

# AN EMERGING CONSENSUS ON CONTROLLING CORRUPTION

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## 1. INTRODUCTION

This is an exciting time to be working to control corruption in international business and development. I am honored to be here to share with you news of recent successes and to enlist your support in confronting the challenges which are still before us.

It is important to remember, in our discussion of the problems confronting the legal and ethical foundations of emerging economies, that they are not alone in facing the problem of corruption or in seeking prescriptions. Indeed, the legal question posed for this conference is whether corrupt activities by Western business have to be addressed before corruption in emerging economies can be curbed, and the parallel ethical question, what moral obligation Western business owes the people in emerging economies.

These questions could not be more timely nor the answers more clear. The West must act, and recently it took an important step forward. The Organization for Economic Cooperation and Development ("OECD"), whose members are home to most of the major western multinationals, agreed to take action to end the corrupt practices of their private sector in their dealings with foreign public officials. They did so out of a growing recognition that the cost of inaction is too great.

The cost of corruption is unacceptable, whether we are part of the private/corporate sector with an understanding of the direct cost of corruption and bribery on the bottom line, policy-makers who understand that corruption undermines political stability and the prospects for democracy, emerging economy leaders competing for investment capital which avoids risks inherent in corruption (or charges a premium because of them), or development officials concerned with the corrosive effect of corruption on

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sustainable development in the countries where the needs are greatest.

This confluence of interests in fighting corruption has propelled the issue to the top of the political and economic agenda and has underscored the need for cooperation and action by all those affected — whether in the West or East, public or private sector, free market or transition economy.

I will discuss why this age-old issue has recently gained new prominence, describe some of the public- and private-sector initiatives, and conclude with the important role of the private sector in achieving implementation, compliance and effectiveness of anticorruption programs.

## 2. A NEW PROMINENCE

Over the past few years, corruption has become, like human rights and the environment in their time, a key issue of the nineties. Daily newspaper stories detail corruption scandals in virtually every country around the world: the United States, Venezuela, India, Zaire, Korea, France, and even the Palestinian Authority, to name but a few. The problem is universal and it is no longer possible to consider it a problem that is confined to the developing world or to a particular political or economic system.

Bribery and corruption's costs have also garnered recent attention. Many used to believe that bribery was a fact of life and, in some cases, the grease that made the wheels turn. Indeed, this conference asks whether corruption should be condemned only when it impedes economic development, regardless of its efficiency. Most political scientists and economists working in the field today would say that corruption always impedes economic development; although, one might dispute the degree of hindrance in those countries where there appears to be both economic growth and rampant corruption.

Today, there is a widespread consensus that there is more at stake than the amount of the bribe or the lost capital. Corruption has the potential to undermine the dividends of the end of the Cold War: (1) the consolidation of democracy, political stability, and respect for the rule of law; (2) effective development; and (3) the expansion of open, competitive markets.

Speaking of democracy in Latin America, U.S. Assistant Secretary of State Jeffrey Davidow recently cautioned that, while democracy is now more commonplace, in many cases it is weak

or dysfunctional, and corrupt leaders and institutions can cause it to fail.<sup>1</sup> This threat is also evident in the former Soviet Union, much of Africa, and parts of Asia as well.

The problem is compounded in the developing world where “long-term developmental goals . . . are impaired by the prevalence of corruption.”<sup>2</sup> The diversion of investment to foreign bank accounts or to projects of negligible social value instead of to much-needed projects, such as schools and hospitals, has a disproportionate impact on the poor. Moreover, with weak administrative and political institutions and generally low civil service pay scales, corruption is more likely to become systemic. In addition, public support for essential macroeconomic reforms is jeopardized when corrupt officials ignore the rule of law in favor of ad hoc special deals. Finally, corruption erodes political support for development programs in the donor nations.

For those trying to do business globally, the problems are equally unsettling. The magnitude of the bribe, rather than the quality of the product or service, often determines major procurement and infrastructure projects. On more routine matters, corruption can make it difficult, if not impossible, for business to operate. In Ecuador, hundreds of importers were affected by corruption in customs, and corporations were reportedly charged fifteen percent commissions by the tax authorities to obtain refunds for overpayment.

