1

The Globalization of Corruption

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Over the past four years, corruption has been transformed from a predominantly national or regional preoccupation to an issue of global revolutionary force. In less than a half-decade, the worldwide backlash against corruption has swept like a firestorm across the global political landscape. Governments have fallen. Longtime ruling parties have been hounded from office. Presidents, prime ministers, parliamentarians, and once mighty corporate chieftains have been grilled by prosecutors and herded onto the docket. Italy, France, Japan, South Korea, India, Mexico, Colombia, Brazil, South Africa: no region, and hardly any country, has been immune.

It is a revolution that even Karl Marx could scarcely have predicted—a simultaneous, though largely peaceful, public revolt on five continents against one of the world's oldest part-time professions: proffering and accepting bribes.

Campaigns against corruption are, of course, hardly new. But this decade is the first to witness the emergence of corruption as a truly global political issue eliciting a global political response. Since 1992 a half-dozen or more international organizations—governmental and nongovernmental—have energetically taken up the question. The United

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Nations, the Organization of American States (OAS), the International Chamber of Commerce, the recently formed Transparency International, the World Economic Forum, Interpol, and—in what may be the most promising initiative of all, the Organization for Economic Cooperation and Development (OECD)—are all making efforts to tackle the problem.

No one imagines that we are about to vanquish corruption, which is deeply entrenched across the globe and shows dangerous signs of spreading. In many countries, new leaders have ridden to office on anticorruption platforms, only to be exposed in turn as thoroughly corrupt themselves. Nonetheless, there is reason to believe we may be at a historical turning point in humanity's long wrestle with corruption. A new global standard appears to be taking shape in human consciousness, with potentially major ramifications for our institutions as well as our political and business lives. The 1990s, we would predict, are unlikely to pass without the achievement of significant legal and institutional anticorruption reforms.

What has been the source of this sudden "corruption eruption" (Naím 1995)? Why is this issue increasingly seen as a global rather than a local or national problem by so many? What international reform efforts are now under way? Are they likely to succeed, and if so why and how? We will attempt here to offer provisional answers to these questions.

Why Corruption Erupted

The corruption eruption has several causes. There have been both real and perceived increases in corrupt activity in various countries. In some regions, systemic political change has weakened or destroyed social, political, and legal institutions, opening the way to new abuses. Elsewhere, political and economic liberalization has simply exposed corruption that was once hidden. But almost everywhere, we observe a marked decrease in the willingness of the public to tolerate corrupt practices by their political leaders and economic elites.

A Legitimation Crisis

In the largest sense, today's anticorruption revolution can be viewed as a continuation of the ongoing legitimation crisis that has become the leitmotif of global politics during the final quarter of the century. From the most advanced democracies to the most repressive states, the balance of power between leaders and publics has been shifting and continues to shift in favor of open, democratic governance. The primary driving forces behind this change are growing affluence and education and the emergence of the Information Age. The increasing worldwide availability and consumption of information, the burgeoning influence of the media, and technological changes that give knowledge and information primacy in economic life have all contributed to an information-rich environment in which leaders, willy-nilly, are forced to give a fuller public accounting of themselves than ever before.

Secrecy and Orwellian manipulation of the truth—those cornerstones of authoritarian and totalitarian rule—have become increasingly difficult to maintain in the ever more transparent postindustrial environment. Empowered by information, people almost everywhere are expressing their revulsion at the traditional sub rosa activities of entrenched and corrupt elites, taking their dissatisfaction to the streets and, where possible, the polls.

The Watergate scandal in mid-1970s America—in which a newly empowered media exposed and brought down a strong president—the peaceful democratic revolutions that toppled dictators across Latin America in the 1980s, Mikhail Gorbachev's fateful decision to revitalize the sclerotic Soviet economy and political culture with a major infusion of openness or *glasnost*, and the subsequent peaceful popular uprisings in Eastern Europe that precipitated the fall of the Berlin Wall and the collapse of the Soviet Union have all been manifestations of this global democratizing trend. The present-day global backlash against corruption is, in a sense, only the latest chapter in this contemporary saga.

The end of the Cold War has clearly accelerated the process. This has been particularly obvious in Italy—the birthplace of the 1990s anticorruption revolt—where fear of communism had long underwritten public tolerance of notoriously high levels of corruption. Beginning in 1992, a coterie of Milanese magistrates discovered that with the demise of the Soviet Union and the elimination of the communist threat it was possible to bring down many of the erstwhile political untouchables on corruption charges. In South Korea as well, the end of the Cold War opened the floodgates of public anger at the antidemocratic and corrupt practices of the politicians and the large conglomerates, or *chaebol*. As *Business Week*'s John Rossant has written, "In every country on the former front of the cold war—South Korea, Taiwan, Mexico, Italy, and even Japan—holding the line against communism was more important than instituting real free markets and political competition. Now, shocks are beginning to rock the Establishments of the industrialized nations" ("Dirty Money," *Business Week*, 18 December 1995).

