establishing controls, in just the past couple of months the Inter-American Development Bank has adopted an ethics code requiring senior management to disclose financial assets and income. This ethics code, I just was speaking with the President of the IDB this morning, has been just put on their Web site. While the Asian Development Bank has implemented measures to protect the identity of whistle blowers.

Holding countries accountable, you mentioned President Wolfowitz's leadership on this front. I'm not going to repeat what you've already said.

The job of fighting corruption, however, is far from finished. For example, we must do more to break the incentive structure of rewarding loan volume as opposed to project performance. We must continue to harmonize procurement standards and procedures. The MDBs must release more project documents earlier and we must establish more robust fiduciary standards at institutions like the Global Environmental Facility.

Mr. Chairman, 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 leadership taken by President Wolfowitz and the other multilateral development banks' heads who just recently created a task force across their institutions to intensify efforts to tackle the problem of corruption, 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 way to achieve concrete results. I can assure you that we will continue to pursue the cause tirelessly. Thank you for your time and I look forward to answering any questions you may have.

[The prepared statement of Mr. Lowery follows:]

PREPARED STATEMENT OF HON. CLAY LOWERY, ASSISTANT SECRETARY FOR
INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

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 reinvigorated 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 fiscal year 2006 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 insti-

tutions. 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 fiscal year 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 ex-

ample, 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 anti-corruption and governance policies. The AsDB concluded that the Bank has not yet completed the process of mainstreaming governance and anti-corruption 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 anti-corruption 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 AsDF'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 decisionmaking 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.

Chairman LUGAR. Thank you Secretary Lowery for your testimony. And I'd like to call now upon Ambassador Perry.

STATEMENT OF HON. CYNTHIA SHEPARD PERRY, U.S. EXECUTIVE DIRECTOR, THE AFRICAN DEVELOPMENT BANK, WASHINGTON, DC

Ambassador PERRY. Thank you Mr. Chairman, Senator Martinez. Distinguished members of the Senate Foreign Relations Committee, thank you very much for your invitation to testify today. This is my fourth time appearing before this committee and I want first to thank you for the encouragement you have given me to do some of the terribly hard jobs I've had to do. This is another one. This an issue of great importance, fighting corruption on the multi-lateral development banks. I have submitted for the record a written statement, but I take this opportunity to highlight a few key areas of importance.

The African Development Bank Group has made significant strides in the recent past against corruption, although much more remains to be done. We have a new President, Dr. Donald Kaberuka, who has made fighting corruption one of his top priorities. And the U.S. Executive Director's office has been working closely with the Bank to ensure that proper safeguards are implemented quickly and that those that already exist are strengthened.

Of course, the fight against corruption cannot be won if the right tools are not at the Bank's disposal. Within the Bank, there must exist the right mechanisms to prevent, detect, and punish corruption. In member states, the right leadership must exist to foster a culture of zero tolerance when it comes to graft, and to strengthen national systems so that they can withstand the scourge of corruption. And, as a donor, we must do our part to sustain pressure and demand results.

Both management and staff of a financial institution must be able to rely on systems and processes, in addition to corporate ethos, to make the fight against corruption effective. With our backing and our constant pushing, the Bank established the anti-corruption and fraud investigation unit and an oversight committee on fraud and corruption last year. The unit will undertake investigations in response to specific allegations of corruption and fraud and the oversight committee will ensure that punishment is meted out appropriately. Getting this unit fully functional, however has been delayed somewhat, but we've worked closely with management to ensure this important work proceeds at pace.

The Bank is also expected to bring to the board a whistleblower protection policy in the coming weeks which will include the definitions adopted by the MDB taskforce. We need to ensure that this policy is both comprehensive and successfully implemented.

To support these efforts, the Treasury Department's Office of Technical Assistance agreed earlier this month to provide an advisor to this new anti-fraud unit to help develop capacity to carry out investigations and to detect fraud. I very much hope that this will strengthen African capacity to detect and punish corruption.

The Bank is also updating its guidelines for financial governance and financial analysis of projects, which are used by all Bank staff as they design and implement projects. The completed guidelines should substantially improve portfolio quality and performance, and further mainstream the importance of fighting corruption in all Bank activities by all Bank staff.

Diagnosis of opportunities for fraud and corruption is critical if the fight is to be won and the Bank uses the latest diagnostic tools. Country Financial Accountability Assessments, Country Procurement Assessment Reviews, and Country Governance Profiles, are used to assess operational risks and recommend ways to help borrowers fight corruption, restore integrity, and promote good governance. Nine Country Governance Profiles, and two CFAA's will be done this year.

The Bank has joined with the OECD through the Partnership Against Corruption in Africa, PACA, to help member countries strengthen ongoing anti-corruption efforts and to initiate new ones. Invitations to join have been extended to 14 countries that received debt relief in 2005 from the Bank. In return for joining PACA we'll offer them a menu of reform programs to curb the supply and demand of corruption, a platform for regional dialogue and development of joint programs, and opportunities for the exchange of lessons learned.

The Bank is also an observer of the Financial Action Task Force and regularly attends FATF meetings with other institutions fighting corruption. This Bank is developing a strategy on money laundering and terrorist financing this year.

In late 2005, the Bank's new COSO internal framework—control framework was implemented to help ensure that internal bank procedures are being followed and that risks are appropriately mitigated. In fact, the Bank now collects financial disclosure forms for Executive Board members and their staff, so that wrongdoing will be exposed before damage is done to the institution.

And finally, the Bank's independent evaluation unit, OPEV, pinpoints weaknesses in governance in its member states through its variety of evaluation and reports. For example, the Bank recently found that while it was doing relatively well in Ghana, more had to be done in Mali and Mauritania.

I must add one note of concern regarding OPEV, Mr. Chairman. While we have high regard for the quality and value of its work, we have not been able to secure the kind of independence for OPEV from Management, and we would like this unit to have a very strong—much stronger position. We have asked President Kaberuka to revisit this issue.

The tools of the Bank, Mr. Chairman, when strengthened, will help the Bank take on and fight corruption internally and, also, in our member states. But the Bank's efforts, in order to be successful, have to rely on the second pillar of effectiveness, and that is good country leadership.

Mr. Chairman, it's easy to dictate the importance of fighting corruption from a distance. It is much more difficult to put in place systems and attitudes that fight graft on the ground, on a day-to-day basis. A critical first step is having the right leadership. Leadership that is committed to eradicating corruption and the decay it causes to institutions. Leadership that is devoted to strengthening institutions and the rule of law so that judiciaries cannot be undermined and treasuries cannot be plundered. Leadership, Mr. Chairman, that creates a conducive environment to root out corruption and punish the corrupt.

Through its work with member states, the Bank has helped those African governments with the right leadership to build safeguards and strengthen institutions. In places like Burkina Faso, for example, the Bank is helping develop policies and strategies that will fight corruption. The Bank has taken the lead in helping Benin and Mauritania build institutions to detect corruption and punish the corrupt.

In other countries, like Nigeria, the Bank has helped strengthen the leadership's determination to fight corruption. In the—Gambia, the Bank helped get the word out for the government's Operation No Compromise, a public awareness campaign against corruption.

However, more still must be done in a number of countries, such as you have mentioned, Kenya, Chad, Republic of Congo, and Uganda. New allegations of corruption have recently surfaced. The Bank is reviewing its engagements with those countries. Thus far, the Bank has found that none of its projects in Kenya were corrupted. We expect the Bank to design interventions in these and other countries. Thus far, the Bank has found that none of its projects in Kenya were corrupted. We expect the Bank to design interventions in these and other countries with a focus on anti-corruption and good governance. The Bank's technical assistance and capacity building activities can help these countries strengthen their systems to ensure resources are not being corrupted.

More broadly, Mr. Chairman, the Bank is now working to build awareness in member states, among governments and the people, so that they are aware of the existence and negative impact of corruption.

At my urging, President Kaberuka is organizing a half-day seminar on fighting corruption at the African Bank's upcoming annual meetings in Burkina Faso in May. Ministers from the Bank's 77 member countries will be in attendance, as well as other leading personalities from all over the world. I expect President Kaberuka to emphasize that there is no place for corruption in development, and no place for corruption at the African Development Bank itself. In such fora, where development leaders join together to review and assess the progress they have made, it is more important than ever before to make sure this message is heard loud and clear. By organizing this event, the Bank is showing leadership on a critical issue facing Africa.

Finally Mr. Chairman, I would like to speak to the recent legislation concerning fighting corruption at the multilateral development banks sponsored by you and approved by Congress, and signed into law by the President. Several of the measures you introduced are already being implemented and many more are being strengthened. For example, financial disclosures for board members are now required, and the Bank's whistleblower protection policy is in its final stages of preparation. The Bank is also in discussion with other MDBs on implementing cross debarment of corrupt firms that are dealing with the MDBs.

On the audit side, I've already mentioned the role we played in establishing the anti-corruption and fraud investigation unit and our plans to help develop the unit's investigative techniques. The new independent review mechanism will also build a more responsive and transparent culture within the Bank, and in our member

states. Given some delays in recruitment, however, we will need to continue to press management to be sure that these nascent units become operational and effective without further delay.

One particular area, and I've spoken to this before, I will focus my near term efforts relates to the independence of Bank's evaluation unit. As I mentioned earlier, we will need to redouble our efforts with management and other board members to bring the African Bank into alignment with other MDBs on this important issue.

As a donor, we will continue to raise anti-corruption to the level of global importance that it deserves. For too long discussion of corruption has been swept under the carpet by donors or watered down to nonexistence in order to satisfy supposed exigencies. But without openly discussing the problem, one cannot even hope to tackle the problem. Mr. Chairman, I believe your leadership on this matter has given voice to others, encouraged them to lead, and given strength to all of those who stand against corruption.

Mr. Chairman, progress is being made at the African Development Bank, but it will require substantial, ongoing efforts by all parties concerned. We will work to strengthen the tools we already have, and, as necessary, develop new ones to detect and prevent fraud. Working with like-minded leaders will help us deliver real development results to the neediest.

Mr. Chairman, I hope you will agree that while the road to fighting corruption is a long one, we started off in good stride. Much more must and will be done in our development dollars are to make a dent against poverty. While there is no room for complacency, and we must remain intense and vigilant in our efforts, I believe that the African Development Bank is on the move. I thank you for your strong support.

[The prepared statement of Ambassador Perry follows:]

PREPARED STATEMENT OF AMBASSADOR CYNTHIA SHEPARD PERRY, U.S. EXECUTIVE DIRECTOR, AFRICAN DEVELOPMENT BANK

Mr. Chairman, distinguished Members of the Senate Foreign Relations Committee, thank you for your invitation to testify today on an issue of great importance, Fighting Corruption at the Multilateral Development Banks.

As former President of the World Bank Jim Wolfensohn noted more than a decade ago, "corruption is a cancer . . ." It is a cancer on the hope and dreams of people living in poverty across the globe, in every corner of the world. It is a cancer that eats away at the core of what is good and selfless: the fight to eradicate poverty. But corruption, as you have rightly pinpointed Mr. Chairman, doesn't start or end at the national level. As major international scandals have recently proven, corruption is a transnational problem and, it is clear that corruption and fraud are commonplace in many international institutions charged with fighting this cancer and making the world a better place to live.

The African Development Bank Group has made significant strides in the recent past against corruption, although much more remains to be done. The new President of the Bank Group, Dr. Donald Kaberuka, has made fighting corruption one of his top priorities. Indeed, given his experience as finance minister of Rwanda, dealing with a post-conflict and fragile country, the Bank's new president is well-placed to know just how important institution-building can be. Upon taking office, President Kaberuka set the right tone. In his welcome address to Bank Staff, he told them that internal controls and the fight against waste were everyone's responsibility—not just Management's. Everyone had a stake in ensuring the Bank is clean and effective. The U.S. Executive Director's Office has been working closely with the Bank's senior Management to ensure that proper safeguards are implemented quickly and that those that already exist are strengthened.

Of course the fight against corruption cannot be won if the right tools are not at the Bank's disposal. Within the Bank, there must exist the right mechanisms to pre-

vent, detect, and punish corruption. In member states, the right leadership must exist to foster a culture of zero tolerance when it comes to graft and take it upon itself to strengthen national systems so that they can withstand the scourge of corruption. And, as a donor, we must do our part to sustain pressure and demand results.

Mr. Chairman, let me take each of these areas and detail for you where I believe we are and where I believe we need to go from here.

STRENGTHENING THE BANK'S TOOLS FOR FIGHTING CORRUPTION

Both Management and Staff of a financial institution must rely on systems and processes, in addition to corporate ethos, to make the fight against corruption effective.

For the last several years, I have pushed the Bank to create a strong fraud and corruption investigation office. With our backing and our constant pushing, the African Development Bank established the Anti-Corruption and Fraud Investigation Unit in 2005. The Bank's Board also approved establishing an oversight committee on fraud and corruption. Together, these two functions will comprise an entire division of the Bank Group. Getting this unit fully functional, however, has been delayed somewhat but we have worked closely with management to ensure this important work proceeds apace.

Once fully functional, this unit will undertake investigations in response to specific allegations of corruption and fraud against individual staff members or third parties who engage in business with the Bank. The Bank is currently developing a Whistleblower Protection Policy to bring to the Board in the next few weeks. This policy has taken longer than we expected to develop, but we understand that it may include several other important provisions, such as voluntary disclosure.

Recently, the Treasury Department's Office of Technical Assistance agreed to provide an advisor to the new investigative unit to help the Bank and its member countries develop its capacity to carry out investigations and detect fraud. We expect this help to be mainstreamed in the Bank's member states and to the Bank's lending activities across Africa. In this way, we hope to strengthen African capacity to detect and punish corruption.

The African Bank is also updating its Guidelines for Financial Governance and Financial Analysis of Projects. These guidelines describe and explain the Banks' policies, procedures and approaches to the financial governance, management and analysis of projects and programs that the Bank finances, and are used by all Bank staff as they design and implement projects. Updating the guidelines involves numerous workshops with other MDBs and stakeholders, as well as good governance experts to exchange state-of-the-art lessons learned and best practices. Once completed, the guidelines should substantially improve portfolio quality and performance and further mainstream the importance of fighting corruption in all Bank activities.

Diagnosis of opportunities for fraud and corruption is critical if the fight is to be won. The Bank continues to use the latest diagnostic tools, such as the Country Financial Accountability Assessments (CFAA), Country Procurement Assessment Reviews (CPAR), and Country Governance Profiles (CGPs), to assess operational risks and recommend ways to assist borrowers to fight corruption, restore integrity, and promote good governance. CGP diagnostics are now incorporated into all Bank governance projects, and are used as a tool in Bank policy dialogues with borrowers, particularly in the design of policy-based loans. Last year, five Country Governance Profiles, for Madagascar, Djibouti, Ethiopia, Namibia and Mozambique, were completed, and an additional nine are scheduled for 2006. In addition, the Bank collaborated with the World Bank to carryout two CFAAs, in Togo and Uganda, last year, and six more are planned for 2006.

