4. Economic Governance, the Private Sector and Corruption

<u>Stuart E. Eizenstat, Moderator</u>
<u>Under Secretary of State for Economic, Business and Agricultural Affairs</u>
<u>United States</u>

The second plenary session on "Economic Governance, the Private Sector and Corruption" was moderated by Ambassador Stuart E. Eizenstat, Under Secretary of State for Economic, Business and Agricultural Affairs of the United States.

Ambassador Eizenstat said that corruption is an issue of enormous significance to the future of the global economy and the development of open economic systems and democratic institutions. The convening of this conference highlights that the global fight against corruption has now become a significant priority of United States foreign policy. For the first time in recent memory, there was a genuine sense of optimism about the fight against corruption. Attendance of so many governments reflects a fundamental change in international attitudes. Governments around the world now recognize corruption as a malignancy on their economies and political institutions that can only be fought by creation of transparent and accountable economic and political systems firmly grounded in the rule of law.

All nations plainly have a genuine interest in preventing corruption and promoting good governance. In particular, emerging and transitional economies must address this issue or efforts to attract investment and maintain sustainable development will fail. Corruption thrives where legal systems are incomplete or evolving. Complexity, over-regulation and lack of predictability are incentives to corruption. Paradoxically, as economies liberalize and open to foreign investment and trade, the processes of change -- privatization, procurement, sale and licensing of economic rights, etc. -- become areas where corruption flourishes.

The need for transparency and accountability is not exclusively in the public sector. The recent international financial crisis demonstrated the consequences of crony capitalism and insider lending in the private sector, and the need for reform in areas such as corporate governance and bank lending rules. New empirical work pioneered by Daniel Kaufmann and others at the World Bank provided precise analysis of the adverse economic consequences of corruption. This new research confirms that corruption particularly hinders small and medium business, the engine of jobs and growth in emerging markets. Such costs force small companies into the unofficial sector, and also undermine the ability of governments to collect taxes. World Bank data also indicate that corruption disproportionately hurts the poor, who pay a higher share of "economic rents".

There was an emerging international consensus around a series of important norms in fighting corruption. These included: establishing open and accountable economic governance practices, including enactment and vigorous enforcement of anti-bribery laws and transparent economic decision-making; safeguarding integrity among justice, security and financial regulatory officials; promoting openness and accountability in the private sector; and strengthening institutions that ensure public and private accountability, including a free press. The United States would pursue a series of steps in each of these areas, and invited others to join with them.

The United States would seek ratification and full implementation of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, and would seek the Convention's extension to other key states whose companies compete for international contracts. The United States would encourage implementation through this Convention's important mutual evaluation process, and explore ways to engage civil society in this effort. The United States would also seek to extend the Convention to cover bribery of foreign political parties, party officials and candidates for political office, and a complete end to the practice of allowing tax deductibility of bribes.

The United States would also accelerate efforts to promote the rule of law, transparency and good governance in developing nations, thus limiting opportunities for corruption in transitional environments. The United States would promote global standards to advance transparency and accountability in governance and the private sector; encourage regional approaches to fighting corruption; and support key structural reforms in emerging markets to remove incentives for corruption and foster favorable climates for investment, trade and economic growth. It must be recognized that standards cannot be set and applied by OECD nations alone; transitional and emerging market countries must be part of this effort. The Executive was working with the Senate to secure United States ratification of the Inter-American Convention Against Corruption, and was pleased to recognize efforts under the auspices of the Global Coalition for Africa that should lead to an anticorruption regime for that region.

The United States would also intensify bilateral work with emerging economies to encourage the structural reforms needed to promote transparency and accountability. Corruption must be recognized as a broad systemic problem with many economic aspects. Countries had begun to "de-bundle" the corruption problem, to address key elements separately. Types of reform necessary to break the culture of corruption fell into a number of areas, including:

(1) economic policy reform, including deregulation;

(2) transparency reforms;
(3) public sector/civil service reform;
(4) public finance reform;
(5) judicial reform and enforcement of judicial rulings;
(6) commercial law reform and establishment of appropriate regulatory institutions;
(7) public oversight and participation, including public education, civic awareness, support for citizen advocacy groups and an independent media; and
(8) ethics reform.