Our Enemy Left Us

The end of the Cold War and the emergence of a truly integrated international economy have also contributed to the widespread perception of corruption as a problem with inherently global ramifications. With the world no longer divided into two great camps, our sense of global interdependence has increased. There is growing awareness that security and stability depend not simply on air forces, armies, and national arsenals but also on a host of interacting economic and political factors. The security of one nation can be radically affected by purely domestic developments in a seemingly distant state. There is an indissoluble link, for example, between official corruption in Latin America and drug-inspired crime on American city streets. Disputes over alleged corruption can even drive a wedge between allies—as in the recent scandal over American economic espionage in France ("CIA Confirms Blunders During Economic Spying in France," *New York Times*, 13 March 1996).

Potential links between corruption and political instability are particularly obvious in the case of Eastern Europe and the former Soviet Union. In the short run, removal of authoritarian controls, decentralization, privatization, and opening of these economies to international participation have vastly expanded possibilities for corruption; in some places, such as Russia, it is rampant.

Corruption in these emerging markets is doubly pernicious. First, it compromises the efficacy and efficiency of economic activity, making the transition to free market democracy more difficult. Second, and equally important, corruption distorts public perceptions of how—and how well—a proper market economy works. Under such circumstances it becomes all too easy for economically beleaguered publics to confuse democratization with the corruption and criminalization of the economy—creating fertile soil for an authoritarian backlash and engendering potentially hostile international behavior by these states in turn. If it contributes to derailing democratic reform and provoking an authoritarian backlash, corruption in Russia could ultimately engender a major security threat for America and the West.

Nor, as we have seen, are the political ill effects of corruption restricted to emerging markets. One of the unexpected consequences of the end of the Cold War has been widespread malaise and an intensified crisis of legitimacy in advanced industrial societies—aggravated by the public perception of entrenched official misconduct. To quote French political scientist Dominique Moisï, "Our enemy left us before we were ready" (remarks at the Wharton School's International Forum, Bruges, Belgium, June 1994). As a result, governments in many OECD countries are experiencing difficulties or are even floundering. Italy, Japan, Great Britain, and the United States come easily to mind.

The end of the Cold War has affected the developing countries as well. The longevity of regimes such as those of Marcos in the Philippines, the Duvaliers in Haiti, Stroessner in Paraguay, and those of the many African tyrants who oppressed their citizens and looted their central banks was a concrete geopolitical expression of superpower rivalries. Foreign aid and military assistance continued to flow to these countries even though it was widely known that much of the time the titular destination was no more than a stopover en route to the private Swiss bank accounts of the ruling families and their cronies. Nowadays—when aid budgets everywhere have been slashed, when the communist threat is a fading memory, and when public opinion in donor countries is better informed of abuses that take place anywhere on the globe—corrupt regimes can no longer rely on loyalty to the cause as an automatic guarantee of support.

Rent Seeking versus Vote Seeking

Side by side with these shifts in the international climate have come domestic pressures for reform arising from the growth of democracy itself. In 1996 the human rights organization Freedom House classified 117 states as free and democratic—fully 61 percent of the world's countries, up from just 42 percent 10 years before (Karatnycky 1996). Growing democratization has meant the emergence of more active national media and stronger legislatures with the power to hold leaders accountable.

To be sure, there is no simple correlation between levels of democracy and levels of corruption (see Johnston, chapter 3). Democracy bestows no automatic immunization against public malfeasance, as the countless recent scandals in industrial and developing democratic countries show. Nonetheless, it is probably fair to argue that democratic regimes, over the long run, engender more powerful antibodies against corruption than systems in which political liberties are stifled. A regime that has frequent elections, political competition, active and well-organized opposition forces, an independent legislature and judiciary, free media, and liberty of expression is bound to generate more limits on the scope and frequency of corruption than one that does not have them. The recent succession of cleanups in the belt of South American countries that went democratic in the 1980s bears witness to this basic trend.

Still, in countries undergoing a transition from authoritarian rule to democracy and a market economy, the consequences of corruption can be complex—as the aforementioned problems in many postcommunist states evidence. Initially, democracy may mean only that corruption is decentralized; bribes that were once paid at the federal level are now paid to state and local authorities.

Moreover, the sudden deregulation of entire new arenas of economic activity that were once under the exclusive control of the state can vastly expand room for misconduct, opening the door to fraud and all sorts of abuses by firms trying to take advantage of the opportunities created by capitalism. Government officials in charge of privatizing publicly owned assets can become instant tycoons by selling them at low prices for a bribe or even by acquiring them through their families and friends. Indeed, the opportunities for rent-seeking and rent-taking behavior by public officials during such a transition can be manifold.

Rates for newly privatized utilities—phones, electricity, and the like—can be sold very lucratively. These opportunities peak in the early stages of the transition to a market economy, when monopolistic companies are often privatized without an effective regulatory framework in place or the banking system is liberalized without adequate supervision by monetary authorities. During this period, the coexistence of free-price and free-market sectors, with sectors in which central planning still reigns, creates major distortions and many opportunities for graft and abuse.

In the long run, however, a more competitive, less regulated economy is bound to offer less scope for corruption than a centrally planned one, if only by reducing opportunities for official rent seeking and by shifting the balance of power between the private and public sectors, usually with the effect of increased official accountability (see Klitgaard 1988 for discussion of this issue).

Globalization of the Problem

If political interdependence is particularly marked today, economic interdependence is even more so. Indeed, the globalization of the economy is adding new urgency to the corruption problem. Three related and dramatic changes are at work.