For American business, which is subject to prohibitions against bribery of foreign public officials under the Foreign Corrupt Practices Act (“FCPA”),<sup>3</sup> the demands of competing against companies that are not subject to similar prohibitions is particularly onerous. But even for those not currently subject to home country laws prohibiting bribery, there is evidence that the practice is no longer tenable because of the damage to corporate reputation, risk of being debarred (as is the case in Singapore), and unpredictability of the outcome. Moreover, the anomaly of

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<sup>1</sup> See *An Overview of U.S. Policy in the Western Hemisphere: Hearing Before the Subcomm. on the Western Hemisphere of the Comm. on Int'l Relations*, 105th Cong., 1st Sess. (1997) (statement of Jeffrey Davidow, Assistant Secretary of State for Inter-American Affairs).

<sup>2</sup> DANIEL KAUFMANN, HARVARD INSTITUTE FOR INTERNATIONAL DEVELOPMENT, LISTENING TO DEVELOPING COUNTRIES SPELL THE C. . . WORD 3 (1996).

<sup>3</sup> See 15 U.S.C. §§ 78dd-1 to -2 (1994).

prohibiting bribery of home country officials while making it legal and even tax deductible to suborn foreign ones is untenable and deeply resented in the developing world.

Even for companies operating under current permissive rules, lack of transparency in laws and regulations and uncertainty about the reliability and independence of the judicial system have made doing business unpredictable, a risk that adds to costs and a negative factor in investment decisions. Indeed, we now have several excellent studies documenting what we learned from experience — that corruption reduces inward foreign direct investment and social spending.<sup>4</sup>

### 3. AN EMERGING CONSENSUS FOR REFORM

Faced with these destructive consequences of corruption, few still dismiss it as solely an ethical or cultural issue that precludes interference from the outside, or as so pervasive that little can be done. Leaders of governments and heads of international organizations that formerly would not speak the “C-word” now recognize that too much is at stake to accept the status quo of the existing, inadequate regimes.

With the end of the Cold War, policy makers are less likely to support corrupt leaders for other geopolitical objectives. Success in the global marketplace has become a driving force in foreign policy for both industrialized and emerging economies. With the emergence of democracy, we are witnessing the growth of a free press and investigative journalism as well as more open political competition, more independent judiciaries and prosecutors, and a coming of age of civil society as a political force demanding accountability from those who govern.

### 4. CURRENT MULTILATERAL PUBLIC AND PRIVATE SECTOR INITIATIVES

In sum, international institutions, government officials, and the private sector are beginning to mobilize to bring about broadbased reform. They are also beginning to work together to bring initiatives to fruition. Working together has been the hallmark of Transparency International (“TI”), a coalition against corruption. Since its founding in Germany in 1993, TI has (1) raised public

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<sup>4</sup> See Paolo Mauro, *Corruption and Growth*, 110 Q.J. ECON. 681 (1995).

awareness, (2) mobilized civil society and the private sector to work in coalition in over seventy countries as TI national chapters,<sup>5</sup> and (3) worked with government and institutional leaders on initiatives that would support systemic reform.

There has been a marked change in attitude since the 1970s, when the U.S. government began pressing other governments to enact laws prohibiting transnational bribery. While U.S. leadership continues to be critical, others are now taking action out of self-interest. Members of the OECD, European Union ("EU"), and Organization of American States ("OAS") have taken bold steps. The United Nations ("UN"), World Bank, and International Monetary Fund ("IMF"), are taking stock of their roles, and the private sector, through such organizations as the International Chamber of Commerce ("ICC") and TI, is moving forward as well. I would like to talk about some of these organizations to illustrate just how far we have come.

#### *4.1. The Organization for Economic Cooperation and Development*

The first breakthrough came at the OECD, whose twenty-nine members are home to most of the world's major multinational corporations and whose laws, other than those of the United States, have permitted bribery of foreign public officials and, in many cases, tax deductions for such payments. On May 23, 1997, the ministers agreed to negotiate a convention to make bribery of foreign officials a crime in all twenty-nine OECD member states.

This decision culminates the original recommendation to take "meaningful steps" to address bribery of foreign public officials in May 1994. Since then, working groups have looked at criminalization, tax deductibility, procurement, and accounting practices.

Agreement was reached on the "common elements" for criminalization, as well as on a detailed timetable, under which (a) a treaty in conformity with the common elements would be ready for signature by the end of 1997, (b) the legislation would be submitted to national legislatures by April 1, 1998, and (c) the target date for entry into force would be the end of 1998.

