

# Ethics in a Global Economy: “Code Red” Bribery and Corruption in the World<sup>1</sup>

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**In the global economy, businesses and other organizations must operate in a complex political and cultural environment that can significantly challenge commitments to ethics, integrity, and reputation. This session will explore one of the most pressing issues for ethics in global commerce: bribery and corruption in the public and private sectors around the world.**

Thank you Garry for inviting me to join you today and my compliments to Herb and Karen Baum and to Drake University for organizing this symposium on business ethics. It couldn't be more timely to consider the ethics challenges facing those in business today and those who are training here at Drake to be the business leaders of tomorrow. In my remarks, I'd like to focus on the broader ramifications of business ethics failures, particularly bribery and corruption, and on how the rules of global commerce are changing to foster ethics and integrity.

## **I. The Adverse Impact of Business Ethics Failures, Bribery and Corruption**

The lapses in ethics and integrity which contributed to the recent financial crisis here in the US have taken a toll on the *economic* well-being of most Americans. However, the damage has not been solely economic. The numerous instances of unethical and even illegal conduct that contributed to the crisis have shaken the trust of the American public in corporate America.

Vikram Pandit, Citigroup's CEO, in a *Fortune* interview about the Occupy Wall Street movement, agreed that "... trust has been broken between financial institutions and the citizens of the U.S. and ... it's Wall Street's job to reach out to Main Street and rebuild that trust. "

More recently, a high level UK official<sup>1</sup>, commenting on the Libor rate-fixing scandal, said it revealed "deeply corrupt practices at the heart of the banking sector" and that in seeking to punish and curtail such practices, the UK government was facing "a moral quagmire of almost biblical proportions."

Many would say that the 'moral quagmire' is not limited to private financial institutions, nor even to the wider business sector. There are ample examples in the public sector, notably in recent pay to play bribery scandals. As a New York Judge [Rakoff] put it in sentencing a powerful official convicted of accepting over \$1 million in bribes in a recent pay to play case, "it is difficult to overstate the evils wrought when government officials succumb to bribery."

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<sup>1</sup> This paper is an edited transcript of a keynote address delivered at the 2012 Herb and Karen Baum Symposium on Ethics and the Professions, at Drake University, on October 2, 2012.

He went on to say that “We have only to look at other countries to see that once corruption takes hold, democracy itself becomes a charade [and] justice becomes a mere slogan camouflaging a cesspool of self-interest.”<sup>2</sup>

As a former leader of Transparency International, I'd have to agree with this formulation of the adverse consequences of corruption. So, too, would many colleagues in TI's national chapters around the world who see and live with the consequences of corruption and are seeking to combat it through local and international initiatives.

Many live and work in the countries that are ranked on TI's Corruption Perception Index for their high levels of corruption. The Index scores range from a perfect score of 10 for countries with little to no corruption, to a score of 1 for those perceived to have systemic and pervasive corruption. It is most disturbing that, of the 183 countries on the 2011 Index, 134 -- or over 70% -- score below 5, and almost 50% score 3 or less.

These scores are based on surveys conducted by independent reputable organizations, including the World Economic Forum; commercial risk analysts, such as the Economist Intelligence Unit; and country experts from international institutions, such as the African, Asian and World Banks.

The surveys on which the Index is based include questions about corruption, or abuse of public office for private gain, by civil servants, public officials and politicians, including through bribery, kickbacks in procurement, or embezzlement of public funds. They also ask about the effectiveness of anti-corruption measures, such as transparency, prosecution and whistleblower protection.

There's more about the methodology on the TI website, and I'd be happy to answer questions in the Q&A period. For now, let me say that, when the CPI was first published, many in the academic and development communities were critical of the methodology, because it was based on perceptions rather than hard facts. But, in part, this was due to the inherently secretive nature of bribery and corruption and the difficulty of obtaining data.

Nonetheless, over the years, as other organizations have issued their own indices, there have been few major differences. Indeed, for the most part, the TI Index reflects the public's perceptions, including those in the business community.

### **Corruption Distorts Fair Competition and Adds to the Cost of Doing Business**

Those in the business community know from first-hand experience the challenges systemic and pervasive corruption presents in countries where they operate. In fact, many use the TI Index in their country risk assessments so they can apply the appropriate risk-mitigation measures.