Holes in the Dike

First, broadening and deepening of global economic integration increases the probability that the effects of corruption will spill over and resonate throughout the world economy. When the corrupt Bank of Credit and Commerce International went belly-up in 1991, for example, the entire social security fund of Gabon was wiped out (Passas 1994). The increasing permeability of national borders limits the reach of national territorial jurisdiction and makes it impossible to wall off national economies or policies, to separate the domestic from the international.

Second, the emergence of an electronically networked international financial system markedly enhances opportunities for corruption, the difficulty of controlling it, and the potential damage it can inflict. Paradoxically—when we consider the present-day ability of intelligence and other agencies to monitor such electronic traffic—it also may offer new opportunities for its exposure and control.

Third, there has been a dramatic increase in the number of cooperative strategic alliances, both within countries and across borders. In many strategic sectors, the emerging global economy resembles a complex worldwide network of interfirm agreements. The relational nature of alliances makes control much more difficult for both managers and public policymakers. Furthermore, alliances or networks depend on mutual trust to a much greater extent than the traditional, hierarchical firm. Such trust can be compromised directly by corruption. Globalization affects both the problem and its solution: the new global realities facilitate corruption, as well as serve in other ways to expose and inhibit it. In the following sections we explore both sides of this coin.

Atoms and Bits

By the early 1990s, some 37,000 transnational corporations with worldwide sales of about $5.5 trillion controlled roughly one-third of the entire world's productive assets. Interfirm trade between subunits of these corporations now accounts for between 30 and 40 percent of all world trade. Today the value of sales of transnational subsidiaries is far greater than that of world exports (UNCTAD 1994, 131).

At the same time, in Nicholas Negroponte's words (1995), trade in "atoms" is being replaced by trade in "bits." Today the most valuable product in international commerce is information transmitted electronically. It has become increasingly difficult to separate manufacturing from services and goods from information; in fact, in 1995, *Fortune* decided to combine its industrial and service 500s into a single listing.

Many countries that tolerate corrupt practices—to the extent, for example, of allowing corporate tax deductions for overseas bribes—do so under the assumption that the illicit activity in question will take place somewhere else. However, in an integrated international economy, there is no somewhere else. The walls around national markets are crumbling; the separation between international and domestic economics and politics is vanishing rapidly. The very concept of national products, national firms, and even national markets is losing meaning.

Both corruption and standards of conduct are globally contagious today. With an increasing portion of the world economy in the hands of global firms, it is unreasonable to expect that corporate practices, culture, and ethics will not interpenetrate all markets. If it works abroad, why not try it at home?

As a growing number of experts are beginning to recognize, widespread corruption threatens the very basis of an open, multilateral world economy. Multilateralism depends on trust and a belief that others will play by the rules. The tendency to cheat, to free-ride, is a constant threat to the international economic system. Tolerance of corruption tilts the playing field—against firms (and countries) that will not or cannot engage in bribes and other corrupt practices. Corruption distorts competition and may reduce gains from free flows of trade and investment. That is equally true of countries that tolerate corruption domestically and those that tolerate—or even tacitly encourage—corrupt activities by their firms abroad.

Millions by Mouse Click

In no sector of the world economy have bits replaced atoms to the extent that they have in international finance. Today the international financial system comprises hundreds of thousands of computer screens linked by satellites in instantaneous communication with one another; they are in closer contact than the stalls in a village market. The volume flowing through this network is almost incomprehensible—well over $1 trillion a day in foreign exchange transactions alone. In the vast majority of instances, the only physical act needed to transfer funds is a tap on a keyboard or the click of a mouse. Money circulates around the globe literally at the speed of light. Once funds enter the system they can be disbursed in an instant to any number of far-flung locations. As *Time* magazine has put it, law-enforcement officials today are forced to search for dirty funds afloat on the oceans of legitimate payments—a daunting task at best ("A Torrent of Dirty Dollars," *Time*, 18 December 1989).

The globalization and digitization of international finance mean that it is technically easier than ever before to dispose of the fruits of corruption, regardless of the size of the payment. Consequently, corruption and criminal activity such as the drug trade increasingly pose a direct threat to the integrity of the international financial system itself. It is more and more difficult today to draw a clear line between legal and illegal funds, to separate bribes and drug money from less criminal but still dubious corporate and individual transactions designed, for example, to minimize a tax burden. Such an integrated and digitized international financial system only partly under the control of national authorities by nature increases the occasions of sin—and its potential consequences.

Developments just over the horizon threaten to exacerbate the problem. Any number of firms are now working hard to develop electronic cash, E-money, which can be used in the growing number of commercial transactions on the Internet. E-money, in whatever form, will combine the attributes of cash—universal acceptance and a lack of a clear audit trail—with the ease of electronic transfer (Post 1995). From a regulatory standpoint, the one advantage of cash is that it is cumbersome to transport in large quantities and possible to spot as it enters the system. E-money will be instantly transportable at the touch of a computer key and very difficult to track and regulate. It could conceivably make buying a government official just one more transaction on the Net.