In response to the accord between African leaders and the G8 at the Gleneagles Summit in 2005, the AfDB and OECD joined forces through the Partnership Against Corruption in Africa (PACA) to support member countries in strengthening ongoing anti-corruption efforts and to initiate new ones. Through the PACA framework, the two institutions merge their experience—both in Africa and internationally—in the fight against corruption, money laundering and related activities. Working with the OECD, the Bank plans to engage local and international partners, including the private sector, so that it can help African countries design, implement, and monitor the fight against corruption. Invitations to join have been extended to fourteen countries that were provided debt relief in 2005. In return for joining the partnership, PACA will offer countries a menu of reform programs to curb the supply and demand of corruption, a platform for regional dialogue and development of joint programs, and opportunities for the exchange of lessons learned. The Partnership could

be an important tool for the Bank as it takes a lead role in raising awareness throughout Africa and the world on the costs of corruption.

The Bank has also assumed its Observer role with the Financial Action Task Force (FATF) and regularly attends FATF meetings for information gathering and exchange of views with other institutions fighting corruption. These include African agencies engaged in the fight against money laundering and terrorist financing. In 2005, the Bank launched a process of preparing a strategy on money laundering and terrorist financing, which is expected to be finalized in early 2006. The United States has been pushing for the strategy for several years and we hope—once the Board approves the Bank's strategy for the Bank to mainstream it into member states' efforts. Working relations have also been established with African FATF-Style Regional Bodies (FSRBs) for the development of a common approach to tackling money laundering and terrorist financing.

In late 2005, the Bank implemented a new COSO (named for the Committee of Sponsoring Organizations of the Treadway Commission) internal control framework. The framework is an important tool to check that internal Bank procedures are being followed and that risks are appropriately mitigated. The COSO framework tests Management policies and practices that could lead to fraud, waste, and corruption. The system, currently in use in most of the Fortune 500, should strengthen Management's ability to detect and stop corruption.

In addition, the Bank recently instituted a means to ensure that corruption and conflicts of interest do not exist among members of the Bank's Board. Through a series of financial disclosure forms, we hope such conflicts and wrongdoing will be exposed before damage is done to the institution's integrity.

Finally, the AfDB's independent evaluation department, the Operations Evaluation Unit (OPEV) continues to support the Bank's governance and anti-corruption work. In 2005, it issued 168 evaluation reports of Bank projects and activities covering the entire range of sectors and countries in which the Bank Group is active. These evaluations have helped to pinpoint weaknesses in governance in member states. OPEV has also completed a thorough review of the Bank's Country Strategy Papers (CSPs), which provide a framework for dialogue with borrowing countries on governance and corruption issues. The review concluded that the Bank's CSPs have covered governance issues adequately for about 84 percent of the cases reviewed.

Also in 2005, OPEV undertook four Country Assistance Evaluations. The CAEs for Ghana, for example, found that the Bank's institutional support project, which included a component on governance, had a substantial positive impact on the country's institutional development. This is particularly helpful in Ghana because it is a HIPC country in the process of strengthening its institutions. In the other three CAEs, Bank institutional support was rated as modest but with substantial room for improvement. Some of the recommendations from the reviews have focused on paying even greater attention to governance in future CSPs for Mali and Mauritania.

I should note, Mr. Chairman, one issue of concern regarding OPEV. While we have high regard for the quality and value of OPEV's work, we have not been able to secure the kind of independence from Management we would like this unit. A recent Board resolution—which we opposed—calls for the head of OPEV to be hired and fired by the Bank's President, with only consultation of the Board, not its concurrence. We have asked President Kaberuka to revisit this issue.

Mr. Chairman, the above elements help form a set of tools that, when fully implemented and strengthened, can help the Bank take on and fight corruption. But the effort—in order to be successful—has to rely on the second pillar of effectiveness: good country leadership.

CREATING A CONDUCTIVE ENVIRONMENT

It is easy to dictate the importance of fighting corruption from a distance, Mr. Chairman. It is much more difficult to put in place systems and attitudes that fight graft on the ground, on a day-to-day basis. A critical first step is having the right leadership. Leadership that is committed to eradicating corruption and the decay it causes to institutions. Leadership that is devoted to strengthening institutions and the rule of law so that judiciaries can not be undermined and treasuries can not be plundered. Leadership, Mr. Chairman, that creates a conducive environment to root out corruption and punish the corrupt.

Through its work with member states, the African Development Bank has helped those member states with the right leadership to build safeguards and strengthen institutions. I would like to share a few examples with you of this important work and, most importantly, of the results the Bank has been able to achieve thus far:

- After developing an anti-corruption program with the help of the Bank in 2003 and 2004, Benin started implementing anti-corruption efforts last year, including acceleration of institutional reforms, revamping and strengthening government policies, and consolidation of public finances. With the Bank's help, Benin also established an office to monitor anti-corruption efforts.
- Nigeria's anti-corruption campaign is also supported by the Bank, which provides technical assistance and capacity building. Nigeria's National Empowerment and Development Strategy (NEEDS), developed with the Bank's help, aims to enhance public sector capacity for good governance and responsible economic management, including fiscal planning. Nigeria has also established the Economic and Financial Crimes Commission (EFCC) and the Independent Corrupt Practices Commission (ICPC), and the government has acted to remove high ranking civil servants from office on grounds of corruption. The Anti-Money Laundering Act was also reviewed last year, and a revised version is currently with the National Assembly for approval.
- After going off-track from its IMF program in 2003, Gambia engaged the Bank and other international donors on a wide-reaching anti-corruption campaign. In late 2003, the Gambian government passed the Financial Institutions, Insurance and Money Laundering Act. The government also launched "Operation No Compromise," a campaign aimed at raising public awareness of corruption and governance issues.
- The government of Burkina Faso has adopted the National Policy to Combat Corruption, and is in the process of establishing a national anti-financial crimes office. In 2005, the government passed the National Policy on Good Governance and both the Bank's Results-Based Country Strategy Paper and two lending programs are designed to better identify and combat corruption.
- In 2005, a new State Inspector General was appointed to help investigate corruption charges in the government of Mauritania. At the same time, the government has moved forward to improve governance and the quality of services it provides to its citizens. Over the course of 2005, the amount of time it took to process a government complaint form has decreased from 1 day to 45 minutes. The government is also working with the AfDB, the World Bank and other donors to strengthen the National Good Governance Program.
- The Ghana Anti-Corruption Coalition (GACC), made up of the government and its partners (including the AfDB), has organized workshops and agreed on an action plan to combat corruption. The Serious Fraud Office (SFO) investigates corruption and the Police Special Investigation Unit, which acts as a financial intelligence unit.

Of course much more must be done in the Bank's operations to fight corruption, both in countries and in Bank-funded projects. In a number of countries, such as Kenya, Chad, Republic of Congo, and Uganda, new allegations of corruption have surfaced recently. The Bank is reviewing its engagements with these countries. Thus far, the Bank has found that none of its projects in Kenya were corrupted. We expect the Bank to design interventions in these and other countries with a focus on anti-corruption and good governance. The Bank's technical assistance and capacity building activities can help these countries strengthen their systems detect and prevent corruption.

More broadly, Mr. Chairman, the Bank is working to build awareness in member states, among governments and the people, so that they are aware of the existence and negative impact of corruption. In July 2005, the Bank collaborated with other donors to host a regional workshop on Pro-poor Local Governance, and preparations are underway in the Bank to develop a strategy paper on rebuilding state capacity for better governance and development effectiveness. Printed information and public workshops are offered to sensitize local populations to the problem of corruption. Bank representatives form an integral component of this dialogue, so that corruption is fought at every step of Bank Group engagement.

The Bank's role in building conducive and supportive environments is potentially very large. And the Bank should use its convening powers to raise awareness among member states. At my urging, President Kaberuka is organizing a half-day seminar on fighting corruption at the African Bank's upcoming Annual Meetings in Burkina Faso in May. Ministers from the Bank's seventy-seven member countries will be in attendance, as well as other leading personalities, from all over the world. I expect President Kaberuka to emphasize that there is no place for corruption in development, and no place for corruption at the African Development Bank itself. In such fora, where development leaders join together to review and assess the progress they have made, it is more important than ever before to make sure this message

is heard. By organizing this event, the Bank is taking an important leadership role on the African continent.

SUSTAINING PRESSURE

Finally Mr. Chairman, I would like to speak to the recent legislation concerning fighting corruption at the Multilateral Development Banks sponsored by you and approved by Congress, and signed into law by the President.

Several of the measures you specifically introduced are already being implemented. And many more are being strengthened. For example, the African Bank is in the process of presenting a Whistleblower Protection Policy, which we hope to have up and running very soon. Financial disclosures for Board members are now required. The Bank is also in the process of discussing ways to implement "cross debarment" across the MDBs of corrupt firms found to be doing business with other MDBs. This was the topic of a high-level discussion between the Heads of the MDBs in Washington in February.

On the audit side of Bank operations, we have successfully pushed for the establishment of an Anti-Corruption and Fraud Investigation Unit and I am proud to say that the United States is playing an active role to help the Unit develop investigative techniques and mainstream them to member states. As I noted earlier, getting this unit operational is the key next step, and we will continue to press Management on this score.

The Bank has also established an Independent Review Mechanism which consists of a Compliance Review and Mediation Unit and a Roster of Experts to help advise the Board, if necessary, on projects that adversely affect people. Like the Anti-Fraud and Corruption Unit, however, staffing the unit has slowed its full effectiveness. We will continue to work to ensure that this becomes an effective mechanism that builds a more responsive and transparent culture in the Bank and member states.

One particular area where I will focus my near term efforts is on the area of the independence of OPEV. As I mentioned earlier, we will need to redouble our efforts with Management and other Board members to bring the African Bank into alignment with the other MDBs on this important issue.

As a donor, we have to raise anti-corruption to the level of global importance that it deserves. For too long, discussion of corruption has been swept under the carpet by donors or watered down to nonexistence in order to satisfy supposed exigencies. But without openly discussing the problem, one can not even hope to tackle the problem. Mr. Chairman, your leadership on this matter has given voice to others, encourages them to lead, and gives strength to anyone who stands against corruption.

CONCLUSION

Mr. Chairman, progress is being made, but it will require substantial, ongoing efforts by all parties concerned. We must strengthen the tools we already have to prevent and detect corruption, and, when necessary, develop new ones. We must work with like-minded leaders to raise awareness and strengthen institutions in the African countries. We must demonstrate our strong international leadership that helps keep the spotlight shining on fighting corruption. These efforts will help the Bank deliver real results to the neediest.

Mr. Chairman, I hope you will agree that while the road to fighting corruption is a long one, we have started off in good stride. While there is no room for complacency and we must remain intense and vigilant in our efforts, I believe that the African Development Bank is on the move. I thank you for your strong support.

Chairman LUGAR. Thank you for that good news. We appreciate your testimony. Let me raise some questions. We'll have a 10-minute question period. I'll ask some questions and then I'll yield to my dear colleague, Senator Martinez.

First of all, Mr. Lowery, there is a U.S. News and World Report issue that has just come out focusing on internal problems at the World Bank, including that they are alleged to be "kickbacks, payoffs, bribery, embezzlement, collusive bidding, plague bank funded projects around the world." The article states that, "knowledgeable analysts believe corrupt practices may be associated with more than 20 percent of the funds disbursed by the World Bank each year."

Does Treasury agree with this figure, and, if not, what is your assessment? That article focuses American attention and probably a wider worldwide audience than our committee has on this particular issue.

Mr. LOWERY. Thank you very much. I also read this article. The estimates on how much money is lost on the MDBs on corruption are, frankly, all over the map. I've actually—I went back and looked through the different testimonies that I've seen in this committee for the last couple of years, and I saw that there have been different figures thrown out by different experts and some of it has been refuted by other experts.

We do not have a great figure. Let me just say that my view is this—is that, I think Treasury Department's view is not one dollar—not 1 dollar should be lost. So how do we do that? We need to set up the right types of transparency mechanisms, the right types of internal controls, and the right types of punishment regimes in order to basically try to root that out. So while we don't have a figure, I actually want to, instead, focus on how to get rid of any figure.

Chairman LUGAR. Let me just ask about a specific area in which the Department of the Treasury is involved. You've been supporting the Extractive Industry Transparency Initiative and promoting its adoption resource developing countries. What steps has the Department of the Treasury taken to press the MDBs to require natural resource revenue and contract transparency for all projects and lending in the extractive industry sector?

Mr. LOWERY. Sir we—obviously—the State Department has the lead on the EITI initiative. We work very closely with the United Kingdom, which has been one of its biggest proponents. At the multilateral development banks, we are—we do a few things. First of all, we try to promote very much the idea of transparency in budgets. It is a crime that the countries of the world that have found oil have not been able to use this oil to help their—the betterment of their people.

Let me just take a recent example. You mentioned in your statement earlier the Congo-Brazzaville just received debt reduction. The Congo-Brazzaville is a very, very poor country. The average person there lives on basically 2 dollars a day. And they are quite indebted. So there's an understanding as why they should get some debt relief. But, at the same time, there has been allegations of corruption in the government, some of them are very related to the oil sector and the National Oil Company. And what we supported and actually pushed very hard on, and President Wolfowitz supported, was basically, we provide the debt relief but we do it under a few different things. First is we would get annual certified audits of the National Oil Company during the time that it was getting debt relief, that's something that has not been happening in the past. Second, we basically said that we would put into escrow funds from the interim debt relief that could be monitored and overseen by Congolese civil society and by external experts. And third, we required that government officials disclose their assets and divest any financial holdings that they might have in the oil company.

So we are very concerned about this problem. We agree with you and we're trying to push this both at the more systematic level, which is EITI, but also at the country level.

Chairman LUGAR. All right. I appreciate that emphasis. Anecdotally, let me mention that Senator Barack Obama of this committee and I had the privilege of visiting Azerbaijan in early September of last year. They are not into the banks for loans presently, in large part because they have become suddenly wealthy. But the British petroleum platforms out in the Baku Harbor and the Baku-Ceyhan pipeline have brought extraordinary revenues. I raised this question with the President of Azerbaijan and his answer was encouraging, that they're going to adopt what he called the Norway Plan. The Norway Plan roughly is to set up these extractive incomes from oil, or natural gas that will be coming in two years along the same pipeline, into sort of an endowment for the country. They plan to extract the income as it proceeds. If that's the case, it will be a wonderful course of action. It will be fairly unique in the area.

Perhaps Treasury might have opportunities in its own international diplomacy, at conferences or what have you. Without calling it the Norway Play or the Azeris plan or what have you, the general idea of this is tremendously important. Because these resources finally run out and if, furthermore, they've been stolen and squandered in the process, they're in double or triple jeopardy. This is essentially what we're talking about with these loans and these opportunities for people.

You've touched upon the Congo situation. What is our general call on that? I, in my opening statement, brought up some distressing circumstances and you've reiterated that in a way, but are we satisfied sufficiently in the Congo that those loans should proceed? And, if not, what sort of stipulations do we have for the future?

Mr. LOWERY. Actually, the two points you made are very related in terms of the Norway Plan and Congo. The—or the Azerbaijan Plan. It's basically—that's actually what we've been trying to do in Congo with this debt relief, is work—our Executive Director at the World Bank, Bob Holland, worked very diligently with the World Bank management who, I think, believed the exact same thing we did. The debt relief was kind of on its way forward and basically the United States raised concerns that we don't know exactly what's happening with the money. We're worried about some corruption issues in this country. So they established, basically, some of the things I just mentioned, including areas of how to kind of take the money that's being raised through debt relief, which is slightly different than oil revenues, obviously, and put it into accounts to use for people for health care programs, education, that type of thing. So that's what we were trying to do in Congo.