Governments now have a number of important tools available to develop and implement concrete and integrated anticorruption strategies. These include:

(1) diagnostics, which would be discussed in greater detail by Mr. Kaufmann of the World Bank later in this session;
(2) work with the private sector, which would be discussed further by Ms. Cattaui of the International Chamber of Commerce later in this session;
(3) results-oriented policy dialogue and technical assistance;
(4) work with international financial institutions;
(5) mutual evaluation and national implementation; and
(6) work with non-governmental organizations.

It is essential that governments, the private sector and non-governmental organizations join together to assure that popular confidence in democratic reform and economic liberalization is not undermined by corruption.

Maria Livanos Cattaui
Secretary General
International Chamber of Commerce

Ms. Cattaui appreciated the opportunity to offer to the Global Forum the views, experience and hopes of the international business community. Business did not see itself as having purely a role of seeing who does well, and who not. Rather, the private sector would like to accompany the efforts of public officials. Businesses wished to define and implement the very best practices, as part of a partnership effort with governments against corruption.

The International Chamber of Commerce was the authoritative representative body to speak for the private sector, including 8000 companies and associations of companies in 137 countries. Their goal was to promote an open, rules-based international trade and investment system, based on sound business practices, business self-regulation and operation of the market economy worldwide. Some would be familiar with the ICC's International Court of Arbitration, the leading institution of its kind.

The ICC had first addressed the issue of corruption some 25 years before, forming its first committee on extortion and bribery headed by Lord Shawcross. Thus, it had taken a quarter century to reach the situation that pertained today. The economic implications of the problem of corruption were fundamental to the daily struggle of countries in competition for foreign direct investment. Countries today had a choice: they could choose to be part of the international trading system, or they could choose not to be. The OECD Convention and other international instruments were beginning to reverse the general acceptance of a culture of corruption, and increasingly business now has the legal basis to refuse to participate in corruption.

For this reason, business strongly supported an effective monitoring program for the OECD Convention. Unless the Convention were implemented and enforced consistently and effectively by all signatories, countries would be reluctant to impose any stronger regulation on their own firms than other countries might impose on competitors. Business wished to avoid ratcheting down to a lowest common denominator. The OECD Convention was not an end, but only a beginning of a process, with the hard work still being done.

It was clear to all in the business world that investment flows to countries that have a smooth and efficient financial and trading system. Corruption, however, distorts the efficiency of markets. Procedural barriers in the form of excessive government regulation not only increased the cost and diminished the attractiveness of markets for business. Excessive documentation or licensing requirements, border delays, inefficiencies in payment procedures, lack of transparency in government activities, all were compounded by, as they created conditions that promote, corruption. Countries where these barriers flourish could not participate effectively in the global economy.

Among the worst problems was that of the pervasive, sometimes petty, and often invisible corruption that affected the entire business environment. Many tried to blame such conditions on bureaucrats. The ICC, however, would prefer to consider bureaucrats a part of the solution, rather than as the problem. A country has no greater asset than the professional, disinterested services of an efficient bureaucracy, and business placed a premium on operating in environments where this was the case. She noted in particular the significance of customs for business. In the past half century, international trade had increased fifteen-fold. To deal with the growing volume of time-sensitive trade, what was needed was “just in time” customs service. This in turn demanded substantial new investment in equipment and personnel. The long-term benefits of these sorts of improvements would also operate to decrease the possibilities of corruption in the customs systems.

As long ago as 1975, ICC had introduced its first corporate ethics program, when this was an issue scarcely anywhere. It created its committee on extortion and bribery, headed by Lord Shawcross, which in 1977 issued its first report with rules for enterprises to follow Operating in the international environment exposed companies to many problems and issues which they did not encounter domestically. The demand for corruption took many forms, and it was sometimes difficult to be able to identify or even recognize a demand for a bribe. Firms required the assistance of clear rules, consistently applied, to navigate in such potentially confusing conditions.