A Two-Way Street

Yet if the new global realities in some ways facilitate corruption, in other ways they inhibit it. The globalization of electronic communications makes it easier to transfer money across borders and to launder funds of dubious origin. But it has also given rise to the most unrestrained media in history. Government officials are finding it is far from easy to limit the spread of damning information in the age of CNN, the Internet, the fax-modem, and easily affordable desktop publishing. The global explosion of communication and information not only makes secrecy harder to maintain than ever before, it also forces governments to be more responsive to an influential global audience (investors, journalists, politicians, multilateral bodies, and international public opinion in general) that adds to the constraints under which they have to operate. The risks for government officials, and perhaps even more for corporate executives, of seeing their names blackened by corruption charges on a global scale are higher than ever. Presumably, such heightened risks can have a deterrent effect.

Such forces are limiting the freedom that government officials once had to pursue their private interests at the expense of the public weal. Perhaps as important, they are also lowering the tolerance governments have for harboring corrupt individuals or practices.

Over the past decade, for example, the Swiss government, spurred by pressure from other nations, has made major progress in loosening its once-strict bank secrecy laws. Once alleged to harbor millions in ill-gotten funds, Swiss banks are no longer the banks of choice for money launderers (Andelman 1994). In Cuba, the Castro regime decided it could no longer afford to protect Robert Vesco, the fugitive US financier who had lived on the island for decades. The Samper administration in Colombia also determined it could not afford the sanctions that the United States was going to impose if it did not clamp down on the drug kingpins of the Cali cartel—until the Colombian president was himself accused of soliciting millions in campaign contributions from drug criminals.

A Global Breakthrough?

The final engine of change in the current global environment is the emergence of several concrete, coordinated international efforts at anti-corruption reform. Over the past half-decade, a remarkable number of governmental and nongovernmental international bodies have acted or called for action on corruption.

New International Initiatives

Earliest efforts were aimed not so much at corruption per se as at the related problem of drug money. In 1988, nearly 100 governments approved the UN Convention Against Trafficking in Illicit Narcotics and Dangerous Drugs, committing themselves to criminalizing money laundering and lifting the secrecy barriers to its detection. At the Paris economic summit the following year, the industrial nations formed the Financial Action Task Force, an ad hoc organization of 26 states, to carry out the mission. Since then, the task force has endorsed 40 recommended countermeasures, and member countries have agreed to allow technical teams from other member governments to monitor their efforts. The European Union, a regional member of the task force, has developed its own anti-money-laundering standards based on the task force recommendations (US Department of State 1992).

With the advent of the corruption eruption in the 1990s, the international anticorruption agenda greatly broadened and accelerated. In November 1994, the United Nations sponsored a high-profile conference in Naples on cross-border and organized crime. One hundred thirty-eight nations signed the Naples Declaration, pledging stepped-up domestic action and international cooperation to fight organized crime ("138 Countries Seek to Combat Global Crime," *Los Angeles Times*, 24 November 1994). (That conference host Italian Prime Minister Silvio Berlusconi was himself declared at the time to be under investigation by magistrates on corruption charges underlines the need for a certain skepticism concerning such international declarations.)

In 1995, the World Economic Forum—the largest international organization of chief executives—also called for cooperative action by government and business to fight corruption. They established the Davos Group, an informal association of high-level international business executives, law-enforcement officials, and experts—including Interpol Secretary General Raymond Kendall and Siemens AG Chairman Hermann Franz—to study the problem ("Corruption Goes Global, and So Has to Be the Riposte," *International Herald Tribune*, 29 March 1995).

The most significant and promising effort is an attempt to come to grips with a long-standing, central, and until recently seemingly intractable problem—bribery in international business transactions. With the exception of the United States—which criminalized the practice nearly 20 years ago—multinational firms in industrial countries routinely proffer bribes to officials in developing nations as a means of landing business deals. Many developed states not only legally permit such bribery but also permit firms to deduct such bribes as a legitimate business expense (OECD 1995b). This is not only a widespread and pernicious instance of corruption but also a practice by which the industrial nations, in effect, encourage and contribute to corruption in the developing world. In 1993, a group of former World Bank executives established an organization called Transparency International, loosely modeled on the concept of Amnesty International and dedicated to fighting corruption and promoting increased transparency in business and financial transactions worldwide (Cameron 1996). Remarkably active and effective in the few years since its establishment, Transparency International has given high visibility to the overseas bribery problem.

The most important reform, however, came in 1994 when at US prodding the OECD Council approved an official recommendation calling upon member states to "take effective measures to deter, prevent, and combat the bribery of foreign public officials in connection with international business transactions" (Yannaca-Small 1995). The first such formal political commitment by the industrial countries, the OECD initiative, if successfully carried out, could effect a revolutionary change in international business practices. (A small but interesting development came in 1996 when the Paris-based International Chamber of Commerce, partly spurred by the OECD recommendation, promulgated the first amendments in nearly 20 years to its rules and standards for international business, calling for efforts to combat bribery ["Business, Police Chiefs Urge Anti-Corruption Drive," Reuters, 9 February 1996; International Chamber of Commerce 1996]).

Because it seems a turning point in the anticorruption battle, it is worth examining the events that led to adoption of the OECD recommendation and assessing its prospects for success (see also Pieth, chapter 6).