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<sup>5</sup> The U.S. chapter of Transparency International is a coalition of professionals, academics, corporations, and journalists. Financial support is received from over two dozen corporations, foundations, and development assistance institutions.

The agreement resolves a protracted impasse primarily between French and German insistence on implementing criminalization of foreign bribery through a treaty and the position of the United States and most other member states favoring implementation directly through national legislation. The agreed-upon timetable overcomes concern that the treaty process would be used to delay criminalization. The requirement that the treaty be in conformity with the "common elements" addresses the concern that there be adequate terms of reference.

The OECD will also establish a monitoring program, modeled on the Financial Action Task Force, that covers money laundering. This process adds frequent assessment by well-trained individuals from several different states because self-reporting by governments is not sufficient to assure effective and consistent implementation of criminalization.

The monitoring will also cover implementation of the 1996 recommendation to end tax deductibility of foreign bribery. Only a few countries have initiated the necessary legal changes for this recommendation, while others are awaiting criminalization. Some have erroneously interpreted the recommendation to mean ending tax deductions only in cases where there have been criminal convictions of bribery. This practice would effectively permit almost all bribes to continue to be tax deductible. This cannot be permitted.

The 1997 recommendations also include best practices for accounting and auditing, as well as procurement. On a parallel track, the OECD Development Assistance Committee recommended that bilateral donors do more to ensure that their aid programs contain strong anticorruption measures.

Transparency International has provided substantive input to the OECD Secretariat and Working Group on Bribery and, along with the ICC, promoted a public statement by fifteen European business leaders calling for prompt action by the OECD and EU.

#### 4.2. *European Union*

On May 21, 1997, the EU Commission adopted a *Communication to the Council and Parliament on a Union Policy Against Corruption*. It will be sent to the Council of Ministers and Parliament. It lays out a detailed program for action by the EU, its fifteen member states, and the eleven states which have applied for membership. The main points include:

- Criminalization of bribery of officials of the EU and of member states is called for by the end of 1998. This would include a protocol applying to bribery affecting the financial interests of the EU and a recent, much broader protocol, eliminating the financial interests provision, neither of which has yet gone into effect.
- The Commission proposes that criminalization of foreign bribery outside the EU be pursued in cooperation with the OECD and the Council of Europe.
- Tax deductibility of bribes is criticized and the EU is urged to develop a concerted program to abolish tax deductibility.
- A variety of other measures are proposed including strengthening of public procurement rules, criminalization of private corruption, stronger anticorruption measures in EU foreign aid programs, and improving accounting and auditing requirements.

The Commission's policy statement incorporates many of the ideas proposed in a TI Brussels submission and is a major step forward. In the letter transmitting the Communication on an EU policy against corruption to the Commission, Commissioner Gradin commended TI for its contribution to the outcome.

#### 4.3. *Latin America*

Contemporaneous with the OECD effort, Latin American leaders launched a similar effort, placing the corruption issue on the agenda of the Summit of the Americas in December 1994 in Miami.

Only sixteen months later, the Inter-American Convention Against Corruption was concluded. It has been signed by twenty-three states, including the United States, but language discrepancies have delayed ratification. To date, only Argentina, Bolivia, Costa Rica, Ecuador, Mexico, Paraguay, Peru, and Venezuela have ratified the Convention.

The Convention obligates parties to enact and enforce adequate laws against acts of corruption, and it strengthens cooperation between countries on criminal investigations, judicial assistance, and extradition. It also requires states to criminalize transnational bribery and illicit enrichment. Illicit enrichment only requires an unexplained increase in assets rather than proof of receipt of a bribe. Consequently, the Convention lowers the

burden of proof required to prosecute a government official suspected of illicit acts.<sup>6</sup>

Finally, the Convention encourages a series of "preventive measures," including improving procurement practices, corporate books and recordkeeping practices, public ethics standards, and disclosure of assets. Clearly, implementation of these provisions will be key to determining the importance of the convention, and there is an understandable cynicism in the region that, having concluded the convention, nothing further will be done.