In Chad, you mentioned this also in your opening statement, the—when the World Bank helped fund the pipeline in Chad they basically tried to establish something like this Norway fund, which is, let's create a rainy day fund. And, because this will go away at some point. Obviously that's run into a problem over the last few months because the Chadian government passed a—there was a legislation that passed, I don't think it was enacted, but it was

passed to basically—we need to take this money down because we need to spend resources right now.

We were very supportive of President Wolfowitz basically suspending loans to Chad and going back into negotiation with them on this issue because, I mean, quite frankly the World Bank was being held at gunpoint. And it was—that was unacceptable. And so I think the President realized this is not a way to negotiate, we need to have a—and so I think that hopefully we can see a way forward for Chad, but it is definitely a problem. I mean I think we're pretty supportive of things like the Norway Plan, Azerbaijan Plan, I don't know Azerbaijan as well, but the Norway Plan.

Chairman LUGAR. I appreciate that point, as well as the whole issue of transparency that both of you have mentioned, that I mentioned to begin with. I hark back to the Azeris and British Petroleum. One of the important things about that was the transparency by British Petroleum of how much oil is actually going through the pipeline and how much they're getting for it, and who is getting the money. Those facts, likewise, outside the realm of governments, with private businesses are tremendously important in these issues. And I have commended the cooperation of the oil companies that are involved, that will play a very large role in transparency and responsibility by that government.

Finally, is the administration requesting sufficient funds to pay our pledges to the MDBs, including arrearages? What is your take on where we stand on that respect? Is the President's budget adequate to bring us up to date?

Mr. LOWERY. The President's budget basically reflects a bit of a reality, which is that we go into these negotiations for replenishment agreements and we try to figure out what is—what we want to see in a number in terms of the reforms we want in these institutions and how do we take it forward over the next few years and then we put a pledge down. And the problem we've had is that our pledges, frankly, aren't being met and it's losing—we're losing credibility because of it.

We have an arrears problem that has been growing over the last 5 years. In the past, in this administration, we've asked for arrears clearances and we haven't gotten them. So I think what you're seeing a reflection in the President's budget is that we're asking now, let's at least get what we're asking for, what we're pledging, what we're putting the name of the country on. And then we'll start trying to—if we can get that, then we can start making a dent again in our arrears problem.

So our request is sufficient and the President's budget is, obviously I support, and that's because right now we figure we—we were listening to Congress, we're trying to do the best we can, but frankly at some point we need to actually get what we actually ask for.

Chairman LUGAR. That's a very good point and that's the reason I asked the question, to elicit your response. In the past the Congress may not have paid that much attention to the question. So as we begin to have a better dialogue and we make progress together, there probably, I'm hopeful, will be more enthusiasm by members of this committee and members of this body in tackling this, in supporting this. But at the same time, we need to have

clearer figures from you on what the dues are and what the arrearages are so that, at least in the backs of our minds if not more forward, we have some idea of where we stand.

If you can furnish, just for the record of this hearing, where all of that stands, that would be very helpful to us.

Mr. LOWERY. Absolutely. Our arrears are \$738 million. But what we'll do is, we just actually put out our justification document for the budget over the last week, and we'll make sure that this committee gets a full accounting of it.

Chairman LUGAR. Excellent. Very timely.

Senator Martinez?

Senator MARTINEZ. Mr. Chairman thank you very much and thank you for calling this important hearing on the issue that I think is so important to the developing world. I'm delighted to hear from the panel this morning. I'm very encouraged, Ambassador Perry, by the information you give us on the progress being made in the African Development Bank. I would just comment that over the years, I think corruption has always been a concern in all relationships of these multinational banks. But just as much that as I have watched over the years, there's also been the misuse or the poor use of funds and the lack of measurable results on accountability.

One of the things that I've also observed is the concentration of very grandiose and large projects sometimes with, frankly, questionable results. And I wonder, is there any move or any direction, Mr. Lowery or Ambassador Perry, as to whether or not we should be looking or moving in a direction of more people lending, bringing it down to a level of assisting families, assisting small enterprises, micro-lending, things of this nature that might put money more directly in the hands of people. I'm not sure how you get from A to B and to C, but I just wondered if there's anything you can comment to me on that?

Mr. LOWERY. Thank you very much. This is a terrific question because it plays into exactly, I think, the way we like to think of these institutions.

One of the—our biggest priority right now probably, at the Inter-American Development Bank, is to promote small and medium enterprise assistance. The reason is that the—Latin American is going through a lot of changes but we are listening very carefully, very carefully to what Latin America is saying to us. And I think what we are hearing, and hopefully we're hearing it correctly, is the poor people of Latin America don't have the opportunities. They don't have the opportunities to grow a business, to make a living, to create jobs. And we think the Inter-American Development Bank can do a much better job on this area. And I was—again, I was just talking to the President of the IDB this morning about that very subject and we're going to be proposing a resolution, hopefully, at the annual meetings next week to basically engage all the Governors in a more effective manner on this front.

In terms of big infrastructure programs, infrastructure is important for development. We have to—development has got lots of factors to it. We have to worry about social sectors like education and health care, and providing clean water. But we also have to worry about infrastructure. We need to basically make sure that—most

poor countries are reliant on agriculture and so the poor farmers need to be able to get their products to markets, which means building small roads, building ports. Ports are tough to build, and there's a lot of corruption, unfortunately, associated with ports, so you have to be very careful about how it's done. The MDBs can play a vital role in that, but it has to be a very careful role.

Ambassador PERRY. I'm going to say, first of all, that that is not the same problem we have at the Bank. We're not making too large loans. We're making too many small loans. And what we're trying now to do is to think of ways to increase the size of those loans because it takes a lot of our energy and management time to process and to evaluate and to watch over. So we're trying to get into that mode.

But we do share the same concern you have, is that the money should be going to families, building families, and so, therefore, we have an emphasis on lending more to women who will take care of that particular interest, and putting more money into infrastructural development which, in itself, leads to more involvement of women and families in the whole aspect of development.

The President has just appointed two women vice presidents who also have that interest of bringing family—the plights of families and the whole incidence of illnesses and especially in Africa, you know, the HIV/AIDS, but all the attending diseases that need to be treated. So we are looking at the plight of the poor people.

We now, as you may now, have our first American vice president, who has top executive powers. And we hope that this will also help the Bank to move further into delivering to families. But I do thank you for your concern about it.

Senator MARTINEZ. Thank you. I would just ask one other question as it relates to the African Bank. I know that, as expressed by the Chairman and the acts of this Congress and—the United States has a strong commitment in this area of corruption and fighting corruption, and I wonder if the other investors of the Bank, the African Development Bank, share in our concern, are equally committed to that effort.

Ambassador PERRY. I would think that the non-African members are as concerned as we are about corruption. There are only six, let's say EDs who service that area of the non-African countries.

I would say there's less concern about corruption among our African EDs and therefore, we're spending a lot of time educating them to this question of corruption and how it's going to hurt their delivery to their constituent countries. So they support our efforts in this view, even though it might hurt some of their own countries as it goes through, at first. They are committed to supporting it.

Senator MARTINEZ. Thank you, Mr. Chairman.

Chairman LUGAR. Thank you very much, Senator Martinez. I have some additional questions for you, Director Perry. I have noted and many have stated that the African Development Bank is difficult to monitor because its project program and policy documents are not widely available. Should the African Development Bank more actively disseminate this information to civil society? And when should we expect the information about each African Development Bank project to be made available on the Web site of the Bank?

Ambassador PERRY. Many of the projects are already being put on the Web site. And our independent evaluation department, the OPEV, is helping us to do this. Our CSPs, for example, especially the draft CSPs, are being placed so that people can read them. All of our efforts toward anti-corruption are also on. The minutes of our board meetings are not on, but we've agreed to highlight—put the highlights of our actions on the Web. There's a lot of information that is on and is being prepared to go on. We're not where we'd like to be, but it is moving in that direction.

Chairman LUGAR. President Kaberuka has underscored the importance of measuring the development effectiveness of the Bank's operation.

Ambassador PERRY. Yes.

Chairman LUGAR. What can be done to promote these evaluations of the African Development Bank? Or what kind of evaluations has the President promoted at this point?

Ambassador PERRY. He's looking primarily at evaluations of our projects in the field, whether or not they are being completed the way that they say they are, to speed up disbursements, for example, which have traditionally been very slow at the Bank. We are concerned about corruption in some of the projects, to try to make sure it does not exist. This new support that we're getting from the Office of Technical Assistance is very important to our ability to do that, and the President has really pushed very hard for us to get this assistance, and we are grateful for that. That goes to our auditing efforts, goes to our whistleblowing efforts, to our follow up effectiveness evaluations.

We really appreciate this kind of support that is coming from the Treasury Department to us to help Mr. Kaberuka. But he's sort of made a mark in the sand, you know, that corruption is the biggest problem we have and that corruption is a bigger problem than disease and wars and all the things that we're plagued with, and has given it his full attention. I suppose that would be his mark in history, that he's been able to reduce—can anybody say that they will get rid of it? Especially in a tradition where corruption has always existed, to remove that from our country-states. It does not have to go on within the Bank. And that's what he's after, clean up the Bank first, and then let's use this kind of assistance we're getting from Treasury to advise our member-states in this whole area. He's working very hard at it, he has my faith that he's going to succeed.

Chairman LUGAR. You're modest in underscoring your role. It's important as the American Director of that Bank, in support of the President, that you have knowledge of his activities. Likewise as you've cited, this direct aid by the Treasury specifically to bring about changes in any corruption culture that may be there is important.

I'm just curious, is there any independent audit of what's happening? In other words, when you try to evaluate, either the President of the Bank or yourself, you call in technical personnel that you have in your employ, but do you bring in anybody else to look at this situation?

Ambassador PERRY. Yes, absolutely. We do have independent auditors who continually watch over what we're doing and the Bank and bring to our attention things that need to be worked on.

It is a constant kind of watchfulness I think, that did not exist in the last regime that has taken place. Now you understand that this President has only been there since September.

Chairman LUGAR. Yes.

Ambassador PERRY. His first job is to try to get everybody to understand where he's going and to get their complicity and their strength and energies to make it happen, even though it might change some of their lives as well. But we do have the internal and the external auditing function to make sure that we keep it clear. We haven't reached the success we want, but we're working at it. Thank you.

Chairman LUGAR. Let me ask a question which is a correlation of one I asked Secretary Lowery. Has the United States lost voting shares at the African Development Bank because of our failure to fully fund our pledges to the Bank?

Ambassador PERRY. I've got to look through my notes on that so I don't say the wrong thing.

Mr. LOWERY. I believe the answer is—

Ambassador PERRY. No, can I please answer it, though? Yes, I want to answer it myself.

I want to answer this because it's very important to me. It's of great concern to me. The U.S. has been consistently clear to both AFD management and other donors that we fully intended to purchase all of our allocated shares, which we lost during the last replenishment.

In addition to the innumerable hours which my staff and I in my office have spent over this issue over the last 12 months, and senior Treasury officials also engaged and wrote several letters to convey our interest and concern. And we raised it orally with the former and current Presidents, both here in Washington and in Tunis. Nonetheless, the Bank strictly followed its very tight share transfer reviews and, because we were unable to purchase our allocated shares by the deadline, another donor stepped forward to do so. So we lost approximately .2 percent of our voting shares.

Because of funding shortfalls now on the fiscal year 2006 request, we will also be short \$1.4 million on April 4, when our next payment falls due, and our inability to purchase those shares will result in a further reduction of voting share by approximately .5 percent. We can use our influence to get the management and to ring fence our shares and to hold them until we are able to pick them again on subsequent allocations.

But as it is right now, the rules read that if we forfeit it, then another country can move in and pick them up. This uncertain situation makes it much more difficult for us to secure the changes that we seek, and that you seek. It's important to fully fund our fiscal year 2000 request of \$5.02 million. But I must say, I wish it would come before fiscal year 2007 because a loss of these shares minimizes our influence in changing attitudes not only of our G-7 colleagues, but our African colleagues and making things happen at the Bank.

It's more than just really a question of losing voting power, but losing influence is most important. And I, you know, I hate to see it happen on my watch. So anything that could be done to pick up our arrearages would be great as of the 2006 cut. I think we're at

\$2 million now in arrears. That amounts to something like 189 shares. And these—if our shares are put into the general pool, then our G-7 colleagues have already said they'll pick up quickly unless their ring fenced so that they cannot be touched. So I will be working with our President on that. I think I have his confidence. It's a matter of keeping up his resolve and making some very difficult situations. This is the way I see my role, Mr. Chairman. Thank you very much for asking the question because it's very dear to my heart.

Chairman LUGAR. It's very important to us, too. As a committee, we've taken this project seriously. So have you. But our ability to work with others in other nations, our credibility for reform, is based upon at least some of the thrust of our enthusiasm to pick up the tab for our part of it, as we require them to do their share. So we will attempt to work together in this situation.

I would just say to both of you, I am encouraged by what is occurring. I would say modestly that our hearings have not been particularly very well covered in the United States. The people simply lose track of all these banks and what in the world we are doing.

But when we get into specifics of other countries, I can assure you that our press secretaries pick up many articles and editorials and for many countries it's a revelation of what has been occurring. The transparency happens really, because of your testimony or our questions or some combination of this. And that has brought some movement, I believe. It's made for more of a dialogue as our State Department officials or Treasury move around the world and visit with people. People ask what is going on here and why the deep concern, and you have opportunities to witness for this country and our ideals.

So I appreciate both of you coming this morning and the work that you are doing and your cooperation with us and we look forward to seeing you again, because this will be an ongoing pursuit.

Ambassador PERRY. Thank you Mr. Chairman.

Chairman LUGAR. Thank you.

Mr. LOWERY. Thank you very much Mr. Chairman.

Chairman LUGAR. Thank you Mr. Lowery. Let me now call upon our second panel of witnesses: Dr. William Easterly, professor of economics, New York University; Dr. Ruth Levine, acting President of the Center for Global Development; and Dr. Adam Lerrick, Director of the Gailliot Center for Public Policy at Carnegie Mellon University.

We welcome this distinguished panel. Perhaps you were here at the onset of the hearing at which I had mentioned that a number of Foreign Service Officers of the United States have joined us for this hearing.

We're very pleased to see the article in the Washington Post this morning that indicates that Foreign Service Officers in a good number of difficult places around the world will receive additional compensation for those posts. This is relevant to the banks and private firms, that a good number of these take their clue from these raises and these evaluations as to their compensation of persons who are abroad.

This, as the article points out, development today was a rather little known and uncommented part of legislation that actually

passed last year in conference with the Senate and with the House and now is seeing the light of day in the lives of about 80,000 persons in our Government, as well as others who are elsewhere.

I mention this because frequently as we talk about service abroad we are talking about multinational firms, multinational banks, in addition to our own diplomatic representation, and the presence of our country in these countries. These willing persons who are prepared to do difficult jobs and to do so consistently are tremendously important to recognize and, I believe, to compensate. So there is a reason for some rejoicing this morning. I take this liberty to simply mention our feeling in this committee.

We look forward to hearing your testimony about the issues at hand. And I'm going to ask you to testify in the order that I introduced you, which will be, first of all, Dr. Easterly, then Dr. Levine, and then Dr. Lerrick. And all of your statements will be made a part of the record in full and you may proceed as you wish. Dr. Easterly?