The Lonely Boy Scout

The deepest historical roots of the OECD recommendation go back more than two decades to the American Watergate scandal of the early 1970s, when congressional hearings exposed a series of corrupt practices by American multinationals, including illegal payments to the Nixon campaign (laundered through foreign banks) and direct bribes by American companies to foreign public officials. In the most infamous such bribery case, exposure of Lockheed Corporation's $25 million in illicit payments to Japanese officials (to secure sale of its Tristar L-1011 aircraft) resulted in the resignation and criminal conviction of Japanese Prime Minister Kakuei Tanaka. Spurred by the reform spirit of the post-Watergate era, in 1977 the US Congress passed the Foreign Corrupt Practices Act (FCPA). As amended in 1988, the act has two primary provisions: the first criminalizes certain payments to government officials abroad, and the second requires accurate accounting of all transactions and establishment of a system of internal controls with periodic auditing (Pitman and Sanford 1994).

The antibribery provisions of the act are detailed and extensive: they prohibit American individuals or corporations from paying, offering to pay, or promising to pay foreign government officials to influence any official act, induce officials to act or fail to act in violation of their lawful duty, or induce officials to use their influence with the government to obtain business. The FCPA (as amended in 1988) makes American managers liable for prosecution, fines, and possible imprisonment if it can be proved they are aware of an illegal act or show conscious disregard or deliberate ignorance of a likely violation.

The FCPA provides for three exceptions. The most important is for facilitating or expediting payments to lower-level officials (often called grease payments) to secure the performance of routine government actions. Exceptions are also made if the payment is legal under the written laws and regulations of the host country or if the payment is a bona fide expenditure, for example, for travel and lodging relating to a product demonstration or contractual performance. The latter provision obviously opens something of a loophole: one US official, for example, was quoted as expressing surprise at Disneyland's growing importance as an international "training site." (See Klubes and Iraola 1995 and Jadwin and Shilling 1994 for a complete review of the provisions of the FCPA and its amendments.)

Still, whatever its imperfections, the FCPA has placed unique restrictions on the foreign operations of American firms. No other industrial country has promulgated or enforced remotely comparable regulations. Not surprisingly, over the past two decades—particularly as overseas business has accounted for an increasing share of American corporate revenues—the FCPA has remained a sore point and issue of controversy with many in the American business community. The complaint has regularly resurfaced that America's effort to play the lonely boy scout placed US companies at a serious disadvantage compared with foreign competitors (Kimelman 1994).

Has the FCPA hurt American business abroad? On balance, evidence suggests that American firms have paid a price for legally enforced virtue—though the extent of losses remains unclear. A 1996 Commerce Department report estimated (with the assistance of US intelligence agencies) that American firms lost $11 billion worth of business over the previous two years to competitors who paid bribes (Trade Promotion Coordinating Committee 1996, 113; see also chapter 10 for further analysis of this estimate). Unfortunately, the underlying analysis remains classified.

Systematic studies in the open literature, meanwhile, are few and far between. A 1981 General Accounting Office study of 250 firms indicated that fewer than 1 percent reported serious losses as a result of FCPA. Almost one-third reported a negative effect of the FCPA on their international business, however, and more than 60 percent felt it affected the ability of American firms to compete abroad (Pitman and Sanford 1994; Sheffet 1995). Two other studies conducted in the late 1980s found negative, if somewhat weak effects, of the FCPA on exports. Beck, Maher, and Tschoegl (1991) found that the FCPA negatively affected US exports to non-Latin American, bribery-prone countries. Using a mail survey of 336 exporters, Prasad (1993) found that 30 percent reported that the FCPA had little or no effect on their business, while 14 percent noted a very large decrease in their business. About half of the respondents felt that their export business was down "somewhat" or "moderately" as a result of the act.

Although a number of American executives have complained about the FCPA, there have also been business voices on the other side of the issue. For example, former Texaco CEO James W. Kinnear has argued that the FCPA actually benefits US companies by preemptively insulating firms from the costs and ethical complexities involved in bribing (Kinnear 1995). Jack Welch, CEO of General Electric, is also on record as saying US companies can "win without bribes." Welch argues that a firm must be the low-cost supplier, "but in almost all cases, if you have the quality, price and technology, you can win—nobody can sleazeball you" (Tichy and Sherman 1993, 133). General Electric has produced what US officials regard, according to a State Department official interviewed by one of the authors, as a model-company ethics code, designed to insulate the firm completely from FCPA violations.

Although compliance has not been perfect, the burden of evidence suggests that most US firms do comply with the FCPA—though recently reported federal investigations of IBM and Boeing under the FCPA suggest that the strains of international competition may be showing. IBM recently fired the top executives of its Argentine subsidiary after Argentine officials alleged it paid $6 million in bribes. Boeing's Canadian subsidiary, meanwhile, is said to have paid a bribe of $1 million to a Bahamian official in a deal to sell airplanes in that country ("Alleged Payoffs Risk Big Penalties for IBM," *Washington Post*, 7 March 1996; "IBM Fires Three Argentine Executives Amid Investigation of Bank Contract," *Wall Street Journal* [electronic edition], 15 September 1995). Both investigations are ongoing.

Whatever their various views of the FCPA, executives of American multinationals have been all but unanimous in their wish for a level playing field, repeatedly urging the US government to take actions to internationalize FCPA prohibitions or to persuade other nations to adopt similar laws.