Royal Dutch Shell, as one example, had what was widely regarded as one of the most effective corporate ethics programs in the world. Its Chairman said that he observed one simple rule: would the firm like to read about any given payment or act associated with its name in the next morning's world press. General Electric, which operated in dozens of countries, had internal ethics programs that included use of CD-ROM's, videos and individual employee training, recognizing that this issue is not a straightforward one.

The ICC, to assist its companies, would in April publish a new manual on fighting bribery. Firms need to understand how to operate in the new environment established by the OECD Convention. Issues that would be addressed in this publication included the responsibility of enterprises, the role of agents, money laundering, relationship between corporate codes and government reforms, political contributions, among many others.

The case of independent agents or sales representatives, for example, was one of the most significant grey areas. Local agents, because of the circumstances in which they worked, were often most susceptible to the temptation to give bribes to secure business. Even when a firm had codes, they typically addressed issues like agent selection, compensation and the like. The manual would include step-by-step guidance to a firm to protect itself from abuses. It would offer specific warning flags, as for example: did an agent reside in the country? When payments are made for services, where and how are they directed? Did the agent have any connections to officials, and if so, to whom? Did national officials suggest that a particular agent should be employed in a given transaction? Were requests made for increase in payment for a transaction? These are the sorts of things a business, in cooperation with government, must sort out. Activities relating to corruption were not always obvious. The ICC hoped to assist its members to detect and prevent such abuses.

Business leaders around the world would like to see and end to corruption. They do not like to pay bribes. However, they will not cease doing so unilaterally, when they believe competitors do bribe. For this reason, business strongly favored wide adoption and implementation of the OECD Convention.

Much of the practical day-to-day work to fight extortion and bribery must be done by enterprises, and business was aware of it. The five recommendations by the ICC to firms to meet this continued to be:

(1) To develop a manual with a comprehensive code of conduct for corporate practices.
(2) To clearly assign responsibility for implementation of that code.
(3) To implement an effective internal compliance program, including training and disciplinary measures for violations.
(4) To continuously monitor and modify the manual and code if conditions change or original provisions are inadequate.
(5) To apply sanctions against code violators consistently and without bias.

She suggested that many of the same principles as applied to businesses in these recommendations also applied to countries.

Daniel Kaufmann
Governance, Finance and Regulatory Reform Group
World Bank

The full text of Mr. Kaufmann's presentation, along with graphic materials employed during that presentation, may be found in the Appendix.

Mr. Kaufmann related an anecdote concerning the taxi driver with whom he arrived at the building to illustrate the point that the average citizen feels great skepticism about the topic of fighting corruption. He also observed that despite the fact that Chile appears better in terms of corruption and incidence of bribery than many OECD countries, a Chilean Olympic official was one of those named in the recent Olympic corruption scandal. This was a reminder that no country is without corruption, and there is no room for complacency.

He invited participants to consider the consequences of corruption in a country in which there is institutional corrosion of the judiciary and security apparatus. Before the judiciary and security institutions could be considered part of the solution to other forms of corruption, it must be acknowledged that they are also part of the problem. Enforcement issues were important in dealing with corruption, but enforcement comes at a late stage in a corrupt transaction. It was necessary to seek means earlier to ensure that large numbers of people, citizens and officials, were not breaking the law. Prevention and education therefore were at least as important as enforcement, and should complement it.

Second, working to improve judicial and security institutions is predicated on the assumptions of a transparent, open and effective political process, and an effective and functional public sector management system as a whole. Where these assumptions do not hold, a narrow focus on security and the judiciary will not work. One must address the need for institutional economic and political reform. The World Bank did not engage in political reform processes, but is involved in institutional economic reform and had a number of programs to assist in such efforts.

