

SPECIAL REPORT ON BUSINESS ETHICS

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# CURBING CORRUPTION



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Deep gratitude is also due also to Henrik Syse for his guidance on this report. A Norwegian philosopher and author, Syse is a research professor at the Peace Research Institute Oslo and a part-time professor of peace and conflict studies at Bjorknes College in Oslo.

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## Decline and Fall

Corruption has been a source of social ills since time immemorial. In early times, corruption was regarded as a source of physical and ethical ruination. Chapter 6 of the Old Testament book of Genesis states: “Now the earth was corrupt in God’s sight and was full of violence,” a reference not only to moral decay but to the effect it had on human behavior. Writing in 1776, English historian Edward Gibbon described corruption as an important factor in the decline of the Roman Empire. Two hundred and fifty years before Gibbon’s work, revulsion at the immoral sale of papal indulgences helped trigger the Protestant Reformation.

The corrupt practices of the powerful continue to prompt popular outrage around the world, from the Orange Revolution in Ukraine, to the Arab spring in the Middle East and the Operation Car Wash scandal in Brazil. Corruption, as ever, tends to weaken the body politic, prompting a push for democratic change and sometimes provoking its antithesis, authoritarian rule.

Corruption began life as a moral and corporeal concept and has evolved into a political, legal and economic phenomenon. This report explores corruption primarily as a challenge to business ethics and to the pursuit of corporate virtue. But it is impossible to do so without placing it in a political, social and cultural context. Only by understanding the causes and symptoms of the disease can we hope to control corruption, even if we may not be able to eradicate something so multifaceted and deeply rooted.

This is the final installment of four special reports on business ethics that Knowledge@Wharton has produced in collaboration with AKO Foundation. The first was on corporate governance, the second on moral philosophy and the third on business and peace. The topics were chosen, in part, to show the inter-relationships among these themes as companies try to navigate the ethical challenges of the modern world. A strong structure of corporate governance is needed to ensure business organizations operate sustainably. A good understanding of moral philosophy is a critical part of doing business ethically. A company that behaves with integrity can play a crucial role in stabilizing areas of conflict. And finally, businesses that fully understand the risks of operating in corrupt countries will be more resilient and, quite possibly, more profitable than those that do not. Even if there was no

financial profit to be gained, behaving at all times with integrity is the right thing for companies to do.

A logical place to begin this inquiry is to define the term corruption, but this is easier said than done. There are laws pertaining to, and legal definitions of, bribery, but there is no internationally accepted legal definition of corruption, which encapsulates many types of nefariousness beyond a bribe. Just to confuse matters, some analysts believe it is important to include “legal” corruption within the concept. Corporate lobbying of government, for example, is perfectly legal in most countries, but it may give private interests undue influence to bend the framing of laws and regulations in their favor.

The most common definition of corruption is the one used by Transparency International, a Berlin-based nongovernmental organization that describes it as “the abuse of entrusted power for private gain.” This definition captures the principal-agent relationship, whereby an agent, such as a public servant, acts on behalf of a principal, such as a government leader or the populace at large. Francis Fukuyama, a senior fellow at Stanford University’s Freeman Spogli Institute for International Studies, points out that, in this sense, corruption is a modern concept; it did not exist in feudal times, because rulers regarded their domains as their private possessions. “The very notion that there was a potential conflict between public and private interest emerged with the rise of modern European states in the 16th and 17th centuries,” he writes.

The agent is entrusted by the principal with the power to perform a range of duties, such as review permit applications, pass laws or hear legal cases, according to certain rules. If that power is abused, the rules are broken and the principal’s goals are subverted. The harm takes two forms: the corrupt individuals act inconsistently with their mandate, or they take actions in response to a payoff, selling a benefit that was not supposed to be provided on the basis of a willingness to pay. “Thus, corruption includes both accepting a bribe in return for certifying an unsafe building and demanding a bribe as a condition for approving a fully compliant structure,” writes Susan Rose-Ackerman, a professor at Yale Law School, and Bonnie Palifka, a professor at Tecnológico de Monterrey.<sup>1</sup>

In their view, the causes of corruption fall into three broad categories—institutions, incentives and personal

<sup>1</sup> “Corruption and government,” Susan Rose-Ackerman and Bonnie Palifka, 2016.

## Two Ways of Viewing Corruption

### Types of Corrupt Acts

Bribery, extortion, exchange of favors, nepotism, cronyism, judicial fraud, accounting fraud, electoral fraud, public service fraud, embezzlement, kleptocracy, influence peddling, conflicts of interest

### Concepts Under the Umbrella of Corruption

Patronage, clientelism, particularism, patrimonialism, state capture

*Source: Susan Rose-Ackerman and Bonnie Palifka (acts); Bo Rothstein and Aiysha Varraich (concepts)<sup>2</sup>*

ethics—that interact to determine the levels and types of corruption that are found around the world. The existence or absence of the rule of law is one institutional factor. A lack of accountability is a form of incentive to give and/or receive a bribe. The morals of an individual help determine whether the lack of accountability and the rule of law will lead to corruption. In fact, the three factors form a combustible mix.