**STATEMENT OF DR. WILLIAM EASTERLY, PROFESSOR OF
ECONOMICS, NEW YORK UNIVERSITY**

Dr. EASTERLY. Thank you Mr. Chairman.

Mr. Chairman, UK Chancellor of the Exchequer, Gordon Brown recently gave a compassionate speech about the tragedy of extreme poverty afflicting billions of people, with millions of children dying from easily preventable diseases. He called for a doubling of foreign aid, a Marshall Plan for the world's poor. He offered hope by pointing out how easy it is to do good. Medicine that would prevent half of malaria deaths costs only 12 cents a dose. A bed net to prevent a child from getting malaria costs only 4 dollars. Preventing 5 million child deaths over the next 10 years would cost just 3 dollars for each new mother.

However, Gordon Brown and many other aid advocates have been silent about the other tragedy of the world's poor. This is the tragedy in which the West already spent \$2.3 trillion on foreign aid over the last 5 decades and still has not managed to get 12-cent medicines to children to prevent half of all malaria deaths. The West spent \$2.3 trillion and still had not managed to get 4-dollar bed nets to poor families. The West spent \$2.3 trillion and still had not managed to get 3 dollars to each new mother to prevent 5 million child deaths. It's a tragedy that so much well-meaning compassion did not bring these results for needy people.

The two key elements that have been missing in foreign aid have been feedback and accountability. And I salute your efforts to increase the accountability of the multilateral development banks. The needs of the rich, of course, get met through feedback and accountability. Consumers tell a firm that this product is worth the price by buying the product, or they decide the product is worthless and return it to the store. Voters tell their elected representatives that public services are inadequate and the politician, an elected representative, tries to fix the problem.

Profit-seeking firms make a product they find to be in high demand, but they also take responsibility for the product. If the product poisons the customer, they are liable, or at least they go out of business. Elected representatives take responsibility for the

quality of public services. If something goes wrong, they pay politically. If it succeeds, they get the political rewards.

Aid agencies could be held accountable for specific tasks. Instead of what we see are extremely weak or, really, even absent incentives that follow from the collective responsibility of all aid agencies and recipient governments for broad goals that depend on many other things besides aid agency effort, such as the current, very fashionable campaign to achieve the United Nations' millennium development goals.

If a bureaucracy shares responsibility with many other agencies to achieve vague goals that depend on many other things, then it is not accountable. Without accountability then the incentives for finding out what works is weak. True accountability would mean having an aid agency take responsibility for a specific, monitorable task to help the poor, whose outcome depends almost entirely on what the agency does. Then independent evaluation of how well the agency does the task will then create strong incentives for performance.

Although evaluation has taken place for a long time in foreign aid, it is often self-evaluation, using reports from the same people who implemented the project. Mr. Chairman, my students at NYU would not study very hard if I gave them the right to assign themselves their own grades.

The World Bank makes some attempt to achieve independence for its Operations Evaluation Department, which reports directly to the Board of the World Bank, not to the President. However, staff move back and forth between OED, the Operations Evaluation Department, and the rest of the rest of the Bank. A negative evaluation could hurt staffs career prospects. I actually experienced that personally when I wrote a negative evaluation and since moved onto another career. The OED evaluation is subjective.

Unclear methods lead to evaluation disconnects like one that delicately described in Mali. This is a quote: "It has to be asked how the largely positive findings of the evaluations can be reconciled with the poor development outcomes observed over the same period and the unfavorable views of local people."

Even when internal evaluation points out failure, do agencies hold anyone responsible or change aid agency practices? It is hard to find out from a review of the World Bank's evaluation Web site. The Operations Evaluation Department indicated how eight, what it called influential evaluations, influenced actions, not of the World Bank, but of the borrowing government in 32 different ways, but it mentioned only two instances of its evaluations affecting behavior within the World Bank, and one of them was for the worse.

The way forward is politically difficult. Truly independent evaluation of specific aid efforts. Not overall sweeping evaluations of a whole nationwide development program, but specific and continuous evaluation of particular interventions from which agencies can learn. Only outside political pressure on aid agencies are likely to create the incentives to do these evaluations. A World Bank study of evaluation in 2000 began with the confession, despite the billions of dollars spent on development assistance each year, there is still very little known about the actual impact of projects on the

poor. Mr. Chairman, I suggest that's an astonishing statement after a half century of the World Bank's existence.

The World Bank has recently changed the name of its Operations Evaluation Department. It is now called the Independent Evaluation Group, although it is unclear whether a name change is sufficient to achieve true independence. That evaluation unit still remains housed within the World Bank and still uses the same staff, which still obviously compromises their independence.

I know personally from my time at the World Bank of several examples, many examples, of pressure being brought to bear from the rest of the Bank on OED, now called the Independent Evaluation Group, to alter its evaluation reports. Negative reports were censored by the rest of the World Bank until the report was more favorable.

The solution is as obvious as it is unpopular. Create a truly independent group of evaluators who have no conflict of interest with the World Bank or other multilateral development banks. Require all the multilateral development banks to set aside some of their budget, such as the part now wasted on self-evaluation, for these independent evaluators. Many would understandably squirm at the thought of a new evaluation bureaucracy, but the good news about evaluation is that it can, and should, be one of the least bureaucratic activities imaginable. It can be completely decentralized, so that a loose network of independent evaluators can write their reports on a random sample of each multilateral development bank's projects and programs.

Of course, there has to be incentives to do something as a result of the evaluations. Allocations of money to multilateral development banks should go up or down depending on their average performance as rated by the independent evaluators. Also multilateral development banks should get credit for discontinuing failed programs, as reported by the evaluators, or fixing them if they are fixable, while inaction should be correspondingly penalized.

It is time, after half a century and \$2.3 trillion dollars, it is time for an end to the second tragedy of the world's poor, which will help make progress on the first tragedy, that of poverty itself. To gradually figure out how the poor can give more feedback to more accountable agents on what they know and what they most want and need. The big utopian dreams about ending world poverty, such as the U.N. Millennium Development Goals embraced by the World Bank, hold nobody accountable for anything. Can't we just hold the agents of charity accountable, so they do get 12-cent medicines to children to keep them from dying from malaria, do get 4-dollar bed nets to the poor to prevent malaria, do get 3 dollars to each new mother to prevent child deaths?

Thank you very much Mr. Chairman.

[The prepared statement of Dr. Easterly follows:]

PREPARED STATEMENT OF DR. WILLIAM EASTERLY, PROFESSOR OF ECONOMICS,
NEW YORK UNIVERSITY

ACCOUNTABILITY FOR MULTILATERAL DEVELOPMENT BANKS*

INTRODUCTION

I am driving out of Addis Ababa, Ethiopia to the countryside. An endless line of women and girls is marching in the opposite direction into the city. They range in age from 9 to 59. Each one is bent nearly double under a load of firewood. The heavy load propels them forward almost at a trot. I think of slaves driven along by an invisible slave-driver. They are carrying the firewood from miles outside of Addis Ababa, where there are eucalyptus forests, across the denuded lands circling the city. They bring the wood to the main city market, where they will sell the load for a couple of dollars. That will be it for their day's income, as it takes all day to heft firewood into Addis and to walk back.

I later found that BBC News had posted a story about one of the firewood collectors. Amaretech, age 10, woke up at 3 a.m. to collect eucalyptus branches and leaves, then began the long and painful march into the city. Amaretech, whose name means "beautiful one," is the youngest of 4 children in her family. She says:

I don't want to have to carry wood all my life. But at the moment I have no choice because we are so poor. All of us children carry wood to help our mother and father buy food for us. I would prefer to be able to just go to school and not have to worry about getting money.¹

The World Bank and other aid agencies aim at reducing this tragic poverty. Former President James Wolfensohn of the World Bank put on the wall of the lobby of World Bank headquarters the words "our dream is a world free of poverty." He wrote about this dream with inspiration and eloquence:

If we act now with realism and foresight,
if we show courage,
if we think globally and
allocate our resources accordingly,
we can give our children a
more peaceful and equitable world.
One where suffering will be reduced.
Where children everywhere
will have a sense of hope.
This is not just a dream.
It is our responsibility.²

The Two Tragedies of the World's Poor

UK Chancellor of the Exchequer Gordon Brown is also eloquent about the tragedy of the world's poor, at least one of their two tragedies. In January 2005, he gave a compassionate speech about the tragedy of extreme poverty afflicting billions of people, with millions of children dying from easily preventable diseases. He called for a doubling of foreign aid, a Marshall Plan for the world's poor, an International Financing Facility (IFF) to borrow tens of billions more dollars against future aid to rescue the poor today. He offered hope by pointing out how easy it is to do good. Medicine that would prevent half of malaria deaths costs only 12 cents a dose. A bed net to prevent a child from getting malaria costs only \$4. Preventing 5 million child deaths over the next 10 years would cost just \$3 for each new mother. An aid program to give cash to families who put their children in school, getting children like Amaretech into elementary school, would cost little.³

However, Gordon Brown was silent about the other tragedy of the world's poor. This is the tragedy in which the West already spent \$2.3 trillion on foreign aid over the last 5 decades and still had not managed to get 12-cent medicines to children to prevent half of all malaria deaths. The West spent \$2.3 trillion and still had not managed to get \$4 bed nets to poor families. The West spent \$2.3 trillion and still had not managed to get \$3 to each new mother to prevent 5 million child deaths. The West spent \$2.3 trillion and Amaretech is still carrying firewood and not going to school. It's a tragedy that so much well-meaning compassion did not bring these results for needy people.

*My publisher would like me to announce at this point for copyright purposes that this testimony is excerpted from William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good* (The Penguin Press: New York), 2006. This does not prohibit the posting of this excerpt on the Internet.

Planners Versus Searchers

A big part of the problem in aid is that aid agencies like the World Bank adopt sweeping goals like ending world poverty, for which it is impossible to hold them accountable. They follow an unproductive Planners' approach to foreign aid, where a more humble but much more productive Searchers' approach would work better. In foreign aid, Planners announce good intentions but don't motivate anyone to carry them out; Searchers find things that work and get some reward. Planners raise expectations but take no responsibility for meeting them; Searchers accept responsibility for their actions. Planners determine what to supply; Searchers find out what is in demand. Planners apply global blueprints; Searchers adapt to local conditions. Planners at the Top lack knowledge of the Bottom; Searchers find out what the reality is at the Bottom. Planners never hear whether the Planned got what they needed; Searchers find out if the customer is satisfied. Will Gordon Brown be held accountable if the new wave of aid still does not get 12-cent medicines to children with malaria?

Indeed, the two key elements that make searches work, and the absence of which is fatal to plans, are feedback and accountability. Searchers only know if something works if the people at the bottom can give feedback. This is why successful Searchers have to be close to the customers at the bottom, rather than surveying the world from the top. Consumers tell the firm "this product is worth the price" by buying the product, or decide the product is worthless and return it to the store. Voters tell their local politician that "public services stink" and the politician tries to fix the problem.

Lack of feedback is one of the most critical flaws in existing aid. It comes about because of the near-invisibility of efforts and results by aid agencies in distant parts of the world. Many aid critics are beginning to explore how to address this flaw, from employing local "watchers" of aid projects to doing independent evaluation of aid projects.

Of course, feedback only works if somebody listens. Once a Searcher implements the result of a search, they take responsibility for the outcome. Profit-seeking firms make a product they find to be in high demand, but they also take responsibility for the product—if the product poisons the customer, they are liable, or at least they go out of business. A political reformer takes responsibility for the results of the reform. If something goes wrong, they pay politically, perhaps by losing office. If it succeeds, they get the political rewards.

Although all governments include bureaucracy, in well-developed democratic governments the bureaucrats are somewhat more specialized and accountable for specific results to the citizens (although God knows they try hard not to be). Active civic organizations and political lobbies operate from the bottom up to hold leaders and bureaucrats accountable, correcting mistaken steps and rewarding positive ones. Rich voters complain if municipal trash collectors don't pick up their trash; politicians and bureaucrats have political incentives to correct any breakdown in trash collection. Feedback guides democratic governments toward supplying services the market cannot supply, and toward providing institutions for the markets to work.

At a higher level, accountability is necessary to motivate a whole organization or government to use Searchers. In contrast, Planners flourish where there is little accountability. Again, outsiders don't have much accountability and so are Planners; insiders have more accountability and are more likely to be Searchers.

We will see some of the helpful changes that can happen in aid when increasing accountability, shifting power from Planners to Searchers. Aid agencies can be held accountable for specific tasks, rather than the weak incentives that follow from collective responsibility of all aid agencies and recipient governments for broad goals that depend on many other things besides aid agency effort. Aid workers now tend to be ineffective generalists; accountability would make them into more effective specialists.

To oversimplify by a couple gigawatts, the needs of the rich get met because they give feedback to political and economic Searchers, and they can hold the Searchers accountable for following through with specific actions. The needs of the poor don't get met because they have little money or political power with which to make their needs known and to hold somebody accountable to meet those needs—they are stuck with Planners. The second tragedy continues.

The prevalence of ineffective Plans is because the results of Western assistance happen out of view of the Western public. More ineffective approaches survive than they would if results were more visible. The Big Plans are attractive to politicians, celebrities, and activists who want to make a big splash, without the Western public realizing that the Big Plans at the top are not connected to reality at the bottom.

Desperate Needs

The effort wasted on the Plans is all the more tragic when we consider some of the simple, desperate needs of the poor, which Searchers could address piecemeal. The typical country in Africa has a third of the children under 5 with stunted growth due to malnutrition. A group of women in Nigeria report that they are too weakened by hunger to breast-feed their babies. Throughout Africa, there is a long “hungry season” in between when the stores from the last harvest run out and the new crop becomes available. Even in a more prosperous region like Latin America, a fifth of children suffer from malnutrition. Malnutrition lowers the life potential of children, as well as making them more vulnerable to killer diseases. As a woman in Voluntad de Dios, Ecuador put it, children get sick “because of lack of food. We are poor. We have no money to buy or to feed ourselves.”⁴

In Kwalala, Malawi, wells break down during the rainy system because of lack of maintenance. Villagers are forced to take their drinking water from the lake, even though they know it is contaminated with human waste from the highlands, causing diseases like diarrhea and schistosomiasis.⁵ Schistosomiasis is caused by parasitic worms passed along through contaminated water; it causes damage to the lungs, liver, bladder, and intestines.⁶

An old man in Ethiopia says:

Poverty snatched away my wife from me. When she got sick, I tried my best to cure her with *tebel* [holy water] and *woukabi* [spirits], for these were the only things a poor person could afford. However, God took her away. My son, too, was killed by malaria. Now I am alone.⁷

Some success stories show that aid agencies can make progress on problems like these. There have been successful programs feeding the hungry, which means children could get food in Voluntad de Dios, Ecuador. Success on expanding access to clean water could help the villagers of Kwalala, Malawi. In Mbwadzulu, Malawi, in fact, two new boreholes have allowed villagers to discontinue using polluted lake water, causing a decline in cholera.⁸ The Ethiopian man’s tragedy could have been avoided with cheap medicines.