The Index country rankings show that almost all the markets where business opportunities are greatest are also 'Code Red,' or the most challenging from a corruption-risk perspective. They are characterized by weak rule of law and lack of transparency. The best score among the BRIC countries is only 3.8 for Brazil while other emerging markets, such as Indonesia, Mexico, the Philippines and Vietnam, score well below 3.

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<sup>2</sup> New York Times, April 26, 2012 “Former State Senator Is Sentenced to 7 Years in Vast Bribery Case.”

Given these conditions, more than half the executives surveyed recently by Deloitte said their companies were extremely concerned about the impact of corruption on business and their concerns are greater today than only a few years ago. They are concerned about government demands and about partnering with or employing host country nationals who may be accustomed to doing business with bribes, false invoices or inappropriate 'connections.'

For those doing business directly with government, bribery and solicitation are often prevalent in high-value government projects, such as infrastructure, telecom or defense. Even those not engaged in government procurement can face regular demands for bribes to obtain licenses, clear customs or pass health, environment and safety inspections.

The World Bank estimates that over \$1 trillion in bribes are paid annually. In some countries they are routine. For example, the World Bank estimates that 80% of businesses in Nigeria paid bribes to government officials in 2011.

Bribes add to the cost of doing business and act like a tax. One expert estimates that an increase in the level of corruption from the relatively clean level of Singapore to the level in Mexico was equivalent to a tax increase of 20%. Indeed, in some countries, it amounts to what I call 'creeping expropriation,' as the World Bank Institute studies find an investment can be eaten up entirely by demands for corrupt payments.

Despite this, until relatively recently, corruption was considered by many in the private sector to be a part of the culture or the cost of doing business abroad. Most turned a blind eye to it, believing it was simply the status quo.

For American multinationals, participating in or ignoring red flags of corruption was a high stakes gamble. Transnational bribery has been illegal since the Foreign Corrupt Practices Act ("FCPA") was enacted in 1977. In recent years, US companies have faced a significant risk of prosecution for falling afoul of US -- not to mention host country, local bribery laws -- with the attendant monetary penalties, possible jail time or debarment and, above all, severe reputational damage.

Until recently, their foreign competitors had no such legal constraints. Other exporting countries not only permitted bribery by their companies when operating outside their borders, some, like France and Germany, even allowed companies to write bribes off as a tax-deductible business expense.

This disparate legal regime distorted competition in favor of unethical companies. The cost to ethical companies with strong compliance programs was steep.

According to the Department of Commerce, between 2005 and 2010, at least 350 contracts worth more than \$240 billion were affected by bribery of foreign public officials.

A recent Dow Jones survey found that 40% of companies doing business worldwide believe they lost business to unethical competitors and, along with the loss in contracts, a loss in jobs.

### **Corruption Undermines Effective Development Assistance & Economic Growth**

While the impact of bribery and corruption on a level playing field for the private sector is clear, there are many other adverse consequences that should be cause for concern.

For example, bribery and solicitation in government procurement distorts decision-making in favor of personal gain rather than the public good, denying benefits to those in the public for whom it is intended.

Effective use of development assistance to stimulate economic growth and improve the lives of the poor is also adversely affected. Consider that worldwide development assistance is well over \$120 billion, with US development assistance in 2010 accounting for approximately \$30 billion of that total. Countries receiving that assistance fare poorly on the TI Index and, among the largest recipients of US assistance, are those countries at the very bottom of the Index: Afghanistan, Egypt, Haiti, Iraq, Pakistan -- all with scores below 3.

The diversion or misuse of development assistance due to corruption is estimated at from 10-25% and, in some cases an even higher percentage. It leaves countries mired in poverty, despite assistance flows. The TI Index ranking directly correlates with poverty rankings, with countries like Bangladesh and many in Africa as well as the US assistance recipients noted above, at the bottom of the Index.

In 1996, then World Bank President, James Wolfensohn, concluded that corruption is the greatest obstacle to alleviating poverty. During his tenure, for example, as much as 30% of World Bank assistance to Indonesia was embezzled while more than half of its population lived on under \$2 per day.

His bold and very public stand marked a sea-change for the Bank, breaking its taboo on even mentioning the 'c-word' and changing its long-standing position that its mandate did not extend to tackling corruption.

Donors came to recognize that demands for bribes are frequent in high-value government projects as well as in routine government functions, with significant consequences for the poor.

