A

US Policy on Corruption

ALAN LARSON

In the United States, government involvement in curtailing transnational bribery began in 1977 with the enactment of the Foreign Corrupt Practices Act (FCPA). I will outline the evolution of US involvement in this effort, highlight the work we have already done, and describe future initiatives against corruption.

As international corruption scandals flourished throughout the 1980s and 1990s, a growing number of business leaders and policymakers began to see that bribery threatened interests of vital importance.

- First, bribery distorts global markets and hinders economic development by substituting graft for quality, performance, and suitability.
- Second, bribes undermine democratic accountability. Corruption further weakens unstable governments and threatens emergent democracies.
- Third, bribery creates a type of nontariff barrier to trade against companies that refuse to engage in the practice—or are legally barred from doing so, as US firms are by the FCPA. Thus companies with legitimate business practices are penalized.

Let me emphasize that US action against corruption is motivated by all three of these interests. While we naturally regard the competitive

Alan Larson is Assistant Secretary of State for Economic and Business Affairs.

Institute for International Economics | http://www.iie.com

disadvantage to US companies as significant and unacceptable, bribery's effects on economic development and democratic accountability also impel us. To put it in colloquial terms, our goal is not only to level the playing field for US firms, but also to strengthen the rules of the game so that international economic competition will serve to foster economic development and support democratic institutions.

The United States made episodic efforts to address these vital interests as early as 1978. At the time, there was little support for initiatives against corruption in the Organization for Economic Cooperation and Development (OECD) and the United Nations (UN), and it languished. The amendments to the FCPA in the 1988 trade act included a suggestion that the president negotiate an international agreement on the prohibition of overseas bribery. In 1989, I directed the US delegation to propose such a negotiation in the OECD. Although an Ad Hoc Group on Illicit Payments was launched to study the issue, the negotiations made slow progress. To keep the negotiations alive, I organized two breakfast meetings with US negotiators and other key delegations during my tenure as ambassador to the OECD.

However, the fight against corruption made real progress early in Clinton administration. Secretary of State Warren Christopher reviewed the information on illicit payments and decided it was time to put more political muscle behind the US effort in the OECD; my former boss, Dan Tarullo, raised the issue at policy levels. Less than a year later, the United States had successfully convinced OECD members to approve the Recommendation on Bribery in International Business Transactions, a remarkable breakthrough in the battle against corruption. The recommendation calls on member states to take "concrete and meaningful steps" to combat bribery and I would like to briefly discuss the OECD initiative (for details on the OECD, see Pieth, chapter 6).

Successful negotiation of the 1994 recommendation set into motion various initiatives in the OECD and other forums. In April 1996, OECD members agreed that bribes paid to foreign officials should no longer be tax deductible. In addition to their substantive value, these two important OECD recommendations have broader implications. First, they counter the perception that in multilateral forums the group instinct is to talk, not act. The recommendations also prove that if there is political will and strong leadership much can be accomplished. Finally, the OECD initiatives created tremendous momentum that has spurred additional, and sometimes successful work against illicit payments.

US involvement in the OECD initiatives is an obvious indication of our commitment to the multilateral process and our successes encourage us to redouble our multilateral efforts. At the same time, the OECD recommendation calls on members to consider national action, including reviewing "laws and regulations relating to public subsidies . . . or other public advantages so that advantages could be denied as a sanction for

Institute for International Economics | http://www.iie.com

bribery." The United States negotiated with the US Overseas Private Insurance Corporation (OPIC) to require a project company seeking OPIC financing to certify that bribery was not used to obtain the contract. Similarly, we are considering ways of amending export advocacy guidelines to ensure that the United States is not advocating for companies that have paid bribes.

National measures like the ones described are useful resources that we will not hesitate to deploy in the war against corruption. Indeed, national action is often necessary to give effect to multilateral agreements and we intend to pursue a variety of these national measures to foster and support multilateral efforts to combat corruption.

In addition to the OECD recommendations, the United States has successfully shepherded other multilateral initiatives. On 29 March 1996, the Organization of American States concluded the Inter-American Convention against Corruption. The convention serves as a powerful political statement by leaders of the Western Hemisphere that they will no longer tolerate the corrosive effects of corruption on free markets and the democratic system. From the US perspective, the crown jewel of this convention is the obligation it creates for signatories to criminalize transnational bribery of public officials. The convention also makes transnational bribery an extraditable offense, provides mutual legal assistance in investigations of corruption, and calls for the seizure and forfeiture of illicit gains.