The three factors cannot be treated in isolation. If corruption, for example, was solely the result of individual wrongdoing, then governments could raise the penalties to the point where the risk of being caught outweighs the reward. Some countries, such as China, North Korea, Indonesia and Myanmar, have laws that make bribery and other corrupt acts a capital offense, but this has not stemmed the tide. They are still among the more corrupt countries in the world, according to Transparency International.

The definition of corruption of Transparency International is just one among many. Some analysts narrow the definition to comprise only the public sector. Others, as noted in the next section, define corruption by its opposite. Another perspective is to examine the many categories of corruption; the textbox on the preceding page provides a flavor of the diversity. As Fukuyama observes: “It is remarkable that, for all of the academic effort put into the study of corruption, there is still no broadly accepted vocabulary for distinguishing between its different forms.”<sup>3</sup>

The difficulty of defining corruption is both a cause and an effect of the challenge of measuring its impact.

This has not prevented international organizations from trying to estimate the cost, no doubt in part because of the public relations value of doing so. United Nations Secretary-General António Guterres said on International Anti-Corruption Day in December 2018 that the annual costs of international corruption amount to \$3.6 trillion in the form of bribes and stolen money. This is the equivalent of 4% of gross world product. “Fighting corruption is a global concern, because corruption is found in both rich and poor countries, and evidence shows that it hurts poor people disproportionately,” the UN states on its website. “It contributes to instability, poverty and is a dominant factor driving fragile countries towards state failure.”

By way of comparison, the International Monetary Fund estimates the fiscal cost of corruption. It says that the least corrupt governments collect 4% of GDP more in tax revenues than their peers with the highest levels of corruption. “If all countries were to reduce corruption by a similar extent, on average, as those that reduced it over the past two decades, global tax revenues could be higher by \$1 trillion,” says the report. The UN and IMF estimates may actually be conservative. An IMF working paper in 2018 estimated the average size of the shadow economy (much of it made up of corrupt payments) averaged 32% of the GDP of 158 countries from 1991 to 2015.<sup>5</sup>

The IMF has been a latecomer to the cause of curbing corruption, but it is paying attention now, because the problem is so big and so divisive. In the view of Fukuyama, “Corruption has in many ways become the defining issue of the 21st century, just as the 20th century

<sup>1</sup> “Corruption and government,” Susan Rose-Ackerman and Bonnie Palifka, 2016.

<sup>2</sup> “Making sense of corruption,” Bo Rothstein and Aiysha Varraich, 2017.

<sup>3</sup> “What is corruption?” Francis Fukuyama, 2016

<sup>4</sup> “Fiscal monitor: curbing corruption,” IMF, April 2019

<sup>5</sup> “Shadow economies around the world: what did we learn over the last 20 years?” Leandro Medina and Friedrich Schneider, IMF Working Paper, 2018

was characterized by large ideological struggles between democracy, fascism and communism.”

To some, this will seem a startling appraisal of a world dominated by the rivalry among the United States, China and Russia, but to Fukuyama, there is another type of division to ponder. “Today, a majority of the world’s nations accept the legitimacy of democracy and at least pretend to hold competitive elections,” he writes. “What really distinguishes political systems from one another is the degree to which the elites ruling them seek to use their power in the service of a broad public interest or simply to enrich themselves, their friends and their families.” Fukuyama points out that Russia, Venezuela, Afghanistan and Nigeria hold elections for leaders who are conferred with some degree of democratic legitimacy. What distinguishes them from Norway, Japan or Britain, he says, is not so much democracy as the quality of government, which, in turn, is greatly affected by levels of corruption.

The scale of this kind of malfeasance is therefore large both in economic and political terms. As well as being an inefficient way to do business, corruption is deeply corrosive. It undermines good governance and eats away at public trust. Politicians and civil servants lose their authority and have to rely on brute force to impose their will. Corruption respects no national boundaries, destabilizing neighboring countries and creeping its way across continents.

If corruption really is a defining issue of our time, if not the defining issue, is it getting the attention it deserves? This is a hard question to answer. Certainly, some of the best minds in the social sciences have tackled it in search of a cure. In recent years, governments have set anti-corruption standards for themselves through organizations such as the UN. When corruption scandals surface and are covered by the media, there is an outcry, even demonstrations on the streets. Governments have fallen in the wake of investigations. In some countries, heads have rolled. Yet the scourge of corruption in many ways seems as intractable as ever.