These consequences are evident in infrastructure projects that are of little or no value -- other than to the officials and companies who are extracting benefits. These projects too often divert public resources away from basic social services, like clean water, schools or health clinics to big-ticket projects that provide more lucrative opportunities for officials and bidders.

The Bank estimates that corruption can add 25% or more to the cost of such projects, with those costs passed along in the form of higher taxes or increased service charges or in shoddy construction and maintenance.

In India, where over a third of the population lives on less than \$1 per day, a recent World Bank review of a project to upgrade hospitals and health care found collusion, bid rigging, bribery and fraud in 90% of the contracts. The results included shoddy construction of hospitals awash in sewage, dangerous medical equipment and higher costs for medicines.

Even the routine demands for petty bribes that add to the cost of doing business fall more heavily on the public. Bribes paid by companies to circumvent health, safety and environmental inspections have resulted in outdated medicine, tainted milk or polluted water for the public.

The small facilitation payments that companies must frequently pay for routine public services cost the public a higher percentage of their income for the same telephone service, drivers' licenses or electricity and corrode public trust in government.

### **Corruption Denies the Benefits of Natural Resources to the Public:**

The disparate impact on the poor may be most acute in those countries rich in natural resources, such as oil, gas, minerals, diamonds or forests. Given the scarcity of and competition for natural resources, these countries should be thriving. Instead, they are among the poorest, due to rampant and systemic corruption.

Consider that Angola, the DRC, Equatorial Guinea, Venezuela and other resource-rich countries score 2 or below on the TI Index. They are also the poorest, with little benefit trickling down to the people. For example, 75% of the people of Equatorial Guinea live on less than \$2 per day, despite the country's good fortune as the third largest crude oil producer in Africa, with \$7 billion in annual revenue.

### **Corruption Threatens National Security:**

High levels of corruption also correlate with internal conflict and human rights abuses as illustrated by countries like Somalia, Sudan and the DRC. Corruption feeds political instability and was a major factor in the Arab uprisings, from the initial spark in Tunisia to Algeria, Egypt and the broader Middle East. The present political instability and violence promises to continue so long as citizens find themselves marginalized politically and economically by a corrupt elite.

Closer to home, Senator Lugar described the threat of corruption to US national security as follows:

“We want to prevent foreign officials from accepting bribes that might lead to a dangerous container being allowed onto a ship bound for our shores. We want to prevent bribes that might help a criminal or terrorist gain access to our country. And we want to prevent bribes that might provide terrorists with access to nuclear material, chemical and biological weapons, MANPADS, or other dangerous items.”

## **II. Changing the Rules of Global Commerce to Foster Ethics and Integrity.**

Given the threat that corruption poses to so many vital US interests, including a level playing field for ethical companies, effective development assistance, alleviating poverty, human rights abuses and conflict, maximizing the benefits of natural resources and minimizing threats to our national security, the US government has played a leadership role over the past 20 years in the development of a global legal framework aimed at reducing corruption and bribery.

In an all too rare instance of cooperation, the US government has found support in the private sector, labor and non-governmental organizations. As the head of TI's US chapter, I was able to forge this unusual partnership that continues to this day. The US government, leading American multinationals and business associations, the labor movement and NGOs have raised awareness of the damage caused by corruption and contributed to securing global action on the laws, rules and institutional reforms needed to address it.

The result is a sea change in the anti-corruption landscape. Let me cite six examples of the progress that we have made to date:

1. There are now laws criminalizing foreign bribery – similar to the FCPA -- on the books of all the major exporting nations which are members of the OECD, including France, Germany, Italy, Japan and Korea. Other *emerging* exporters, such as China and Russia, have recently enacted foreign bribery laws, and, at this time, India and Indonesia have

draft laws in the works. Vigorous enforcement of these laws is still aspirational, but promises to significantly reduce bribery as a factor in international business.