In Ethiopia, Etenshe Ajele, 36, spent 12 years carrying firewood into Addis Ababa. Now she is trying to help women and girls like Amaretech. She runs the Former Women Fuelwood Carriers’ Association, whose members teach girls so they can stay out of the firewood brigade. Etenshe Ajele and her colleagues also teach women alternative skills, like weaving, and give them small loans for startup capital. “Most women know how to weave but do not have enough money to buy materials,” says Ajele, “So we provide that and we also help them with new and different designs so that they can sell the shawls and dresses that they make more easily.”⁹ This Association is no panacea—it still has not reached Amaretech—but it shows the kind of homegrown effort that foreign donors could support much more.

Accountability and Evaluation

If a bureaucracy shares responsibilities with other agencies to achieve vague goals that depend on many other things, then it is not accountable to its intended beneficiaries—the poor. Without accountability, then the incentive for finding out what works is weak. True accountability would mean having an aid agency take responsibility for a specific, monitorable task to help the poor, whose outcome depends almost entirely on what the agency does. Then independent evaluation of how well the agency does the task will then create strong incentives for performance.

Although evaluation has taken place for a long time in foreign aid, it is often self-evaluation, using reports from the same people who implemented the project. My students at NYU would not study very hard if I gave them the right to assign themselves their own grades.

The World Bank makes some attempt to achieve independence for its Operations Evaluation Department (OED), which reports directly to the Board of the World Bank, not to the President. However, staff move back and forth between OED and the rest of the Bank—a negative evaluation could hurt staffs’ career prospects. The OED evaluation is subjective. Unclear methods lead to evaluation disconnects like that delicately described in Mali:¹⁰

it has to be asked how the largely positive findings of the evaluations can be reconciled with the poor development outcomes observed over the same period (1985–1995) and the unfavourable views of local people. (p. 26)

Even when internal evaluation points out failure, do agencies hold anyone responsible or change aid agency practices? It is hard to find out from a review of the World Bank’s evaluation web site. The OED in 2004 indicated how eight “influential evaluations” influenced actions of the borrower in 32 different ways, but mentioned

only two instances of affecting behavior within the World Bank itself (one of them for the worse).

The way forward is politically difficult—truly independent scientific evaluation of specific aid efforts. Not overall sweeping evaluations of a whole nationwide development program, but specific and continuous evaluation of particular interventions from which agencies can learn. Only outside political pressure on aid agencies are likely to create the incentives to do these evaluations. A World Bank study of evaluation in 2000 began with the confession “Despite the billions of dollars spent on development assistance each year, there is still very little known about the actual impact of projects on the poor.”¹¹

After years of pressure, the IMF created an Independent Evaluation Office in 2001. The World Bank in 2004 laudably created a Development Impact Evaluation Taskforce. The taskforce will use the randomized controlled trial methodology followed by most academic researchers to assess the impact of selected interventions on the intended beneficiaries. The taskforce has started two dozen new evaluations in four areas (conditional cash transfers in low income countries, school based management, contract teachers, use of information as an accountability tool for schools and slum upgrading programs). It remains to be seen if the evaluation results change the incentives to do effective programs in the operational side of the World Bank. The World Bank also changed the name of its Operations Evaluation Department to Independent Evaluation Group, although it is unclear as of this writing to what extent this represents real change.

Despite the use of the word “independent” by both the IMF and the World Bank, these evaluation units still remain housed within these organizations and use the same staff, which obviously compromises their independence. I know personally from my time at the World Bank of several examples of pressure being brought to bear from the rest of the Bank on OED (now called IEG) to alter its evaluation.

The solution is as obvious as it is unpopular—create a truly independent group of evaluators who have no conflict of interest with the World Bank or other multilateral development banks. Require all the multilateral development banks to set aside some of their budget (such as the part now wasted on self-evaluation) for these independent evaluators. Many would understandably squirm at the thought of a new Evaluation Bureaucracy, but the good news about evaluation is that it can—and should—be one of the least bureaucratic activities imaginable. It can be completely decentralized, so that a loose network of independent evaluators can write their reports on a random sample of each multilateral development bank’s projects and programs. An evaluation unit should be more like The New York Times than like The Bureaucracy that Ate Foreign Aid. A minimal staff of “editors” can simply assign projects to “reporters” (evaluators) and publish the results. Of course, there has to be incentives to do something as a result of the evaluations—allocations of money to multilateral development banks should go up or down depending on their average performance as rated by the independent evaluators. Also multilateral development banks should get credit for discontinuing failed programs or fixing them if they are fixable, while inaction should be correspondingly penalized.

Success Through Evaluation

In 1997, the Mexican Deputy Minister of Finance, a well-known economist named Santiago Levy, came up with an innovative program to help poor people help themselves. Called PROGRESA (Programa Nacional de Educacion, Salud y Alimentacion), the program provides cash grants to mothers if they keep their children in school, participate in health education programs, and bring the kids to health clinics for nutrition supplements and regular checkups.

Since the Mexican federal budget didn’t have enough money to reach everyone, Levy doled out the scarce funds in a way that the program could be scientifically evaluated. The program randomly selected two hundred and fifty-three villages to get the benefits, with another two hundred and fifty-three villages (not yet getting benefits) chosen as comparators. Data was collected on all 506 villages before and after the beginning of the program. The Mexican government gave the task of evaluating the program to the International Food Policy Research Institute (IFPRI), who commissioned academic studies of the program’s effects.

The academic findings confirmed that the program worked. Children receiving PROGRESA benefits had a 23 percent reduction in the incidence of illness, a 1–4 percent increase in height, and an 18 percent reduction in anemia. Adults had 19 percent fewer days lost to illness. There was a 3.4 percent increase in enrollment for all students in grades 1 through 8; the increase was largest among girls who had completed grade 6, at 14.8 percent.¹²

More anecdotally, people in a small village called Buenavista have noticed the difference. One mother says that she can feed her children meat twice a week now to

supplement the tortillas, thanks to the money she receives from PROGRESA. Schoolteacher Santiago Dias notices that attendance is up in Buenavista's two-room schoolhouse. Moreover, Dias says "because they are better fed, the children can concentrate for longer periods. And knowing that their mothers' benefits depend on their being at school, the children seem more eager to learn."¹³

Because the program was such a clearly documented success, it was continued despite the voters' rejection of the long-time ruling party in Mexico's democratic revolution in 2000. By that time, PROGRESA was reaching 10 percent of the families in Mexico and had a budget of \$800 million. The new government expanded it to cover the urban poor. Similar programs began in neighboring countries with support from the World Bank.¹⁴

The lesson for aid reformers is: a combination of free choice and scientific evaluation can build support for an aid program where things that work can be expanded rapidly. The cash-for-education-and-nutrition in itself could be expanded, with suitable local adjustments, to more countries and on a much larger scale than it is now. A program like this in Ethiopia could get the girls around Addis Ababa out of being slaves to firewood and get them in school where they can gain the skills to escape poverty.

CONCLUSION

Only an elite few in the West can be Planners. People everywhere, not just in the West, can all be Searchers. Searchers can all look for piecemeal, gradual improvements in the lives of the poor, in the working of foreign aid, in the working of private markets, in the actions of Western governments that affect the Rest. Many Searchers can watch foreign aid at work in many locales around the world and let their voice be heard when it doesn't deliver the goods. It is time for an end to the second tragedy of the world's poor, which will help make progress on the first tragedy. To gradually figure out how the poor can give more feedback to more accountable agents on what they know and what they most want and need. The Big Plans and Utopian Dreams just get in the way, wasting scarce energies. Can't we just hold the agents of charity accountable, so they do get 12-cent medicines to children to keep them dying from malaria, do get \$4 bed-nets to the poor to prevent malaria, do get \$3 to each new mother to prevent child deaths, do get Amaretech into school?

ENDNOTES

¹ http://news.bbc.co.uk/1/shared/spl/hi/picture_gallery/04/africa_ethiopian_wood_collector/html/7.stm

² World Bank, *Our Dream: A World Free of Poverty* (November 2000).

³ Gordon Brown speech at National Gallery of Scotland, January 6, 2005. International Development in 2005: the Challenge and the Opportunity, Gordon Brown Press 2005-03.htm

⁴ WHO and World Bank, *Dying for Change*, Washington DC, 2003, p. 10.

⁵ *ibid*, p. 11.

⁶ http://www.cdc.gov/ncidod/dpd/parasites/schistosomiasis/factsht1_schistosomiasis.htm

⁷ WHO and World Bank, *Dying for Change*, Washington DC, 2003, p. 21.

⁸ *From Many Lands, Voices of the Poor* Volume 3, World Bank, 2002, p. 63.

⁹ http://news.bbc.co.uk/1/shared/spl/hi/picture_gallery/04/africa_ethiopian_wood_collector/html/7.stm

¹⁰ OECD and UNDP 1999.

¹¹ Judy L. Baker, *Evaluating the Impact of Development Projects on Poverty: A Handbook for Practitioners; Directions in Development*, The World Bank, Washington, D.C.

¹² I am paraphrasing the summary of Esther Duflo and Michael Kremer, *Use of Randomization in the Evaluation of Development Effectiveness*, mimeo MIT and Harvard University, 2004.

¹³ http://news.bbc.co.uk/1/hi/programmes/crossing_continents/412802.stm

¹⁴ Duflo and Kremer 2004.

Chairman LUGAR. Thank you very much Dr. Easterly. Dr. Levine?

STATEMENT OF DR. RUTH E. LEVINE, DIRECTOR OF PROGRAMS, CENTER FOR GLOBAL DEVELOPMENT

Dr. LEVINE. Thank you very much Chairman Lugar. I am very grateful for this opportunity to contribute to an essential and time-

ly debate about the effectiveness of multilateral development banks.

To start with an obvious point: to succeed as institutions, MDBs have to succeed in their main business, and that's working with governments to finance programs that improve welfare, productivity, access to credit and other resources, and long term prosperity of those who are sometimes called the ultimate beneficiaries.

The ideal of the development enterprise reflects the spirit of the well-known Chinese proverb, probably heard several times each year in this room: "Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime." So development assistance is not primarily about the transfer of financial resources from wealthy countries to poor countries for immediate survival. It's about providing a foundation of knowledge for long-term development. I am sure that you and others who energetically fight corruption do so because you believe the funds, if used as intended in the project design, will yield those sorts of results. But will they?

Sadly, as Bill Easterly indicated, we now have very few ways to answer that question. From my experience at the World Bank and the Inter-American Development Bank, as well as my recent research, I can tell you that there is much more talk of results than measurement of them. The institutional focus of performance monitoring remains how much money did we move out the door, and what were the outputs? The schools built, the teachers trained, the poor women enrolled in microcredit programs and others. That goes some distance, but it's not nearly enough.

We don't ask whether those investments made a real difference relative to what would have happened without the programs. Did more children get to school and stay in school and then enter the labor market? Did households raise themselves out of poverty?

For most types of programs financed by the multilateral development banks, a body of sound evidence about effectiveness is lacking.

For almost all projects currently in the pipeline, virtually no credible information will be generated about program impact. For lack of feedback through good impact evaluation, the banks continue to repeat failed approaches and miss opportunities to expand successful ones. In short, we don't know how to fish, we're not learning how to fish, and we have very little hope of teaching others how to fish.

At the Center for Global Development, the Evaluation Gap Working Group has spent many months thinking through the reasons for the shortcomings in impact evaluation, and assessing the demand for knowledge about program performance within development agencies, among constituencies, and in developing countries. In addition to encouraging efforts to improving evaluation and create a culture of learning within institutions, we believe this may be a moment to call for a collective international initiative to develop an impact evaluation agenda, agree to rigorous methodological standards and jointly fund design and implementation of a set of independent impact evaluations.

While the overall agenda of evaluation questions should be developed by interested parties, including those in this chamber, impact evaluations themselves need to be done independently of the major

international agencies and borrowing country governments. Returning to the example of the fish, I think we'd all agree that it's better to ask an impartial judge to measure a fish with a standard ruler than to ask the fisherman to guess at the size of his catch.

Independent evaluations would be more credible in the public eye and less subject to the inappropriate pressures that Dr. Easterly referred to within institutions to modify results or conclusions, or limit dissemination of unfavorable findings.

This committee, and the U.S. Congress more generally, can take a leadership role in fostering genuine, long-term success of the multilateral development banks, as well as other development agencies by sending the right signals with three clear statements. First, that Congress values and demands the type of knowledge about program impact that comes from rigorous evaluation. Second, that Congress sees development agencies' success first and foremost in terms of whether the many, many program experiences that are being financed are yielding learning. Some work, some don't, we have to learn from both types of programs. And the relevant new knowledge needs to be shared with partner governments, as a key ingredient for long-term, sustained development. And finally, Congress can send a signal that it has an interest in exploring new ways to foster independent, high quality impact evaluation across the banks and other agencies.

I think if we are really serious about getting to the point where the multilateral development banks are fulfilling their tremendous potential, and for the efforts to combat corruption themselves to be meaningful, we have to systematically, rigorously, and independently evaluate the impact of the programs that are financed. Thank you.

[The prepared statement of Dr. Levine follows:]

PREPARED STATEMENT OF RUTH E. LEVINE, DIRECTOR OF PROGRAMS AND SENIOR FELLOW, CENTER FOR GLOBAL DEVELOPMENT

Chairman Lugar, ranking minority member Biden and members of the committee: I very much appreciate the opportunity afforded by this committee and its staff to contribute to an essential and timely debate about how to improve the ability of development banks to support progress in low- and middle-income countries. What I will speak about today is based on work we have done over the past 2 years, under the auspices of the Evaluation Gap Working Group at the Center for Global Development. I would like my full testimony to be entered as part of the record, and I will summarize my major points.

To start with an obvious point: To succeed as institutions, multilateral development banks must succeed in their main business. In the near term, their main business is working with low- and middle-income governments to finance projects and programs that lead to better economic and social conditions than would have occurred without those projects or programs. The results from these investments should be valuable not only in absolute terms, but relative to the value of alternative uses of the funds. In the long-term, the banks' contributions must be still greater. They must help establish the fundamental conditions under which developing country governments can foster the welfare, productivity and prosperity of their people.

The ideal of the development enterprise, in which multilateral development banks play a special role, reflects the spirit of the well-known Chinese proverb: "Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime." In other words, development assistance is not solely or even primarily about the transfer of financial resources from wealthy countries to meet immediate survival needs of poorer nations; it is about providing the foundation of knowledge that constitutes the basis for long-term development. This is particularly true for development banks, who principally offer loan financing. Such resources are, by defi-

tion, appropriate only for investments oriented toward improved outcomes over the long-term.

In contrast, the success of development banks cannot be measured on the basis of whether they remain solvent, are on good terms with Congress and non-governmental organizations, have contented employees, or fight corruption at home and abroad. These probably are all necessary, but they are not sufficient. Success of development banks, as of other development agencies, rests on whether they can make the lives of those who are sometimes referred to as the “ultimate beneficiaries” better off, in a meaningful and sustained way.

Knowing whether or not the banks are succeeding in financing programs that directly improve people’s lives is the core of accountability. Assessing this type of performance comes from impact evaluations, defined as evaluations that measure the results of an intervention in terms of changes in key variables (e.g. mortality, health status, school achievement, labor force status) that can be directly credited to the program itself, as distinguished from changes that are due to other factors. That is, they are evaluations that permit attribution of program-specific effects.