Another hemispheric success involves the creation of the North American Development Bank (NADB) by the North American Free Trade Agreement (NAFTA). As a result of a joint initiative by the US Departments of State and Treasury, the NADB charter requires companies to certify that they have not engaged in bribery of foreign or domestic officials in furtherance of a Bank project. Companies must also have active corporate policies that prohibit bribery in pursuit of corporate activity, and they must assert that there has been no conviction of bribery within five years of certification. If the Bank discovers that a company has been convicted of bribery, it may debar that company from any future participation in a Bank-funded or guaranteed project.

The New Transatlantic Agenda, the product of last year's US-EU summit, urges EU members to combat illicit payments by implementing the 1994 OECD Recommendation on Bribery in International Business Transactions. The private sector counterpart to the Transatlantic Agenda, the Transatlantic Business Dialogue, went a step further and called on EU nations to criminalize bribery.

One area that is ripe for change and where the United States will channel much energy in the future is government procurement. Procurement markets account for trillions of dollars in commercial transactions. In such a lucrative environment, anticompetitive and illicit behavior flourishes. Countries have responded enthusiastically to US

Institute for International Economics | http://www.iie.com

proposals to increase transparency in procurement procedures. The United States has made such a suggestion in APEC.

Similarly, the United States has set its sight on ensuring that the international procurement process is open and transparent in the World Trade Organization (WTO). The WTO Government Procurement Agreement (GPA) satisfies this standard, but it is of limited use, with only 26 signatories thus far, mainly because few countries can meet its rigorous procedural requirements. The United States will continue to press for universal accession to the GPA, but in the interim, we have developed an alternative strategy. We will seek a mandate at the WTO ministerial meeting in Singapore in December 1996 to negotiate an interim, stand alone procurement arrangement on transparency, due process, and openness in government procurement.[1]

In conclusion, let me simply say that success has many parents while failure is an orphan. The best evidence that combating overseas bribery has come of age as a policy issue is the fact that senior policymakers are clamoring to get involved in it. For leaders like Mark Pieth, who were involved with this issue when no one else seemed to care, this must be an immensely satisfying development.

1. At the ministerial, WTO members agreed only to establish a working group to study the issue. See Elliott, chapter 10.

Institute for International Economics | http://www.iie.com

B

Data Sources for Cross-Country Analysis of Corruption

KIMBERLY ANN ELLIOTT

There has recently been a flurry of cross-country empirical studies of the sources and effects of corruption. The chapter by Mauro (chapter 4) on the effects of corruption on investment, growth, and government expenditure is an extension of his article in the August 1995 *Quarterly Journal of Economics*, which in turn is based on his doctoral thesis. Alberto Ades and Rafael Di Tella have co-authored two papers on how competition and industrial policies inhibit or foster corruption. James Hines has studied the effects of the US Foreign Corrupt Practices Act on US exports to and investment in more and less corrupt countries. Along similar lines and using similar data sources, a number of studies have looked at the effects of institutions and political stability on economic growth. These studies include Keefer and Knack (1994), Fedderke and Klitgaard (1996), and Barro (1991).

The data on corruption used in these studies are of two basic types: expert assessments and surveys of international businessmen or other observers within countries. Firms that provide political risk information and analysis for multinational firms are usually the sources for this data. One corruption index used in this chapter is based on a data set compiled by the Center for Institutional Reform and the Informal Sector (IRIS) at the University of Maryland from data originally collected by Political Risk Services and published in the *International Country Risk Guide* (ICRG). The IRIS data set is described in Keefer and Knack (1994). This data set includes a number of political risk variables including an assessment of the degree to which payments are required at high political levels for large transactions and at lower levels for routine

Institute for International Economics | http://www.iie.com

government functions, such as licensing, customs clearance, etc. The index covers 148 countries. The scale ranges from 0, indicating payments are "generally expected," to 6, indicating little corruption. To be consistent with the second data source (described below), the index was converted to a 10-point scale.

Transparency International (TI) is the second data source for this chapter. In 1995 and 1996 TI released rankings of perceived corruption in various countries. The TI ranking is based on a survey of surveys, incorporating information from six different sources, including the ICRG/IRIS index described above; the World Competitiveness Report of the Institute for Management and Development (IMD), which covers 37 to 48 countries (depending on the year), the Asian consulting firm Political and Economic Research Consulting (PERC), which covers only 10-12 Asian countries (again depending on the year); and a staff assessment for 105 countries compiled by DRI/McGraw-Hill Global Risk Service. For the early 1980s, there are data from Business International (BI, since taken over by the Economist Intelligence Unit), which cover 68 countries. Finally, there is a survey of embassies and chambers of commerce in 103 countries compiled by Peter Neumann and published in a German monthly, and a ranking of 58 countries compiled at Goettingen University based on responses to an internet solicitation of anonymous contributions and interviews of employees of multinational firms and international institutions.