Third, prioritization and sequencing were important considerations. It was relatively easy now to set up a powerful and complex graphic presentation of the corruption problem, which would then present a formidable array of daunting tasks that need to be done in the immediate future. This is not implementable, and in the end, because of political and institutional constraints, nothing happens. It is important to suggest the four or five key priorities in each country, and to realize that these differ from one country to another.

Based on the World Bank's experience, he suggested three aspects of a process that could lead to positive results in an emerging economy.

The first was inclusion, the need to build coalitions involving civil society and the private sector, to combine to provide political will with at least a few champions within government who wanted reform to happen. The Colombian National Police had succeeded in far-reaching reform by combining internal reforms with creating monitoring boards and other means to engage civil society.

Second, empirics was not just a managed research but was a powerful proactive tool for awareness and real action.

Third, there was a need to consider innovative institutional responses to complement conventional responses, as for example employing alternative dispute resolution to promote the rule of law in situations where the official rule of law institutions had become dysfunctional.

He described an example in one Latin American country in which a governor engaged in a reform process became nervous about a major procurement contract for computers. The governor brought in experts and held a public audience to establish the rules for the procurement. After this, the rules were completely redrafted, substantially reducing costs. This illustrated a combination of the power of data, civil society involvement and innovative institutional approaches.

Turning to the new diagnostics utilized within countries, he emphasized that this was only one approach and one input within a broader set of instruments and goals. It should not be used in isolation; this would not work. Second, the approach must be done in partnerships. The World Bank could provide methodological approaches, questionnaires and technical assistance, but ultimately partner institutions in the countries involved must implement the process. Countries must ask.

The new diagnostic empirical tools begun with analysis of the worldwide data base to offer comparisons of a country within its region and with other regions, to provide preliminary identification of problem areas to guide the diagnostics. In-depth diagnostics take place in conjunction with extensive field work. Data are presented at a major workshop involving hundreds from civil society, government, non-governmental organizations and all interested groups. Working groups prepare draft action programs for each area of reform. By the end of the workshop, as had taken place in Bolivia, an announcement should be made by government leadership of the types of action programs that will be implemented.

These diagnostics seek to measure the type, extent and cause of corruption, misappropriation and diversion of public assets and resources. Surveys in a number of Eastern European countries had determined, for example, that the poor bear a disproportionate cost of corruption in terms of public service delivery, paying more as a proportion of income than those better off. The same holds true for businesses. In some countries, evaluation of the tax equivalent cost of corruption demonstrated that corrupt payments in some enterprises paid 15-20 percent of total revenue. Documentation of such facts persuaded the public, business and government of substantial incentives to reduce or eliminate corruption.

Three types of surveys are done, one for households and citizens, a second for businesses and a third for public officials. This is complemented by data from sources such as analysis of customs receipts or procurement prices, and by focus group discussions to determine the basis of problems identified by the empirical diagnostics.

Questionnaires no longer asked opinions and general questions, but rather consisted of questions that were exponential in nature, for example inquiring about actual experience, formulated in a manner that avoided any self-incrimination. The Bank had had good experience with the capability of local partners to absorb these techniques and to continue them without further external assistance. The goal in all cases is to understand the factors that constitute incentives or disincentives to corrupt behavior, as the basis to suggest the most appropriate basis for reform.

In closing, he summarized the salient points of his presentation. First, what is important is coalition of civil society, the private sector and government. Second, rigorous empirics were a powerful means to empower such coalitions. Third, it is crucial to focus on prevention. Fourth, institutional innovations are highly important. And fifth, diagnostic tools were one of a number of inputs. Corruption is a symptom, an important and damaging one, but still a symptom of an underlying systemic weakness of the state. Many anticorruption campaigns had locked some people up but accomplished nothing more permanent. It was important to concentrate also on serious institutional reforms.

It was essential to have realistic expectations. Even with the utmost political will, progress against corruption would only be possible over timeframes of five or ten years, or longer. It was necessary to find political will to sustain reforms, to work continuously and to involve civil society, which could be enormously powerful in helping to address the problem of corruption.