Congress reflected the desideratum of the American corporate community when it amended the FCPA in 1988. The relevant language, attached to the Omnibus Trade and Competitiveness Act, chiefly aimed at clarifying ambiguities in the original 1977 law. But the amendments also include a "sense of Congress" expression urging the executive branch to negotiate prohibitions on bribery within the OECD—the actual legislative genesis of the talks leading to the 1994 recommendation (Sheffet 1995). Yet, while dutifully complying with the congressional mandate and taking up the issue in OECD councils, the then-presiding Bush administration put little energy into the antibribery talks.

Private Debates, Public Diplomacy

Two factors were critical in producing the strongly worded OECD recommendation on international bribery in 1994: a new, high-level US government decision to press for serious OECD action on bribery and a climate of public anticorruption feeling in Europe that made it increasingly difficult for European governments to oppose the US initiative publicly.

A major shift in American policy on the bribery question came after the trade-minded Clinton administration assumed office in 1993. Departing from their predecessors' back-burner approach, Secretary of State Warren Christopher and Assistant Secretary of State for Economic and Business Affairs Daniel K. Tarullo decided to make the OECD bribery negotiation a State Department priority. According to a State Department official, who described the US role in the OECD negotiations in an interview with one of the authors on condition of anonymity, the two were experienced corporate lawyers by training, with a knowledge of FCPA issues. Both reflected the long-dominant wish in the American business community for a level playing field. (State Department officials also argue that the American motivation is not exclusively economic self-interest: they point to the adverse effects of corruption on economic and democratic development in the developing world.)

Predictably, Germany, France, and Britain at first strongly opposed the US effort behind the scenes—though the British have since become more supportive of the American position. In OECD councils in 1993, the Europeans raised several objections to the US approach. They argued that primary responsibility for policing bribery lay with the (mostly developing) nations whose officials routinely accepted bribes, not with the Western companies that might proffer them. They characterized the FCPA as an illegitimate exercise in extraterritoriality, seeking to extend US law beyond US borders. They also accused the United States of seeking to enforce a uniform international criminal code throughout the OECD, in violation of other members' sovereignty. In addition, Germany argued against mixing taxation with morality—a reflection of its peculiar taxation philosophy (box 1).

US officials countered that the FCPA was a legitimate domestic law that relied on Congress's explicit power under the Constitution's interstate commerce clause: companies became criminally liable under the law by virtue of using either the US mails or the American telephone system (both regulated as interstate commerce) to arrange a bribe—one reason that FCPA cases can be difficult to prosecute and prove. They argued that what the United States sought was not a uniform criminal code but a uniform result: OECD members would be free to legislate against bribery in a manner that conformed with their separate constitutions and legal cultures; all America desired was that such bribery be proscribed.

Yet the key to US success in the negotiations lay with the arguments made not at the conference table but in the headlines. Throughout the negotiations, the American administration made frequent and calculated use of public diplomacy to press its case, according to one US official involved. With scores of French politicians under investigation and with corruption exploding as a high-profile issue in Germany and across Europe and Asia, American officials took their case to the international media, which proved remarkably receptive. (Stories on corruption in the international media have burgeoned. A Nexis search shows the number of articles mentioning the word "corruption" in the *Economist* and the *Financial Times*—which averaged 229 per year over 1982-87 and 502 per year over 1988-92—rose to 1,076 in 1993, 1,099 in 1994, and 1,246 in 1995.)

Whenever the issue went public, the Americans could count on holding the high ground. "The embarrassment factor [in these negotiations] is very high," the official pointed out. Meanwhile, behind the scenes State Department officials collaborated with Transparency International, which helped make a parallel public case for OECD reforms.

Nonetheless, outside observers were generally surprised by the strength of the final language of the recommendation approved by OECD ministers at their May 1994 ministerial. The storm of scandal engulfing Europe at the time was doubtless the critical factor. In the climate of the corruption eruption, European foreign ministers and governments could simply not afford to go on record as favoring bribery in any form.

Even more surprising, however, has been the pace of activity since the recommendation's adoption. The first follow-on task mandated by the OECD after May 1994 was a review of domestic legislation relating to the issue of tax deductibility of bribes. The OECD's Working Group on Bribery, under the chairmanship of Swiss official Mark Pieth, duly embarked on the legislative review. A breakthrough came in 1995, when the British unearthed a long-forgotten 1906 Prevention of Corruption Act, which prohibited such bribery in terms closely paralleling the 1977 American statute. The discovery of this antiquated law, albeit long ignored and unenforced, refuted the European argument that the FCPA had been a unique and unprecedented American exercise in extraterritoriality. It also catalyzed a shift in the British stance on the issue toward the American position.

Coincidentally, the tax deductibility issue arose at a regular meeting of the OECD's Committee on Fiscal Affairs—an expert group comprising mostly economists and tax specialists. For some reason, according to an American official, the OECD tax experts "bonded" on the issue of tax deductibility of bribes—arriving at a powerful consensus on its economic disutility. The fact that OECD tax experts were now on record as opposing tax deductibility of bribes gave new impetus to Pieth's efforts. Allied with the Fiscal Affairs Committee, Pieth's OECD Bribery Working Group during 1995 developed tough new recommendations on tax deductibility that were adopted at the OECD's annual ministerial in May 1996 (OECD 1995b and 1996; "Meeting of Council at Ministerial Level," OECD press release, 21-22 May 1996).