At the World Bank and other development banks, as in the field of development more broadly, there has been far more talk of “results” than measurement of them. Much emphasis has been placed on measuring and tracking inputs (such as commitments and disbursements) and assessing at the conclusion of a project whether the activities anticipated at the design stage have been completed. For example, were the schools built, teachers trained, blackboards procured? Did the government undertake the hoped-for changes in hospital finance or contracting with NGOs for delivery of basic health services? I can tell you from my experience within the World Bank and the InterAmerican Development Bank, and my observation from my current vantage point at the Center for Global Development, the institutional focus of monitoring performance remains very much on the “how much money did we move out the door?” and “what was financed?”

Distressingly, very little investment has been made in conducting rigorous impact evaluations that are necessary to tell us which interventions and approaches do and do not work in achieving the real goals of all that spending and program activity. Did those schools, teachers and blackboards result in more children attending and completing school than would have occurred in the absence of the project? Did the innovations in health finance and organization yield the results anticipated: less financial exposure of poor people when they became ill? Better use of essential health services, and ultimately better health? The failure to answer those basic questions in a systematic way leaves the banks, and the professionals and high-level decision-makers within them, lacking feedback to foster improvement; it leaves Congressional overseers, taxpayers and others who wish to hold the institutions accountable for results with little to go on. I suspect those in this chamber are personally familiar with this deeply frustrating situation. I imagine that when you evaluate the development bank’s performance, you would rather hear the results of serious impact evaluations of a sample of important programs than a recitation of amounts committed and disbursed, or number of textbooks procured.

Paradoxically, underinvestment in impact evaluation (and consequent under-supply of evidence about the relationship between specific types of investments and their effects) means that the banks have few chances of succeeding in the even more important goal of “teaching a man to fish”: If we don’t learn whether a program works in changing the well-being of beneficiaries, how can a government know if it is worth putting the money and effort into similar programs in the future? If we don’t bother to measure the results that are direct consequences of the specific program, how can anyone make a credible case for this, or any other type of expenditure of public funds? If we don’t learn whether and why our investments yield benefits, we have fundamentally failed.

Why So Little Impact Evaluation?

Several factors explain the lack of impact evaluation.

- Good impact evaluations require a degree of technical sophistication that has only emerged only recently among those who focus on international development, although it has been available to US domestic social programs since the 1970s. (Think, for example, of the landmark studies of Head Start, the tradition of excellent evaluations of within income support and job training programs in the US, and the Department of Education’s laudable program evaluation initiatives today.) While many studies compare conditions before and after a project, such comparisons can be quite misleading without attention to other factors that might have also contributed to observed changes. Only by comparing observed changes among those who benefited from a project to some other control group is it possible to begin to disentangle how much of the effects can be at-

tributed to the project or program itself. For example, when HIV prevention programs are evaluated, it is essential to measure the change in HIV incidence with both those participating in the program and a set of similar individuals or communities not exposed to program activities. Without such a comparison, before-after changes are impossible to interpret. A fall in HIV incidence in the population within the program—an observation that would likely be called “success” by the program implementers—might simply reflect declines due to non-program factors. A rise in HIV incidence among program participants—something that might be seen as “failure”—might actually reveal success if incidence is rising more slowly than in the general population. Without appropriate comparisons, we will never know. Separating out the changes due to projects from changes due to other factors is a complicated business that may require random assignment of beneficiaries or other methods. Fortunately, advances in research methods and increasing capacity around the world to conduct such impact evaluations are beginning to surmount these technical difficulties. Interestingly, we have seen how feasible this is through experiences in Mexico, where excellent design of PROGRESA, a conditional cash transfer program, illustrated the possibility and the value of introducing rigorous evaluation within the design a program as it scales up.

- Demand for the knowledge produced by impact evaluations tends to be distributed across many actors and across time. It is only at the moment of designing a new program, however, that anything can be effectively done to start an impact evaluation. At that precise moment, program designers want the benefit of prior research, yet have few incentives to invest in starting a new study. In contrast, they will get rewarded for quickly starting implementation, rather than doing the spadework to undertake a baseline study. Paradoxically, if they do not invest in a new study, the same program designers will find themselves in the exact same position 4 or 5 years later because of the missed opportunity to learn whether or not the intervention has an impact.¹ Because information from impact evaluations is a public good, other institutions and governments that might have obtained valuable knowledge from the experience also lose when these investments in learning about impact are neglected.
- Evaluation simply is not seen as the central business of the development banks. When material and human resources are stretched, short-term operational demands will over-ride the longer-term, more strategic imperative of evaluation and learning. As one indication, resources spent to design and implement impact evaluations were not even recognized as a separate item in the World Bank’s budgeting system until 2005. Most task managers at the development banks can tell very sad tales about watching their evaluation budgets disappear during negotiations with either management or borrowing governments.
- Those rare individuals within large bureaucracies who wish to undertake impact evaluations typically encounter daunting resistance. Program implementers may perceive evaluation as a threat, potentially leading to a cut-off of funding if results are not uniformly positive. At higher levels in an organization, managers who are responsive to demands by shareholders for “results, results, results” may prefer to promulgate anecdotes about success, without regard to the strength of evidence, rather than expose the genuine lessons of experience—including the occasions when results were poor. This behavior continues if it is tolerated by the institutions’ constituencies and funders, including legislative bodies.

All of these reasons contribute to the situation observed today: For most types of programs, a body of scientific evidence about effectiveness is lacking. For almost all projects currently in operation or in the pipeline, virtually no credible information will be generated about program impact. The banks don’t know whether they are succeeding, and they are not generating knowledge for the future. For lack of feedback, the banks continue to repeat failed approaches, and miss opportunities to expand upon successful ones. In short: We do not know how to fish. We are not learning how to fish. We have little hope of teaching others how to fish.

What Can Be Done?

Fortunately, some have recognized this problem, care about solving it, and are trying hard to find a way to do so. Within the development banks, the Independent Evaluation Departments make heroic efforts to squeeze knowledge out of the experiences of projects that are conducted without baseline data, without comparison

¹O’Donoghue, T., Rubin, M., 1999. “Doing It Now or Later.” *The American Economic Review* 89, 103–124.

groups, frequently without any impact indicators at all. This is a difficult and often fruitless task, although it does generate the basis for improvements in the operational activities, which is very valuable. They deserve additional resources so that they can undertake more in-depth studies.

Separate from the Independent Evaluation Department (previously called Operations Evaluation Department), in the past couple of years, the World Bank has created a new initiative called the Development IMPact Evaluation (DIME) to increase the number of Bank projects with impact evaluation components, particularly in strategic areas and themes; to increase the ability of staff to design and carry out such evaluations, and to build a process of systematic learning on effective development interventions based on lessons learned from those evaluations. The regional development banks also have undertaken a limited set of impact evaluations, within either research or evaluation departments. These efforts should be recognized and provided with additional institutional resources so that they contribute to a cultural change.

But much more is required, both within and outside of the institutions. Indeed, a broader and bolder solution to the problem is needed. Three central elements are required for a lasting and genuine solution to the problem of lack of knowledge about what works.

First, we need to use good evaluation methods to get answers to important questions. This means identifying the enduring questions, a process that would be done best in true partnership between developing countries and the range of institutions that provide development finance. The World Bank has made a start by identifying a handful of thematic areas within its impact evaluation initiative. But the benefits of concentrating such studies around enduring questions across agencies and countries would be far greater.

Second, we need to use evaluation methods that yield answers. This means increasing the number of impact evaluations that use rigorous methods—such as random assignment and regression discontinuity—and applying them to a small number of programs from which the most can be learned.

Third, while the overall agenda should be developed by the “interested parties,” impact evaluations themselves need to be done independently of the major international agencies and borrowing country governments. Returning to the example of the fish, I think we’d all agree that it is better to ask an impartial judge to measure a fish with a standard ruler than to ask a fisherman to guess at the size of his catch! Independent evaluations would be more credible in the public eye, and less subject to inappropriate pressures within institutions to modify results or conclusions, or limit dissemination of unfavorable findings. We have learned about the value of independence in evaluation many times over in other fields, including medicine and social programs in our own country. The existence of an independent source of impact evaluation—geared to a longer time frame and toward learning—will avoid many of the inevitable pressures to focus on implementation alone, and restrict the communication of bad news to higher levels of management.

At the Center for Global Development, we have spent many months thinking through the reasons for the shortcoming in impact evaluation, assessing the demand for knowledge about program performance, learning about the efforts in the development banks, bilateral agencies and developing country governments related to evaluation, and developing options and recommendations. In addition to encouraging within-institution efforts to improve evaluation and create a culture of learning, we believe this may be a moment to call for a collective international initiative for leading-edge bilateral and multilateral development agencies to develop a shared impact evaluation agenda (working with interested developing countries), agree to methodological standards and, potentially, jointly fund both design and independent implementation of impact evaluations on enduring questions in international development. We have developed ideas about many of the specific functions for such an initiative, and believe that there are technically, politically, and financially feasible institutional options.

CONCLUSION

This committee, and the U.S. Congress more generally, can take a leadership role in fostering genuine, long-term success of multilateral development banks, as well as other agencies. This can be done by making three clear statements: First, that Congress values and demands the type of knowledge about program impact that comes from rigorous evaluation. Second, that Congress sees development agencies’ success first and foremost in terms of whether the program experiences are yielding true learning, with relevant new knowledge being shared with partner governments, as a key ingredient for long-term, sustained development. Third, that Congress has

an interest in exploring mechanisms to foster independent high quality impact evaluation across agencies.

I firmly believe that the development banks have tremendous untapped potential to contribute to improved outcomes over the long term—the healthier children, more productive adults, cleaner environment and lasting prosperity that we wish for all nations. From personal experience as well as recent research, I believe that they will not be firmly on the track toward fulfilling that potential until the development banks ask, and publicly answer, serious questions about the impact of their programs.

Chairman LUGAR. Thank you very much. Dr. Lerrick?

**STATEMENT OF DR. ADAM LERRICK, DIRECTOR OF THE
GAILLIOT CENTER FOR PUBLIC POLICY, CARNEGIE MELLON
UNIVERSITY**

Dr. LERRICK. Senator, I think you're going to hear quite a few things over and over again during this hearing—but given my reputation as an outspoken critic, they'll just be louder, possibly, from me.

Chairman LUGAR. Very well.

Dr. LERRICK. I will remark that those who say nice things about the bank are called economists, and people who say critical things are called outspoken critics. However, I consider myself a member of the loyal opposition.

First of all, it's a privilege to appear before the Senate Foreign Relations Committee.

The World Bank has just changed the name of its Operations Evaluation Department. This sends a clear signal that the Bank has no intention of changing its ways. The new sign on the door reads Independent Evaluation Group. The Bank is digging in to fend off an increasingly vocal demand for a truly independent review of its stewardship of aid. I think what this panel has said confirms that.

After half a century and more than half a trillion dollars, there is little to show for World Bank efforts. But we have no measure of the Bank's performance except the one it chooses to promulgate and no means to validate the wisdom of the industrialized world's collective investment decision.

The optimism of weighty reports cannot cover up the realities on the ground. The living standards of the poorest nations have stagnated and, in sub-Saharan African, actually declined 25 percent over the last 10 years. Thirty-eight countries have amassed \$71 billion in unpayable multilateral loans, encouraged by the Bank's self-serving projections of country growth, and on these loans it's going to be the rich country taxpayers who now must now make good. Corruption has been exposed both within the Bank and in its programs and is now estimated at more than \$100 billion. Protest is rising among Africa's own who seek to stop all aid because it serves only to entrench and enrich a series of corrupt elites. Massive anecdotal evidence of waste, ineptitude and outright theft can no longer be ignored.

The Bank gives itself good marks and boasts that more than three quarters of its projects achieve satisfactory outcomes. But when the auditors are captive, when the timing of judgment is premature, when the criteria are faulty and when the numbers are selectively manipulated, how credible are the conclusions?

Should we just take the Bank's word for it when U.S. taxpayers are being asked to commit more than \$2.5 billion per annum for the next 40 years?

Independence at the Bank is purely cosmetic, for a temporary change of desk and a new nameplate do not alter the signature on the paycheck nor the rewards of the Bank's personnel system. The Independent Evaluation Group is a department of the Bank like any other, save the ceremony of reporting to an executive board that is passive at best, and for a titular head, the Director General, who cannot return to the bank. But for all others, a revolving door leads back to standard line jobs and advancement.

This hardly fosters disinterested and rigorous judgments, even though the Bank boasts that staff cannot review projects that they themselves designed. Fact-finding missions are suspect when they do not stand at full arm's length from their subject. The magnitude of the Enron failure spotlighted the folly of placing credence in inside oversight and even in outside auditors who can be intimidated by well-paying clients.

In 2002, scandal arose at the German government employment office when claims of 50 percent placement rates were sliced to 17 percent by an independent audit. Corporations always seek to elevate the price of their stock, public agencies always wish to expand their funding. External auditors beyond the subject's influence are needed to pierce the film of self-congratulation and to provide the discipline that protects the public interest.

What the Bank proclaims as results are really only projections made at a moment when optimism is high. Outcome means only likelihood rated by the loan officer when the disbursement of funds is complete. That is often years before physical plants are up and running. Seldom does the Bank return to inspect the long-term project performance and many onsite investigations come up empty for lack of monitoring and records. The focus is on quantity of inputs with little effort expended to measure the effective output of programs.

Performance measures have been manipulated to bolster management claims of success and refute critics. In the late 1990s, satisfactory ratings jumped when the criteria were revised upon the instruction of Bank management without a corresponding adjustment to previous years to ensure consistency of measurement, again, upon the instruction of Bank management. After the Meltzer Commission in 1999 noted that sustainability, the sine qua non of development, had languished at 50 percent success rates for years, ratings jumped to 72 percent in 2000. Were these true improvements or had the bar simply been lowered?

The Bank is better at managing its numbers than at managing its programs. What is needed is a bonafide external audit by private sector companies onsite to determine the lasting contribution of Bank projects in the poorest countries after a 3- to 5-year operating history and to provide a continuing benchmark for the efficacy of Bank aid. Auditors would report directly to the legislative and executive branches of the Group of Seven governments. Independent program audits and aggregate evaluations of performance would be published and the exercise repeated every 3 years.

Five to seven million dollars, or less than two-tenths of 1 percent of the U.S. commitment to the Bank's IDA funding for the next 3-year cycle, would pay for the cost of an audit of the performance of a one-third of IDA projects.

As an anecdote, when the Meltzer Commission asked independent auditors what the cost of performance audit would be, the estimates came from three different firms were \$4 million, \$6 million, and \$1.5 million. I asked the head of the firm submitting the \$1.5 million bid why his estimate was so low, and his response was, we know these countries very well, we know the Bank very well, we know the Bank's programs very well. We operate the infrastructure of many of these countries. We fully expect that when we arrive, on one-half of the programs there will be nothing. There will be no evidence of anything at all. And those will be very quick audits. There will be no road, there will be no school, and therefore, we're actually charging \$1.5 million to do half the audits, because the first half will be very quick.

For 6 years the Bank has resisted an independent evaluation of its programs. Its objections to external examination have centered on damage to the institution's morale, on the waste of funds and on the irrelevance of a past record that has been allegedly rectified by the latest version of the New Bank. As the Millennium goal of halving extreme poverty has gained momentum, donor nations are poised to fund an exponential increase in development aid, a \$50 billion doubling of annual flows to the poorest nations by 2010 and another \$50 billion annual increment previewed for 2015. The Bank will get more than its share. Then there is the windfall of so-called "debt relief", where the Bank extorted 100 cents on the dollar from the G-7 for a \$46 billion portfolio of worthless developing country loans on which it had been sitting for more than 20 years. The result is an assured stream on automatic pilot to fill deep holes in the Bank's balance sheet and then pour out as unauthorized new aid.