Irene Hors
OECD Development Center

Beginning the comment period, the Moderator recognized Irene Hors of the OECD Development Center, to offer a summary of the related meeting on private sector action against corruption held in Washington earlier that week.

Ms. Hors said she spoke on behalf of the Director of the OECD Development Center, Mr. Bonvant, who regretted not being able to attend. She would offer a summary of the findings of a conference on the role of the private sector in fighting corruption in developing countries and emerging economies, which had been held in Washington February 22-23, immediately before this Global Form. The OECD Development Center was particularly suited to host such a conference, serving as it did as the bridge between the OECD countries and the developing world.

At that conference, over 250 leaders from the private and public sector in over 50 countries had participated. They had concluded that fighting corruption was a probusiness agenda. It is in the interest of the private sector as a whole to operate in an environment of workable free competition in the framework of the rule of law. Second, fighting corruption cannot rely only on government and civil society alone to be successful. The private sector must be actively involved.

What should multinationals and local firms do to advance efforts against corruption. Multinationals should take steps such as strengthening compliance with international treaties, conventions and agreements; establish codes of ethics, conduct ethics training programs; establish and implement ethics programs; and identify and cultivate pockets of integrity to promote ethical behavior in dealings with local governments. Local enterprises should establish partnerships with their governments and civil society to fight corruption, and should establish and implement their own ethics programs.

Their conference had discussed four examples of success in this regard. In Africa, the West Africa Enterprise Network, including some 300 enterprises, had established an observatory of abnormal practices to help serve as a watchdog for local governments to strengthen the rule of law. In Malaysia, an important share of imports and exports had previously passed through the port of Singapore to avoid bribery among customs officials. Business firms had approached the authorities and proposed to commit themselves to greater use of Malaysian ports, if customs procedures could be reformed to eliminate bribery. This reform had been done, and firms were making use now of Malaysian ports. An American company had developed ethics resource materials that were being used in implementation of ethics programs in the United Arab Emirates, South Africa and Colombia. In Morocco, the Ethics Committee of the General Confederation of Morrocan Business had adopted a Charter of Ethics, and had begun negotiations with the government to reform the judicial system. In all these and other cases, there was impressive enthusiasm in anticorruption efforts at this time, which it was important to sustain.

The conference had concluded that business associations should continue bottom-up efforts to promote anticorruption agendas; that the private sector should play an active role in monitoring compliance and implementation of the OECD Convention; and that it would be desirable to have similar conferences in various specific regions. The OECD would be reflecting the results of this conference in a publication which should be available shortly.

Luis Alfonso Davila
President of Congress
Venezuela

Senator Davila expressed regret that President Chavez of Venezuela, who had planned to attend this conference, had been unable to do so.

To solve the problem of corruption, it was necessary to include consideration of two sets of wills, the will of the country suffering from the problem of corruption, and that of other countries surrounding it.

Venezuela had been suffering from the endemic ill of corruption for over forty years. The activities of those who directed the country during that time seemed to have been guided by the idea that in Venezuela, there was no reason not to steal. This had been said for a very long time, in an epigram difficult to translate into English that implied that while one was stealing, others were doing so as well. Over 20 years, more than $300-billion in oil revenue had been received by Venezuela, but its 20 million people remained over 86% impoverished, a level that was a critical national emergency. The scourge of corruption had led to the virtual collapse of state institutions; there was no credibility left today among the people in the judiciary or other institutions of government.

This had now begun to change, in what former United States President Jimmy Carter, as he witnessed the elections that led to it last December, had called the greatest peaceful democratic revolution in the country's history. For the first time, the country had initiated processes that it was believed could do away with the problem of corruption, and efforts were in process to convene a constitutional assembly to codify a new system of justice that would make it possible to imprison those involved in corruption. Venezuela was seeking to move back toward the goal of participatory and responsible democracy. To attain it, she needed the help of all countries of the world.