The OAS approved a *Program for Cooperation in the Fight Against Corruption* on June 2, 1997, at the General Assembly meetings in Lima, Peru. Questions of allocating sufficient financial and human resources and political authority for those at the OAS tasked with implementation must still be answered. The *Program* calls for development of a strategy to promote ratification. It also provides for drafting model laws on transnational bribery and illicit enrichment and for promoting their implementation along with preventive measures.

The issue is also receiving attention in other parts of Latin America. The Latin American Trade Ministers agreed at the recent meeting at Belo Horizonte, Brazil to launch the Free Trade Area of the Americas negotiations at the Summit of the Americas in March 1998 in Santiago, Chile. The Business Forum, which met prior to the Ministerial, has recommended that an agreement be negotiated on transparency in procurement.<sup>7</sup> The business participants called for countries to guarantee transparency of government procurement; provide potential competitors with access to information on its purchasing system, existing laws and procedures, and the size of government purchases; and establish a mechanism for contesting and settling disputes.

Participants also called on countries to amend laws to permit dispute settlement outside existing local legal systems, and to

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<sup>6</sup> This offense was an important tool in the successful Hong Kong effort to reduce corruption. See JOHN F. KENNEDY SCHOOL OF GOVERNMENT, HARVARD UNIVERSITY, OVERCOMING POLICE CORRUPTION IN HONG KONG: CASE PROGRAM 6.

<sup>7</sup> The Business Forum called for the simultaneous negotiation at the World Trade Organization ("WTO"). While it is premature to seek global consensus at the WTO for a broad anti-corruption requirement, at the December 1996 Ministerial in Singapore, ministers agreed to establish a working group to make recommendations on the elements of an agreement on transparency in procurement. Conclusion of an agreement should be achievable in the near term.

establish procedures to permit settlement by independent entities. The business leaders also submitted recommendations to enhance transparency and reduce illicit practices in Customs procedures.

#### 4.4. *The United Nations*

In December 1996, under United States Secretary of State Albright's leadership, the UN adopted the *Declaration Against Corruption and Bribery in International Commercial Transactions*. The *Declaration*, while not legally binding, reflects the growing political consensus.

#### 4.5. *The World Bank and International Monetary Fund*

The heads of the World Bank and IMF have provided significant impetus to the emerging consensus, particularly since the 1996 annual meetings, when World Bank President James Wolfensohn spoke openly about the bank's commitment to fight what he called the "cancer of corruption."<sup>8</sup> At the same meeting, IMF Managing Director Michel Camdessus said fund officials would consider it their duty to press for anticorruption reform in borrowing countries.<sup>9</sup> This is a remarkable shift from only a few years earlier, when many in these institutions considered the issue too political.

#### 4.6. *International Chamber of Commerce*

The role of the private sector in anticorruption reform is particularly significant. The ICC took up extortion and bribery in international business transactions twenty years ago, recognizing that a comprehensive program was needed to attack corruption from both the supply side and the demand side. Its report, issued in 1977, made detailed recommendations for action by international agencies, national governments, and the business community. The *Rules of Conduct to Combat Extortion and Bribery* were to serve as a basis for corporate self-regulation.

A dispute over a proposal to establish a panel to investigate allegations of infringement of the Rules of Conduct limited the

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<sup>8</sup> *IMF Chief Says World Economy on Safer Course*, FIN. POST, Oct. 2, 1996, at 14.

<sup>9</sup> See Paul Blustein, *IMF, World Bank Target Third-World Bribery*, WASH. POST, Oct. 4, 1996, at D3.

impact of the 1977 action. Last year, in response to a wave of bribery scandals, the ICC established a new committee, with representatives from over one dozen countries, including the chairman of TI-USA, to develop new recommendations.

Under the chairmanship of François Vincke, General Counsel of Petrofina, the Belgian oil company, the committee drafted the *Report on Extortion and Bribery* and the *Corporate Rules of Conduct* ("Rules"), which were adopted by the ICC's Executive Board under the leadership of Maria Livanos Cattai on March 26, 1996. The *Report on Extortion and Bribery* endorses the OECD actions and the strong positions taken by the heads of the World Bank and IMF. It calls for more transparent government procurement procedures, including disclosure of agents' commissions and requiring antibribery certifications by bidders. It also urges governments to regulate the conditions under which political contributions are made, including public recording and reporting.