Giving masses of money does not end our responsibility to the developing world. Donors have an inescapable interest in the uses to which aid is put and the results that aid achieves. Sums this significant must be weighed against alternative uses of scarce taxpayer resources.

This is the moment to insist that the World Bank be under serious, continuous external review. The Bank must become the exemplar for the transparency and accountability it commends to the developing world. Provision for a tri-annual external performance audit must become a condition of approval of the Gleneagles accord on debt relief and the funding of future aid. There will be no reform without the recognition of past failure.

Thank you Mr. Chairman.

[The prepared statement of Dr. Lerrick follows:]

PREPARED STATEMENT OF ADAM LERRICK, DIRECTOR OF THE GAILLIOT CENTER FOR PUBLIC POLICY FRIENDS OF ALLAN H. MELTZER, PROFESSOR OF ECONOMICS, CARNEGIE MELLON UNIVERSITY, AND VISITING SCHOLAR AMERICAN ENTERPRISE INSTITUTE

IS THE WORLD BANK'S WORD GOOD ENOUGH?

It is a privilege to appear before the Senate Committee on Foreign Relations.

The World Bank has just changed the name of its Operations Evaluation Department. This sends a clear signal that the Bank has no intention of changing its ways. The new sign on the door reads Independent Evaluation Group. The Bank is digging in to fend off an increasingly vocal demand for a truly independent review of its stewardship of aid.

After half a century and more than US\$ 500 billion, there is little to show for World Bank efforts. But we have no measure of the Bank's performance except the one it chooses to promulgate and no means to validate the wisdom of the industrialized world's collective investment decision.

The optimism of weighty reports cannot cover up the realities on the ground. The living standards of the poorest nations have stagnated and even declined as much as 25 percent.¹ Thirty-eight countries have amassed \$71 billion in unpayable multi-lateral loans, encouraged by the Bank's self-serving projections of country growth, on which rich country taxpayers must now make good. Corruption has been exposed both within the Bank and in its programs and is now estimated at more than \$100 billion. Protest is rising among Africa's own who seek to stop all aid because it serves only to entrench and enrich a series of corrupt elites. Massive anecdotal evidence of waste, ineptitude and outright theft can no longer be ignored.

The Bank gives itself good marks and boasts that more than three quarters of projects completed had "satisfactory outcomes". But when the auditors are captive, when the timing of judgment is premature, when the criteria are faulty and when the numbers are selectively manipulated—how credible are the conclusions?

Should we just take the Bank's word for it when US taxpayers are being asked to commit more than \$2.5 billion per annum for the next 40 years?

"Independence" at the Bank is purely cosmetic, for a temporary change of desk and a new nameplate do not alter the signature on the paycheck nor the rewards of the Bank's personnel system. The Independent Evaluation Group is a department of the Bank like any other, save the ceremony of reporting to an executive board that is passive at best. For everyone save the titular Director General, a revolving door leads back to standard line jobs and advancement at the Bank. Because results are published, there is strong pressure to display success. Outside verification is precluded because there is no public access to the underlying data. This hardly fosters disinterested and rigorous judgments, even though the Bank boasts that staff cannot review projects that they themselves designed.

Fact-finding missions are suspect when they do not stand at full arm's length from their subject. The magnitude of the Enron failure spotlighted the folly of placing credence in inside oversight and even in outside auditors who can be intimidated by well-paying clients. In 2002, scandal arose at the German government employment office when claims of 50 percent placement rates were sliced to 17 percent by an independent audit. Corporations always seek to elevate the price of their stock; public agencies always wish to expand their funding. External auditors beyond the subject's influence are needed to pierce the film of self-congratulation and to provide the discipline that protects the public interest.

The "independence" issue aside, the Bank's evaluation methodology spews out conclusions without worth.

What the Bank proclaims as results are really only projections made at a moment when optimism is high. "Outcome" means only "likelihood" rated by the loan officer when the disbursement of funds is complete. This is often years before physical projects are up and running. Generalized "adjustment programs" attract the highest marks. Yet promised reforms will require years to impact the economy if they are indeed ever implemented.

Seldom does the Bank return to inspect long-term project success and many onsite investigations come up empty for lack of monitoring and records. The focus is on quantity of inputs with little effort expended to measure the effective output of programs.

Performance measures have been manipulated to bolster management claims of success and refute critics. In the late 1990s, satisfactory ratings jumped when the criteria were revised upon the instruction of Bank management without a corresponding adjustment to previous years to ensure consistency of measurement, also upon the instruction of Bank management. After the Meltzer Commission in 1999 noted that "sustainability", the sine qua non of development, had languished at 50 percent success rates for years, ratings jumped to 72 percent in 2000. Were these true improvements or had the bar simply been lowered?

The Bank is better at managing its numbers than at managing its programs. What is needed is a bona fide external audit by private sector companies onsite to

¹Aid was not the moving force behind the impressive gains in China, India and Indonesia where virtually all progress in developing country living standards has occurred.

determine the lasting contribution of Bank projects in the poorest countries after a 3–5 year operating history and to provide a continuing benchmark for the efficacy of Bank aid. Auditors would report directly to the legislative and executive branches of the Group of Seven (G7) governments. Individual program audits and aggregate evaluations of performance would be published and the exercise repeated every 3 years.²

Five to seven million dollars or less than 1/10th of 1 percent of the U.S. commitment to the Bank's International Development Association (IDA) funding for the next 3-year cycle, would pay for the cost of an audit of the performance of a 1/3 sample of 3 years of IDA projects.

Bank objections to external examination have centered on damage to the institution's morale, on the waste of funds and on the irrelevance of a past record that has been allegedly rectified by latest version of the "New Bank". This last has been the routine response by a series of managements over the past three decades.

The technicalities of client confidentiality and sovereignty rights of nations that wish to evade scrutiny have also been advanced as impediments. For those on the receiving end of billions of dollars of subsidies that flow from industrialized nation taxpayers through the channel of World Bank financing, there should be a corresponding obligation. Free access to the facts and the ability to publish them must become a condition of all World Bank loans.

As the Millennium goal of halving extreme poverty has gained momentum, donor nations are poised to fund an exponential increase in development aid—a \$50 billion doubling of annual flows to the poorest nations by 2010 and another \$50 billion increment previewed for 2015. The Bank will get more than its share. Then there is the windfall of so-called "debt relief" where the Bank extorted 100 cents on the dollar from the G7 for a \$46 billion portfolio of worthless developing country loans on which it had been sitting for more than two decades. The result is an assured stream of funds on automatic pilot to fill deep holes in the Bank's balance sheet and then pour out as unauthorized new aid.

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Chairman LUGAR. Thank you very much Dr. Lerrick. I appreciate this panel. I think you had an extraordinarily profound influence upon our deliberations here.

Let me just start with basics to add to our own edification. First of all, let's say a development bank decides that a road in a particular country is going to be of value, or a network of roads, several roads. Did the road get built? You've addressed that in a way, Dr. Lerrick. Maybe half of the roads don't get built, or some percentage. If a school is the objective, did the school actually get built? Physically, did the money come to fruition with completion of a project?

Now you're raising questions, obviously, beyond that. But that's sort of fundamental, and one of the audit questions to begin with is did it happen, as opposed to the money being diverted to other purposes by a government or contractors.

But, second then, you're raising more difficult question, should the road have been built, or, in fact, when the road was built, what difference did it make to the country or specific persons who might use the road? Did it disrupt the environment or completely change

² Senator Crapo of Idaho and Senator Enzi of Wyoming focused on the issue of an external performance audit of World Bank programs in the 106th Congress. See S. Con. Res. 136 in the 2nd session.

commerce in diverse ways? So that this is a question which then verges, some would say, upon the sovereignty of the country. Officials there would say, we're the folks who were elected or appointed, or however they got there, and we are making some judgments about what is important for our country. And we think that school ought to be built and the road ought to be built. Are poor people helped? The Millennium idea that somehow we can lift millions of people from desperate poverty is sort of an outside evaluation on our part, humanitarian part. Others in the country would say, we know best how to do this.

Let's accept the fact that the internal audits that are now being conducted, however one wants to characterize the renaming of them and so forth, are inadequate and maybe worse. But let's say that we had a truly independent audit that was incorruptible, not like the companies that were auditing Enron, that supposedly were outside Enron.

Let's say we find these honest people who are bright, who understand the world, and they weighed into this. First of all, can you find such persons? And then, second, who does set the philosophy, or the basic parameters of what is helpful to poor people or to development in a way that is internationally accepted? We're talking about international banks, different cultures, different histories all looking at these things. Anyone want to make a comment about that sort of general set of questions? Please, Doctor.

Dr. LEVINE. Thanks very much. I'll tackle a couple of the dimensions of them.

The programs that the development banks finance are negotiated, as you know, with the developing country borrowers. And those borrowers have to repay the loan, albeit on often soft terms. And so it is very much the case that the resources are shared. The designs are or should be shared designs and the goals of the programs are, themselves, shared between the development banks and the national governments.

Chairman LUGAR. Is it taken for granted now that the people at the development banks know something about the country? In other words, is there engaging in this dialogue with—

Dr. LEVINE. Yes.

Chairman LUGAR [continuing]. The leaders? That this is an intelligent, up front way of saying how can we help people?

Dr. LEVINE. Right. My point is that unlike perhaps granting agencies, development banks actually do develop their loans in collaboration with national counterparts. Who among that group is informed about local conditions one can argue. But they are shared programs. And what those programs can generate if they're evaluated effectively against their ultimate aims—the more kids in school and so the people being moved above the poverty line. What that can generate is knowledge that then the developing country governments can use to assess whether or not that's the right use of both the development bank financed resources and their own.

I'm thinking of the value that the U.S. Congress has seen in things like the evaluation of Head Start, the evaluations of the income support and job training programs. The current, really laudable evaluations that the U.S. Department of Education is undertaking—this is the kind of knowledge that we generate for our own

social programs and public investments, and that legislative leaders in this country use to decide, well, what do we do next? How do we safeguard the interests of the taxpayer?

So I guess I would resist the idea that the independent evaluations would be done solely for the benefit of the agencies. The long term goal is that they'd be done to inform public spending priorities in the countries themselves. That's the end goal.

Dr. LERRICK. Senator, first, I frequently say that on my tombstone they're going to write "It's not as simple as he thought". Because that's what usually people say when I talk about these issues. I truly believe these are very simple issues. I think, first, one of the lessons we've learned over the last 50 years, why it took 50 years, I can question, is that aid does not succeed, projects do not succeed, unless the recipient wants it to succeed, has an interest in the project. That was viewed as a revolutionary concept as recently as 6 years or 7 years ago when David Dollar wrote it.

But so first let's assume the host government chooses the project, decides this is a priority of our people. Second, one of the issues here is there is a terrible problem in aid that every measurement is done on inputs. At the World Bank now they basically measure inputs of cash. Now they're saying we're going to measure outputs because we're going to measure the number of textbooks arriving at the schools, the number of teachers trained, the number of miles of roads built. But those are still inputs.

What we should be measuring is number of children who can read, the number of roads that are passable and workable after 5 years, not how many roads were built on the day we started. And those are very easy to quantify. This is not to go out and measure the number of roads that still are functioning after 10 years or the number of children that can read or the number of babies that have been vaccinated. It's easily audited, it's easily evaluated.

And, in fact, that's why one of the areas that I've focused a lot of research on: turning aid from a loan-based mechanism to what I call a performance-based grant mechanism. Where you literally only pay money upon audited performance. That will go a long way to achieving our goal.

The second question you raised is a much more difficult question. How do you translate number of passable roads to how has that raised the income level of the people in the country? That's a much more difficult question and I don't think we have the metrics to do that. But I think the first step is just making sure that the roads are built and they're still functioning. And we can measure the traffic over the roads.

Chairman LUGAR. Let me just comment anecdotally, that in our own country with the No Child Left Behind concept we've been trying to evaluate how third-graders, eighth-graders and what have you are doing, maybe all the way through the grades as you magnify those tests. Of course you might point out, why do states choose how much evaluation they want? Some states have tougher tests than others and so forth. But let's take for granted that it's a reasonable concept here. We find out that maybe 70 or 75 percent of children are achieving third grade results or something of this sort.

The idea is that therefore, on a performance basis, people ought to be rewarded for achieving this. But that is not so easy because the rest of the schools there, they would say we have special problems. Without enumerating all of them, from educational conferences you have a long list. Do you mean this? Are you going to shut down these schools that are nonperforming? And we say, well no, we opened those up to other people and we try to shore up things. But the fact is, you know, a great deal of money is going into these programs, Federal, state, local. So here we're wrestling with problems that are profound. Ultimately you raised the question, if you're being difficult about it, even if people can read third grade level, how does that affect their performance? Are they likely to have higher incomes, better lives, all the rest of it?

But now you're saying, keep it simple. Don't begin to get profound to the third or fourth order judgments, just see whether, after 5 years, the road still works, or whether in fact the school got built and some children entered it and learned something. They may be more modest goals. And that's sort of important because as we try to structure this independent audit system, wherever it's going to come from, the kinds of questions we asked this group to evaluate will probably determine the public confidence in this. And that kind of structure can come from you as experts in your experience, probably better than from us. That's why I'm raising these questions.

Dr. LERRICK. You have chosen the most controversial issue among the areas we're talking about, which is education. There's a huge debate in this country about evaluation.

I think you're right, it has to be kept simple. It has to be transparent, it has to be simple, everyone has to recognize how it was done and accept that this is a valid metric for measuring the performance. As I said, one way of doing this, which makes it simpler, is to say, we're only going to pay, we're only going to deliver cash dollars based on each child that can pass a literacy test, we will pay aid of this amount. For each child vaccinated against measles we will pay \$4.50 upon independent audit.

When you think of the World Bank, all its client countries are viewed as similar. They're not. There is one group of countries, what we call the middle income countries that have totally different problems from the really poor countries, such as Africa. The poorest countries that don't have access to capital, private capital, they are so far away from what we would call the desired goal, that getting them 90 percent of the way there is not—should not be controversial. The last 10 percent may be controversial, but we have a long way to go before that happens.

Chairman LUGAR. Dr. Easterly, do you want to weigh in on this?

Dr. EASTERLY. Yes, Mr. Chairman, if you'll permit me to return to your original question about how to work with sovereign governments. I think this is an issue that the aid community has been stuck on for 50 years and has not found a way out of this conundrum. They're so stuck on it that they—despite, as Dr. Lerrick pointed out, despite the increased knowledge that we have, that it is obviously counterproductive to give aid to corrupt autocrats, which just props up gangsters in power to stay longer in power. Amazingly enough, despite that knowledge, there has been no

change in the aid community in how selective it is to give money to better governments.