For the 1996 index, TI used three surveys each from PERC and IMD (for 1993-95) and the most recent survey from the other sources, except BI. A country had to be included in at least four of the indices in order to be included in the TI ranking, which resulted in a list of 54 countries. More information on how the TI ranking was compiled and the underlying sources can be obtained from the Internet website maintained by the ranking's creator, Dr. Johann Graf Lambsdorff of Goettingen University (http://www.gwdg.de/~uwvw/icr.htm).

The index used in this chapter differs slightly from that used by Mauro in chapter 4. The index he uses is the simple average of the ICRG index (averaged over 1982-95) and the BI corruption index (averaged over 1980-83), where both are available, and the ICRG index otherwise. The index used here combines the 1996 TI and ICRG indices (averaged as Mauro does over 1982-95 or a minimum of 10 years). The TI index is used where it is available in the expectation that, because it incorporates data from a variety of sources, it should contain fewer anomalies than a single source. But because the TI ranking covers only 54 countries, the ICRG index was used to expand the sample. After excluding countries in the ICRG sample not covered a full 10 years, 111 countries remained, doubling the TI sample size.

The correlation matrices provided by TI indicate that the various measures of corruption are fairly highly correlated with one another. The TI

Institute for International Economics | http://www.iie.com

1996 ranking is also highly correlated with the ICRG index alone (0.89 when averaged over 1982-95 and 0.88 when averaged over 1992-95), the "bureaucratic efficiency" index compiled by Mauro (1995) from the BI data for 1980-83 (0.91), and the hybrid ICRG/BI index used by Mauro in this volume (0.91). The TI ranking is consistently more closely correlated with other data expected to either cause or be a consequence of corruption. Unfortunately it is impossible to know whether this is because the TI data better reflect "reality" (at least as seen through the eyes of international businessmen) or whether it is simply the case that the larger the number of countries, the weaker the conclusions that generally apply.

Other Data Used

The data on per capita income and trade as a share of GDP are from Summers and Heston (1991). The data on government expenditure as a share of GDP are from the World Bank World Tables (on CD-ROM); the data on the role of state-owned enterprises are also from the World Bank (1995, 272-75). The measure of "political openness" is based on the Freedom House (1996a) ranking of countries, from "free" (a score of 1) to "not free" (a score of 7) and is available for all 111 countries in the sample using the combined IRIS/TI corruption index. To be consistent with the economic freedom index (described below), the political freedom index was inverted, with 1 indicating the unfree and 7 indicating the free. The measure of "economic openness" is based on a new Freedom House (1996b) assessment of the degree of economic freedom in 66 countries, ranging from free (a score of 16) to not free (a score of 0). The economic freedom index is the sum of 6 separate variables, including the freedom to own property (scored from 0-3), freedom to earn a living (0-3), freedom to own and conduct business (0-3), freedom to invest one's earnings (0-3), freedom to trade (0-2), and freedom to participate in a market economy (0-2). The last variable includes an assessment of the degree of corruption in the economy. It was subtracted from each country's score, thus reducing the possible score to a range of 0 to 14.

References

Barro, Robert J. 1991. Economic Growth in a Cross-Section of Countries. *Quarterly Journal of Economics* 106, no. 2, no. 425 (May): 407-43.

Fedderke, Johannes, and Robert Klitgaard. 1996. Economic Growth and Social Indicators: An Exploratory Analysis. Unpublished (March).

Freedom House. 1996a. *Freedom in the World: The Annual Survey of Political Rights and Civil Liberties, 1995-96*. New York: Freedom House.

Freedom House. 1996b. *World Survey of Economic Freedom 1995-96*. New York: Freedom House.

Institute for International Economics | http://www.iie.com

Keefer, Philip, and Stephen Knack. 1994. *Institutions and Economic Performance: Cross-Country Tests Using Alternative Institutional Measures*. IRIS Working Paper No. 109. Maryland: University of Maryland, Center for Institutional Reform and the Informal Sector.

Summers, Robert, and Alan Heston. 1991. *Penn World Tables*. On diskette, available from National Bureau of Economic Research, Cambridge, MA.

World Bank. 1995. *Bureaucrats in Business: The Economics and Politics of Government Ownership*. London: Oxford University Press for the World Bank.

Institute for International Economics | http://www.iie.com