This led to the other will necessary for success, that of the suffering country's neighbors. The existence of this will was reflected in this extraordinary meeting, in which so many countries had gathered to understand and try to solve a problem common to them all. When it began, corruption corrupts quickly. He hoped that this meeting would end with commitments that would allow the participants to attack corruption head on.

Robert S. McNamara
Global Coalition for Africa

Noting that he had participated the previous day in an important meeting to advance an anticorruption initiative by 11 African countries and the Global Coalition for Africa, the Moderator called on Mr. McNamara to offer comments on that initiative and the subject of the meeting.

Mr. McNamara commented that he was not certain he should be speaking, as at 83 years of age he was not widely in touch with current affairs. However, he had been involved with development matters for over 30 years. During that time, this was only the third occasion on which he had seen developed and developing countries come together and admit that corruption was a problem that they all had in common. He felt this recognition of the problem and the need to address it could be tremendously important.

Nevertheless, it was vital to move beyond generalities and reach to specific actions that countries could take against corruption. Mr. Kaufmann of the World Bank had offered a range of very specific propositions, and the World Bank and other development agencies had identified pragmatic approaches to act against a problem that all now recognized existed, but often did not know how to affect. He was departing the following Sunday to visit Mozambique to offer such advice and encouragement as he could to the head of state there. He strongly urged participants, when they returned to their countries, to call on their heads of state to become personally and directly engaged against corruption, as only with this sort of strong political will from the top could such an effort succeed.

The previous day, 11 African countries had adopted a new declaration of specific anticorruption principles which they had committed themselves to incorporate in their national programs to attack corruption. This was an important and positive development; he would not have dared five years ago to suggest that such a thing would have been possible. Seven of those countries had already started national programs to implement these anticorruption principles, and the other four were to do so shortly. He strongly urged all countries participating in this meeting to take advantage of the opportunity offered by the current international attention to this issue to develop and begin to implement serious comprehensive national anticorruption programs.

N. Vittal
Central Vigilance Commissioner
India

Mr. Vittal said he fully agreed with Mr. McNamara's recommendation that participants should address issues of corruption as specifically as possible. He wished to offer some comments on what India is doing now against corruption.

The Central Vigilance Commission of the Indian Government was established 34 years ago, as an advisory body. About five and a half months ago, on September 3, 1998, an ordinance had converted it into a statutory body. Selection of its Commissioner, as appropriate in a democracy, required the agreement of the Prime Minister, the Home Minister and the leader of the parliamentary opposition. In conducting its inquiries into matters involving corruption, it was responsible to provide supervision for the Central Bureau of Investigation.

A second important element in the prevention of corruption was the fact that many departments or agencies of government had been encouraged to define and publish charters or codes so that citizens would know their rights in dealing with the government. This promoted greater transparency in the operations of government, serving as a useful check on corruption.

Third, India developed strong institutions for the supervision and protection of public servants. The Public Service Commission was a politically independent body which could protect civil servants from political attack.

The speaker agreed with Vice President Gore's observation that morning that many of the most important steps a government must take to fight corruption were the same steps that it needed to take to re-invent to enhance its efficiency. There were similar relationships in other areas. For example, steps to fight corruption were also similar to those that one encountered in the World Trade Organization to enhance global trade. Many of the steps necessary to fight corruption were also identical to those necessary to combat terrorism, and terrorists often employed corruption to attain their ends.

Stuart E. Eizenstat, Moderator

The Moderator expressed appreciation to those who had contributed to discussion. He suggested that this discussion indicated a number of specific measures or actions that were indicated to follow up, and invited participants to return to their countries and identify the specific steps they would take and inform the United States and others of them. He noted that a new situation existed. At this meeting, developed countries were not pointing fingers and developing countries. Bribes, to a very substantial degree, come from the developed countries. While the OECD Convention was a major step, the developed countries also faced their own domestic problems with bribery. The problem of official corruption was one that all countries faced, and that all must share in solving.