The *Corporate Rules of Conduct* prohibit extortion and bribery for any purpose, not merely "to obtain or retain business," the FCPA standard and the one provided for in the ICC's 1977 rules. Thus, extortion and bribery in judicial proceedings, tax matters, regulatory cases, and legislative proceedings are covered.

The prohibition bars kickbacks and other techniques, such as subcontracts and consulting agreements, to channel payments to government officials, their relatives or business associates. Companies are also required to take steps to ensure that agents do not pay bribes, and payments to agents must be for legitimate services.

The financial provisions of the *Rules* prohibit the use of "off the books" or secret accounts and call for the establishment of independent systems of auditing to disclose any transactions that contravene the rules. Boards of directors are to establish and maintain proper systems of control, conduct periodic compliance reviews, and take appropriate action where indicated. The *Rules* provide that political contributions be only in accordance with applicable law and that public disclosure requirements be respected.

Companies are asked to draw up their own codes, consistent with the *Rules*, and to develop clear policies, guidelines, and training programs for implementing and enforcing its provisions. Employees are to be encouraged to report possible violations and

must be reassured against retribution. Higher levels of management should be involved.

An ICC Standing Committee, with additional representatives from the Middle East, Africa, and Asia, plans to work with ICC national committees in over sixty countries to encourage member companies to adopt the new rules and to work with the OECD, WTO, and other international organizations.

The work of the ICC and other private sector groups can make a critical contribution, complementing the public sector reforms. Last year, TI-USA developed a *Corporate Anti-Corruption Program: Survey of Best Practices* ("Survey") as a contribution to the dialogue on what companies can do to control corruption. It draws on two decades of experience with corporate compliance of legal and ethical rules.

The *Survey* indicates that the codes of many of the over two dozen corporate supporters that contributed to it go further than legally required. It was in the interest of corporations, stockholders, and employees to resist corrupt means to obtain business. The *Survey* found that bribery undermines the competitive dynamic that is needed to spur innovation and cost reduction.

Because bribery requires secrecy and masking book entries, it also interferes with managerial control. Management may have difficulty learning the real reasons for expenditures and whether some funds end up with intermediaries or the enterprise's own employees. The potential for blackmail by an employee with knowledge about corrupt payments could have a corrosive effect on discipline within the organization.

Moreover, the double standard of paying bribes abroad but competing honestly at home proved difficult to maintain. European countries, for example, have discovered that bribery can no longer be restricted to outside their borders. Mixed messages were found to undermine the effectiveness of domestic anti-corruption programs: slush funds reserved to obtain orders abroad found their way into deals at home.

Perhaps the most expensive cost of tolerating corruption was, and continues to be, the adverse effects of disclosure. In addition to damage to reputation, significant loss of property or opportunity can be involved. For example, the government of Singapore barred several German and Japanese companies from bidding on public contracts because of allegations that they had bribed an official. In short, the risks and the penalties have increased.

The private sector must observe the highest standards. Companies, however, fear being disadvantaged if everyone does not subscribe to consistent antibribery rules. Recognizing this dilemma, TI has developed an "islands of integrity" concept as an interim device until criminalization is universal. Under an "island of integrity," the rules are the same for all players. For example, in a procurement project, the procurement agency and bidders would certify to not permit bribery; would disclose all payments; and would agree to sanctions for violations. The World Bank is considering the use of such a device on bank-financed projects.

##### 5. THE SYNERGY OF INTERACTING MEASURES

These public and private sector initiatives are not a panacea, and laws alone will not change behavior. But they are the building blocks for creating a new political reality.

Progress will not come easily. As the chairman of TI-USA has observed, "[c]orrupt officials can make vastly more money by taking bribes than by being honest. For corrupt companies, paying bribes has been an easy and effective way to win orders. Bribery has provided a way to beat competitors with better technology and lower costs."<sup>10</sup>

Change has resulted from the combined efforts of all the stakeholders in the industrialized and the developing nations, and in the public and private sectors. All must remain involved if the laws, conventions, and other reforms are to prove effective. We must foster a continued change in attitude and take advantage of this window of opportunity to achieve practical results.

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<sup>10</sup> Fritz F. Heimann, *International Corruption and Corporate Codes of Conduct*, Presentation at Institute for International Economics Conference on Corruption in the World Economy, Washington D.C. (Apr. 17, 1996).