2. The World Bank and other multilateral development banks and bilateral aid agencies have made fighting corruption an important element of their country assistance strategies and are sanctioning companies and individuals engaged in illicit practices. This promises to promote more effective use of resources and greater progress stimulating economic growth and alleviating poverty.
3. Over 150 countries are now parties to a UN Convention Against Corruption, taking on commitments to prevent, detect and prosecute corruption. The Convention addresses both the payment of bribes and the demand for them. It calls for preventive measures to enhance transparency and accountability in public service delivery and for cooperation in the investigations and prosecution of officials as well as companies. Parties to the convention, including countries such as China and Pakistan, are participating in a review mechanism that assesses and promotes effective implementation of these commitments through peer pressure.
4. TI and other organizations, including the International Chamber of Commerce, the World Economic Forum and the UN Global Compact, have developed and are promoting adherence to voluntary private sector anti-bribery standards of conduct. The OECD has also published guidance for companies. The commonalities among these standards should help companies to develop effective compliance and ethics programs.
5. A number of private sector companies are going further than adopting their own programs. They are engaging in the policy arena, promoting adoption and enforcement of the new foreign bribery laws and transparency and anti-corruption provisions in conventions, trade agreements and the G20 Anti-Corruption Action Plan. They are also engaging with each other in collective action to raise standards within industry sectors, such as in the defense, extractives, medical devices and construction sectors.
6. A growing number of academic institutions, like Drake University and the Washington College of Law where I teach, have recognized the importance of corruption and are educating students for the responsibilities that await them when they go into business, finance, law or accounting.

These changes in the global legal landscape are significant for their potential to create an environment conducive to ethical business practices. They set out a way forward, but the challenge now is to ensure that they are effectively implemented in practice.

Both the public and private sectors must take action in the developed and developing worlds.

- It is not enough for the US to ramp up its FCPA prosecution; other exporting nations need to do the same.
- It is not enough – although it is essential -- to have a credible threat of prosecution to deter paying bribes. The private sector must recognize the pressures on their employees to ‘make the numbers’ and devote the time, effort and resources necessary to embed compliance and values-based programs that incentivize and reward ethical practices.

- It is not enough to prosecute those who pay the bribes; those who demand them or who embezzle public funds must also be punished and prohibited from keeping stolen assets.
- It is not enough for governments and companies to take action; gatekeepers, including bankers, lawyers, accountants and auditors must adhere to their legal obligations and ethical values and do their part and not facilitate corruption by officials or corporations.
- It is not enough for development assistance agencies to foster good governance in countries where they operate and to sanction companies engaged in illicit practices; governments receiving assistance must take action to foster an ethical and transparent environment in which funds are used as intended.

US government and private sector leadership on the anti-corruption agenda will continue to be critical. However, this will be more difficult if the declining ranking of the US on the TI Index is any indication. The most recent Index ranks the US 24th out of 183 countries, not even in the top 10%. Recent events have contributed to this decline and to a loss of the moral high ground that underpinned US leadership for the past two decades in setting and promoting high standards of transparency, integrity and accountability around the world.

While there may be many factors contributing to this decline, it is clear that many in the US public believe that ethics has taken a back seat in the private sector and in public service. A recent *NY Times* article titled “The Spreading Scourge of Corporate Corruption” posits that corporate misconduct no longer surprises the American public. The same might be said for some public sector institutions. From the financial institutions to mortgage lenders who engaged in questionable, if not illegal conduct, to the manipulation of Libor and the municipal bond market, to the NY State pay to play system, to a campaign finance system awash in contributions from special interests, and often unknown interests, to those seeking to roll back Dodd Frank disclosure requirements and weaken the FCPA, there are ample examples to support the American public’s perception that ethics has taken a back seat.

As the lobbyist convicted in the NY pay to play scandal put it at his sentencing, “At a critical point in my life, I simply forgot everything I learned and lived by.” Have we forgotten about ethics or, rather, like the frog in the pot of water, has the heat been rising so slowly that we haven’t noticed just how hot it is.

Drake University and Herb and Karen Baum apparently noticed and stepped forward to do something truly meaningful to restore ethics to its rightful place. Last night’s award, today’s symposium and the mission of the Herb and Karen Baum gift – to guide students in developing a firmly grounded personal commitment to the highest standards of ethics and ethical decision-making – could not come at a more critical time. Commitments such as these are critical to restoring the American public’s trust in our markets, in our government and in each other. They are also critical to restoring our stature abroad.

So, thank you to Herb and Karen Baum and to the many others at Drake University for making business ethics such a high priority. And, for the students who are here today, I hope you take full advantage of what is being offered and that, while it won’t always be easy, you take your values with you when you leave these walls. It will be to your benefit no matter where your professional life takes you.

Thank you.