Box 1 From Watergate to Opelgate: Germany's struggle with corruption

Since Congress's passage of the Foreign Corrupt Practices Act in 1977, European and Asian states have been by and large content to regard the US law as yet another peculiar expression of America's Puritanism and penchant for international moralizing. Industrial countries continued to permit their firms to bribe abroad and deduct such bribes on tax returns; not only were European and other governments happy to reap the competitive windfall from America's lonely boy scout posture, but anecdotal evidence suggests that some European embassies also even facilitated such bribery in foreign capitals.

The 1990s have brought an important transformation in the political landscape, however, and such attitudes appear to be changing. The case of Germany illustrates the trend. Germany is one of a number of nations that not only permit overseas bribery but also allow companies to deduct such bribes from their tax returns. In fact, until last year domestic bribery in the private sector was deductible under German tax law—so long as the recipient of the illicit transaction was named. (The provision applied to bribery of businesspeople; bribing public officials remains a serious crime.) Furthermore, criminal sanctions for such bribery have been quite lenient and cooperation between tax and criminal authorities minimal.

Germany has embraced a philosophy of taxation profoundly different from that of the United States. Germans have traditionally prided themselves on a worldly, pragmatic, even cynical attitude toward the financial fallout from morally stigmatized activities. German officials have insisted, with perhaps an almost admirable fiscal realism, that issues of morality and taxation should be kept entirely discrete. For example, German prostitutes operating legally in many cities dutifully pay taxes on their income, in the same fashion as shop clerks or postal workers, and are required to do so by law (see, for example, "Interview mit Klaus Offerhaus [Präsident des Bundesfinanzhofs]," *Süddeutsche Zeitung,* 28 August 1995).

The reluctance to use the tax code to enforce morality has gone hand in hand, however, with a certain national moral self-confidence. Germans have tended to view their society as inherently well-ordered. Traditionally, Germans have taken pride in the self-image of their country as one of Europe's and the world's least corrupt states.

Yet over the past two years this national moral self-confidence has eroded. While corruption in Germany has by no means approached the

As an example of international action against corruption, the OECD initiative has two major virtues. First, it relies on a broad political agreement among states to alter their domestic laws instead of attempting the daunting task of achieving unanimity on language for an international convention or treaty or establishing a new international regulatory agency. Second, paralleling US actions in the drug war, it takes a supply-side rather than a demand-side approach to the problem. In the long run, to prevent companies in well-ordered industrial countries from proffering bribes is clearly a far more manageable task than achieving

Box 1 (*Continued*)

ministers-for-sale levels seen in France and especially Italy, a spate of scandals has dealt powerful blows to the German national self-image, and corruption has emerged as an explosive issue for German politicians. The most widely publicized corruption case involved GM subsidiary Adam Opel, in which 65 executives were investigated for taking bribes in an elaborate kickback scheme with suppliers. Also, a former chairman of the prestigious firm Mannesmann was forced to resign from its board over charges of conflict of interest—an almost unheard-of development in the German business community ("Europe's New Morality," *Business Week*, 18 December 1995). In 1995, a senior prosecutor alleged that the German construction industry paid 10 billion marks to corrupt officials each year (*European Business Report* 1995).

In February 1995, the president of the Federal Criminal Office described domestic corruption as an epidemic (*European Business Report*, 17 February 1995). Adding to the pervasive sense of ethical collapse was the jailing of the father of German tennis hero Steffi Graf on tax-evasion charges ("Germans Fear Corruption Is Eating at Heart of the Nation," *Times of London*, 26 August 1995).

Also in 1995, Berlin-based Transparency International issued its first country-by-country ratings of corruption. To the widespread dismay of Germans, their country was shown to be regarded as more corrupt than Britain or Switzerland, although less dishonest than the United States, France, and Japan. The issue has become one of the leading concerns of the German public. A 1995 poll by *Die Woche* found that three-quarters of Germans believe political and economic life to be seriously threatened by corruption. In eastern Germany, the figure ran as high as 84 percent (*Times of London*, 26 August 1995).

Partly as a consequence, the country's opposition Social Democratic Party was able for the first time to gain partial passage in 1995 of an antibribery bill it has introduced annually for several years. The German Bundestag voted to make tax deduction of domestic bribery illegal, even though Helmut Kohl's ruling Christian Democratic Union successfully beat back an effort to extend the prohibition to overseas bribery by German firms.

In effect, in the 1990s a host of nations in Europe and Asia—Germany, Italy, France, Korea, Japan—have been experiencing an upheaval in many ways comparable to America's Watergate experience 20 years ago. The politics of scandal is no longer a peculiarly American preoccupation but a global political phenomenon.

the necessary legal and political reforms in the scores of developing countries where such bribes are routinely accepted (though the United States simultaneously pushed for parallel reforms in Latin America through negotiations that resulted in approval of an Inter-American Convention Against Corruption, signed by OAS states in March 1996). Indeed, the OECD initiative has been one of the most important and unsung achievements of Clinton administration foreign and trade policy—one that could, over time, change the face of international commerce and vastly curtail opportunities for corruption in the developing world.