The World Bank's latest ratings on democracy and corruption showed no—there's no association whatsoever between the amount of aid a country receives and how corrupt it is or how democratic it is. And that I—for example, just to give you a particularly egregious example, Paul—the dictator Paul Biya of Cameroon, who's been in power for decades, he had something like 80 percent of his government revenues from foreign aid, despite the fact that Cameroon also has oil revenues. Where does that kind of result come from? It comes from the intense pressure that there is to try to help Cameroonians, individual Cameroonians, to help poor people, even if they are so unlucky as to be stuck with a bad government.

And, you know, that conundrum leads to continued engagement with very bad governments, even failed states are now getting aid under the rubric of reconstruction aid, which is also funneled through the warlords that are now in a temporary coalition government in places like Democratic Republic of the Congo.

What is the way out of this conundrum? First of all, you know, the evaluator should hold the World Bank and other aid agencies accountable for how selective they are, for how they choose the governments that receive their money. It's a disgrace that Paul Biya is still getting aid money.

And second, that the aid agencies like the World Bank should explore ways in which they can try to help individuals directly, like Dr. Lerrick was talking about, bypassing the governments. And this—of course they have to be sensitive to the issue of not undermining the sovereignty or the political development of the host country, but they can do so by working to try to empower individuals from below to make them better educated, to give them better roads. All of these things help individuals and, you know, better individuals can themselves create the conditions for political reform and form the next generation of political leadership, which could give us better government.

The attempt to change bad government directly through aid conditions has totally failed. It's been tried over and over again. It's been a complete failure. So I think the answer is to just be really ruthless about screening out the bad governments, not giving them money, but if there is still the need to help desperate poor people in those countries, then try to help them as individuals, not through the government.

Chairman LUGAR. In the governance of these banks, obviously the United States plays a role, we play a large one. We were discussing today whether we're paying our fair share and whether we're up to the plate. Still these are multinational banks. There are a lot of people here.

This may be an extreme case, but in February the United States had the Chairmanship of the Security Council at the United Nations. I was honored to be invited to give a speech to the Security Council, which I did, and we did not dwell upon these particular issues, but we did in a sense by getting into the Human Rights Commission reform. Just after visiting with the Security Council about this, Senator Voinovich, Senator Coleman and I visited with a group of 77 leaders. These are countries that clearly have very

special problems in terms of development. They have a feeling that by banding together they can be heard with regard to the members of the Security Council or the Permanent Five or what have you.

But here we have an issue about who is going to evaluate human rights. Who ought to be eligible to be on a human rights commission that is trying to bring about human rights for people? There are profoundly different views on this. I don't cast dispersions on any of those with whom we visited, but some might suggest, who is to be the judge of this? Is this a unilateral decision of the United States or Great Britain or France? Furthermore, if it is, that's why we have a group of 77, to stop that kind of evaluation. We are evolving in our political procedures, they would say. You really can't get there all at once.

So if there are some human rights problems, that's been mankind's fate and the fate of the poor people who lived under those governments. This is a big question. Who will evaluate human rights—on the commission, there are 40-some members who would cast just judgment and make criteria.

My guess is, back at the headquarters of some of the development banks there are similar issues of countries saying our place in the sun comes from solidarity with some others who have similar problems. And, as a matter of fact, all together we're a majority, if you vote one by one, but maybe not if you vote by the stock in the bank or what the contributions are. But for whoever is trying to govern these situations, this must be very, very difficult. In any event, the United States objects to whatever the compromise is, we vote against it, we're one of four countries in the world. All the rest are willing to accommodate the fact that Rome is not changed in a day and you have to sort of understand these conditions.

I raise this simply because, as reformers or as people trying to generate this, we're dealing with people who have real lives in these banks. You've been there Dr. Easterly, so you understand acutely and you very modestly said in your own experience as a whistleblower, this is not a comfortable situation. In fact, termination likely to come to you. And help me a little bit, how do we influence some sort of reform given sovereignty, given the feeling that if we are small and we band together to have a common culture, which may not be quite there, or may, in fact, not be there at all, but nevertheless might be helpful to us in our leadership in those countries right now?

Dr. EASTERLY. Mr. Chairman, I think the ideal is to get the feedback from the poor intended beneficiaries themselves. And that the evaluators that are truly, truly credible are those that find ways to really represent—give a political voice to those poor people that—

Chairman LUGAR. Let's say they go into a country and they interview the poor people—

Dr. EASTERLY. Uh-huh. [Affirmative]

Chairman LUGAR [continuing]. And the government says, well you're interfering. You're like an NGO that's trying to foment democracy in our country. I'm just curious, how, as we search for these evaluation methods, do we really get to the grassroots without retribution of the people who gave the interviews or who saw these auditors?

Dr. EASTERLY. Right. That's a very—these are very subtle insights and you rightly put your finger right on the core of the problem. And I think it has—the independent evaluation unit would have to be independent in another sense in that it would have to be independent from rich countries so it's not seen as the tool of rich country governments. You're not trying to interfere in other countries' internal affairs.

It has to be just a worldwide network of truly independent grassroots people who—and, you know, academics and researchers who have no political allegiance. And it certainly should include people from the poor countries themselves in large numbers. So that it would not be a representative of the U.S. Government trying to meddle in the politics of Cameroon or something.

Chairman LUGAR. Dr. Lerrick?

Dr. LERRICK. I disagree with much of what Dr. Easterly said. Let's be clear, there is a small group of countries in this world that are financing all development aid. And the fact of the matter is the donors are the ones who must receive the account as to whether their money is being spent. Former Secretary of Treasury Paul O'Neill use to refer to the carpenters and plumbers of the United States, that he was not going to dump the money of the carpenters and plumbers into this bail out or this aid agency or this failed program.

I think it cannot be a solely U.S. initiative, that's not what these institutions are. But I think it has to be a coordinated effort of the donor countries to establish what are the benchmarks for aid and for performance.

The Bank has often hid behind some of the issues you raised, what they call the technicalities of client confidentiality, that they just can't release information about their projects, or the sovereignty rights of nations. But the problem here is that for those on the receiving end of billions of dollars of subsidies that flow from industrialized nation taxpayers through the channel of World Bank financing, there's a corresponding obligation. They must give free access to the facts and the ability to publish them. And the control mechanism is that the report, the audits, the evaluations will be published, at the individual project level, at the country level, at the combined bank level.

I think, Senator Lugar, a good idea would be if you were to try to implement this process, to set up a commission of, I don't know whether you would call them leading experts or senior statesmen, who would oversee the establishment of what this audit would look like, how will it be performed, what would be the standards, who would execute the audit? Again, a public process, hearings, input, and there should be on that commission representatives of the major developing countries to get their input as well.

But I think you have a much deeper problem in this whole process which is the fundamental problem in the aid business: The donors are more desperate to give than the recipients are to receive. If that is true, aid will fail. It cannot but fail, because, I would ask you, what would you do, and when Secretary Lowery spoke about this, what are you going to do if Chad just says no, or Congo says no? We're just not going to implement the anti-corruption meas-

ures. And they dare you to say you're not going to give the money? What are you going to do?

The President of Chad has already said, if you cut off my funding, it doesn't bother me. It's the poor people of Chad that are going to suffer. And they were poor for centuries before and they'll just be poor again until you decide to give me my money. And that's a very difficult position.

Chairman LUGAR. That is the problem and, you know, let me just say that this is, you know, acutely the problem felt by the American people, who are compassionate, who see hundreds of millions of very poor people and feel surely there is some way we can help those people. So then we have the mechanisms of banks, and even our own foreign aid or the Millennium Challenge in which we try to do this. But, as you say, it could very well be that our overwhelming sense of conscience that we ought to do something is more overwhelming than the recipient side of what is to be done with the money.

Dr. LERRICK. And it's not just in the official sector. The Gates Foundation has encountered the same problem. They've tried to implement what would be a kind of performance-based aid, where they were actually going to go in and audit the performance. But in the end, when Kenya refused to comply, the head of the Gates Foundation said very simply, the greatest failure of a foundation is not distributing the money. If that is a fact, then there can not be a successful outcome.

Chairman LUGAR. Yes. Dr. Levine.

Dr. LEVINE. I've been listening carefully to my colleagues and I think that in this discussion we are conflating a couple of different interpretations of the word evaluation. One being more linked to the accountability mission: Did something pass or fail? So getting to your education example, did schools pass or fail in terms of how students did on tests.

The other function of evaluation is to look at the relationship between impact, passing or failing, with what was done in the first place, what approaches were taken. So in the education example, what's the relationship between say, class size and how kids do on tests. That, over the long term, is the real contribution that can be made from evaluation.

There's obviously a short term need to look at that pass/fail question, but then it leaves you with exactly what you posed, well, what do we do about the failures? Do we neglect them entirely? Do we close down schools? No, of course not. What you do is you look for ways to improve. Where do you look? There's the kind of eminence-based approach of asking a bunch of very smart people what they think. That's what we often do. Then there's a more evidence-based approach, which is that you actually look carefully, do in-depth evaluations, and learn from comparing across different approaches and comparing doing something with not doing anything.

I just want to highlight that as we talk about evaluation, independent or otherwise, it's useful to make that distinction.

Chairman LUGAR. I'm trying to gather now, from your collective testimony, just who ought to be appointed, and by whom, and who should pay for it.

You mentioned the Gates Foundation. One suggestion would be that this is not going to happen, this evaluation, from a governmental entity or something that the Congress conjures up, but rather there must be some independent people out there who have independent money and so forth. And maybe the Gates Foundation or others might provide this sort of thing. But even if they do, who selects the persons who go down in the weeds, as you suggested, Dr. Levine, as opposed to having high-minded thoughts without the evaluation in the field? And what do we do in the Congress? Do we try to provide through legislation a provision for these independent audits, or a group that does this kind of work? Do we offer some criteria as to who ought to be involved in it and some idea of who pays for it?

I'm just grappling with the questions that you've raised, which I think are very important, and which we wanted you to raise, so that we're not left at the end of the hearing with the thought that, sadly enough, back in the banks are still these people who we don't think are as independent as they ought to be. Even though they're doing better and the whole question has been elevated by five hearings plus all of what they're doing, we're still not quite there.

I know you need to leave at some point, Dr. Easterly, so I respect that. Would you have a go at that first, in the event that you need to leave our hearing?

Dr. EASTERLY. Mr. Chairman, I think that as far as who pays for it, I think the aid agencies themselves should all be asked, and we should try to start this as an international effort, but we can start with the multilateral development banks, that they should be required to set aside part of their budget, it doesn't have to be a huge amount because these evaluations are not that costly compared to the volume of lending.

Chairman LUGAR. Set it aside outside their structure.

Dr. EASTERLY. Set it aside outside the structure to fund an independent evaluation group that's truly independent, not like the name change that both Dr. Lerrick and I have made fun of. And, you know, there are lots of development professionals, economists, academics, social reformers of all kinds that are out there that will be judged on the basis of just professional standards, whether they're qualified to do evaluations, and they can be assembled in a very decentralized, loose network. It doesn't have to be a large bureaucracy. But funded by these funds that are set aside from the development agencies.

I think they can operate in the same sort of independent way that we have an auditing industry that provides audits on corporations, you know. It's not part of the U.S. Government, it doesn't serve sort of U.S. Government strategic policy. And, in the same, I think the—to disagree a little bit with my friend, Dr. Lerrick, I think there needs to be a firewall between anything that would smack of U.S. Government strategic interest or the strategic interest of any donor country. And just the goal of pure altruistic aid to help the poor. And those auditors should be only concerned with the effectiveness of altruistic aid to help the poor.

There is a large group of auditors available out there that could be hired. A lot of them could be from developing countries them-

selves. There are many highly trained professionals in developing countries that could be paid to do this.

Chairman LUGAR. Dr. Lerrick?

Dr. LERRICK. First, Senator Lugar, I'd just like to call your attention to Senators Crapo and Enzi who actually put forth a Senate resolution in the 106th Congress calling for an independent audit of IDA programs. The question—I'll divide the question in two parts, who should pay for it? That really should not be a major problem because, as Dr. Easterly said, we're not talking about large amounts of money. It's a relatively small amount of money. I will tell you that I have been approached by two foundations that are willing to finance such a performance audit. The main difficulty is cooperation, not participation, but cooperation of the World Bank, which means, literally, just access to the files, to the documents. What is the project? What was the project supposed to do? What did it cost? Where did it go?

And, as Dr. Easterly said, it's not very difficult finding auditors to do this. I would propose that a commission could be set up of what I would call senior statesmen to supervise the structure of what the audit process would be and how it would be implemented. And then you would actually have private sector auditing firms go out and literally compile the reports in different countries.

There are major multinational firms that do this as a business. And they could do this as well. If you wanted to go to a more grass-roots approach and have many little individual auditors I think it would be more difficult, but it is feasible.

The third method would be, basically, to say that we are going to have a performance audit and have it report to the legislative and executive branches of the leading donor countries, all of them, and I agree with Dr. Easterly, it has nothing to do—it should have nothing to do with strategic interests or foreign relations interests. It's purely effectiveness of the programs. And each one of those governments has the counterpart to the GAO. Why can't the GAO supervise on behalf of Congress and say this is how the structures were done, these were the processes that were put in place, we consider them reasonable and pass judgment not on the individual programs, but on the mechanics that were implemented. That would be a third way of going about it.

Chairman LUGAR. We might appropriate money for the GAO to begin with.

Dr. LERRICK. Again, appropriate the money and have the GAO to review how the process was done.

Chairman LUGAR. But then how do they get the records in the World Bank? The GAO goes over there and—

Dr. LERRICK. No. The World Bank would have to say we are going to cooperate. And that will only come if the major shareholders agree the World Bank should cooperate with this process.

Chairman LUGAR. Dr. Levine.

Dr. LEVINE. Again, I think we're running into a little point of departure about what the aim of this sort of function might be. I agree with my colleagues that the financing is small, very small relative to the total funds that are disbursed by the World Bank, the Inter-American Development Bank, and the grant-making

agencies. So a small share of each devoted to a collective enterprise would certainly be adequate.

But in terms of who and how, I think it depends very much on what the aims are. There's the auditing idea. I'm fearful that would be quite unsatisfying because, in fact, most World Bank programs do not even have baseline information. So you could barely even do before and after comparisons, let alone comparing what would have happened with a different approach, what would have happened in the absence of the program.

So I think a collective evaluation agenda needs to be set on enduring questions in development: How to get kids in school, how to prevent HIV/AIDS, and other things for which huge amounts of money are being devoted against very little evidence. So set that evaluation agenda, establish methodological standards. As Dr. Easterly said, there is an academic industry devoted to that practice. And then commission independent evaluations through an open and competitive process with the results being disseminated widely, again to stimulate the kind of learning that we've talked about earlier.

Chairman LUGAR. I thank you very much. You've been most helpful, I believe, in giving the parameters of the problem, as well as some specifics toward solutions. As you suggested, Dr. Levine, there are probably people out there who are going to be able to set some standards. There probably is money to be obtained. It's not very much. Hopefully we will obtain access to the records, imperfect as they may be, as you say. If they are as rudimentary as you have suggested, this is going to be tough for the auditors, but there has to be a beginning at some point, at least establishment of the independence of the process, so that it's not an in-house affair and it's not business as usual.

My guess is that even the discussion of the project and the formation of all of this is likely to bring about some salutary results as countries and banks and so forth think through the implications of that. We look forward to staying in touch with all three of you. We appreciate your insights and your specific public testimony today. And so saying, the hearing is adjourned.

[Whereupon at 11:37 a.m., the hearing was adjourned.]