Yet, despite the progress already made, the most important and contentious issue still lies ahead: concrete recommendations on the actual criminalization of bribery in international business transactions. Governments must agree to pass laws to make such bribery illegal. The target date for final OECD recommendations on criminalization is the organization's annual ministerial meeting in May 1997.

Moreover, even if the OECD ministers manage to agree on final recommendations, it will remain for individual governments and legislatures to pass and, equally important, enforce the laws necessary to make bribing foreign officials a crime. While the combination of a strong OECD stance and the continued public saliency of the corruption issue is likely to wear down resistance to such action over time, there is little question that achieving the needed legal reforms in Europe—and perhaps even more so in Asia—will mean a prolonged and hard fight.

Thus far, the Clinton administration appears committed to the battle. Following reports of the IBM and Boeing overseas bribery investigations, US Trade Representative Kantor blasted America's OECD partners in March 1996 for continuing to permit overseas bribery and threatened to use trade sanctions to combat it (though he reportedly lacked cabinet approval for the proposal and the Clinton administration has since been silent on the threat ["Kantor's Battle against Bribery," *Journal of Commerce*, 18 March 1996]). Kantor also announced he would press for reforms of government procurement standards at the inaugural ministerial meeting of the World Trade Organization in December 1996 ("Kantor Declares War on Bribes," *Financial Times*, 7 March 1996; see Elliott, chapter 10, on the outcome of the WTO meeting).

Conclusion: Seychelles by the Offshore

Still, although the global task of rooting out corruption remains enormous and a world freed even of rampant overseas bribery is undoubtedly still some years away, change is clearly in the air. Take the recent case of the tiny island republic of Seychelles.

In late 1995, the government of the Seychelles islands enacted an innocent-sounding law called the Economic Development Act. One of its provisions offers foreigners that invest more than $10 million immunity from prosecution on all criminal offenses. The language of the statute even ensures that the law can be changed only through a national referendum and a constitutional amendment. It is, in short, an open, official, cynical invitation to money launderers and drug kingpins: come to the Seychelles with your dirty cash.

In a different era, the world would almost certainly have greeted such a development in a tiny island nation with indifference and inaction. Not so today. Almost immediately, the European Commission, the OECD, the Commonwealth Secretariat, the US State Department, the French and British foreign ministries, Interpol, and the Financial Action Task Force all denounced the law, calling for its revision and threatening sanctions.

Furthermore, it was announced that all financial transactions originating from that country or routed through it would be subjected to special monitoring and tracking by regulatory and law enforcement agencies around the world ("Seychelles Condemned over Money Launderers' Charter," *Financial Times*, 3 February, 1996; "Investment à la Seychelloise," *Economist*, 17 February 1996). While the law has not yet been revoked, the international reaction has almost certainly already scared away some of the investors whom the Seychelles government was hoping to lure. It seems doubtful, over the long run, that the law will survive such an international assault.

The Seychelles case provides a vivid illustration of three main themes of this chapter. First, globalization has drastically altered the nature of corruption. Second, while recent changes have opened new avenues for corruption, they have also created new conditions that provide unprecedented opportunities for containing or even reducing it. Third, because corruption is now an inherently global problem, governments acting alone can accomplish little. Systematic collaboration and coordination among the authorities of different countries has become an indispensable precondition for success in the anticorruption battle.

These new efforts at cooperation may seem to be small steps toward tackling a gargantuan problem. They are, however, giant steps compared with what seemed possible even a few years ago—which helps explain why there is a growing sense in many quarters that the fight against corruption need not be a lost battle. Political will is combining with new tools and new institutional arrangements to create a sound basis for cautious optimism.

It is worth remembering that many major, present-day international institutions also began with what at the time seemed rather limited technical agreements. Today's European Union, for example, grew out of an arrangement originally designed to coordinate coal and steel policies. Much of the institutional apparatus that now exists to ensure a modicum of stability in the world's financial markets originated in modest and narrow accords to share information. As Ethan Kapstein (1996) has written, two banking failures in the United States and Germany in 1974 had massive fallout in the world money markets, prompting the central bankers of the Group of Ten industrialized countries to establish the Standing Committee on Banking Regulations and Supervisory Practices, also known as the Basle Accord. The Basle Accord originated as an effort to ensure a minimal level of supervision of international banks. Later, as a result of the 1982 Mexican debt crisis, the members agreed on international guidelines for minimum capital requirements of international banks.

Combatting corruption is certainly a bigger task than regulating financial markets. But the Basle agreement is instructive, both as an example of effective international action and as a model for the form that such action is often likely to take in the present-day environment: some combination of international harmonization of legislation with greater home-country responsibility for multinational firms' actions abroad.

In his classic text, *Bribes*, written more than a decade ago, John Noonan (1984) ventured the bold prediction that "as slavery was once a way of life and now . . . has become obsolete and incomprehensible, so the practice of bribery in the central form of the exchange of payment for official actions will [one day] become obsolete." Even today, Noonan's ambitious prophecy looks premature, not to say utopian. But when a future historian writes the long and ugly story of human corruption, there is reason to suppose that the 1990s could be to corruption what the 1850s were to slavery: a decade of irreversible change.

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