One possible reason for the lack of progress is the fact that, for many years, a discussion of corruption was taboo among researchers and policymakers, something that was highlighted by Swedish economist Gunnar Myrdal. In the first five decades after World War II, Western governments and universities avoided the topic. Corruption was thought of as a malady of the developing world, and it was not mentioned for fear of being labeled imperialist or self-righteous. (Yale’s Rose-Ackerman was the exception who proved the rule; her first academic work on the subject was published in 1975.)

## *The U.S. was the first major country to criminalize bribery and corruption of foreign officials, enacting the Foreign Corrupt Practices Act in 1977.*

Attitudes began to change in 1993, when a few individuals led by Peter Eigen, a former World Bank staffer, launched Transparency International with a secretariat in Berlin to raise awareness of the problem, setting up chapters in more than 100 countries. Armed with its annual Corruption Perceptions Index that ranks countries on how corrupt their public sectors are seen to be, it has engaged with governments and companies to increase accountability, joining a growing band of non-governmental organizations to fight corruption.

At the level of government policy, the turning point came three years later, when the World Bank president at the time, James Wolfensohn, gave a speech to the board of governors. We “need to address transparency, accountability and institutional capacity. And let’s not mince words: We need to deal with the cancer of corruption. In country after country, it is the people who are demanding action on this issue. They know that corruption diverts resources from the poor to the rich, increases the cost of running businesses, distorts public expenditures and deters foreign investors....Corruption is a problem that all countries have to confront.”

One academic whose career changed after Wolfensohn’s address is Philip Nichols, professor of legal studies and business ethics at Wharton. “That speech effectively took the lid off scholarly work on corruption. It also created a market for research on corruption,” he says. Since then, Nichols has pioneered legal studies in this field. His work and that of others has led to many papers and international conferences, and to the emergence of a global anti-corruption regime made up of national anti-corruption laws and international standards.

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*International anti-corruption efforts have been stepped up. Enforcement agencies now often collaborate to bring perpetrators to book.*

to the Watergate scandal, which exposed the use of corporate slush funds to bribe governments abroad as well as to make illegal political contributions at home.<sup>6</sup> Many countries have followed suit with new laws or amendments to existing statutes. The United Kingdom's Bribery Act of 2010 goes further than the FCPA by imposing a strict liability on companies for failure to implement adequate provisions designed to prevent bribery. Other major economies, such as Brazil, Russia, India and China, have not only stepped up their enforcement but also enacted compliance mandates that, in some cases, go beyond the U.S. and British statutes, at least on paper.

International anti-corruption efforts have also been stepped up. Enforcement agencies now often collaborate with one another to bring perpetrators to book. International organizations have raised the bar for business transparency and accountability, again, at least on paper. The Organisation for Economic Cooperation and Development (OECD) set up the Convention on Combating Bribery of Foreign Public Officials in 1997, followed by the UN's Convention against Corruption six years later. Rose-Ackerman and Palifka list 16 global conventions and other initiatives to fight corruption, money laundering and organized crime since 1988.

A lot of energy in the 1990s was directed at raising awareness and putting global standards in place. NGOs were pushing hard. "The focus of TI's work at the time

was around actually making sure there is some kind of standard that governments can be held accountable to, in terms of the progress they're making in curbing corruption," says Max Heywood, Transparency International's global advocacy coordinator. In recent years, TI has promoted the importance of global standards for beneficial ownership transparency so that corrupt officials cannot hide behind shell companies.

It can be said, with some irony, that the anti-corruption movement has spawned its antithesis. Despite all the efforts by international bodies, individual governments, NGOs, companies, the media and the mobilization of citizens, corruption remains a huge problem requiring many solutions, big and small. But our understanding of corruption has widened and deepened. An awareness now exists that corruption does not mean just bribery, but it is multifaceted; it is not just the vice of individuals, but an institutional malady, too. This is progress.

The next section considers a somewhat contrarian view of the concept of corruption, not to take sides but to elucidate certain facets of the phenomenon. It then looks at one ethical aspect of wrongdoing, that corruption can be bad even when you can't measure its impact. Together, these observations help explain the importance of seeing corruption as a social phenomenon and that it is hard, though not impossible, to change people's attitudes. The following two sections look at how corruption varies by country and, after these, by industry. ■

<sup>6</sup>"The new era of regulatory enforcement," Richard Girgenti and Timothy Hedley, 2016.



## Standard Operating Procedures

**T**he previous section showed that there is disagreement among researchers and academics about how narrowly to define the term corruption or even whether it is useful to define it at all. In the view of Bo Rothstein, a professor of political science at the University of Gothenburg, the problem is that abuse is not clearly defined, so what might count as abuse in one country may be very different from what counts as such in another country. It is a little like comparing apples and oranges.

Rothstein takes a different tack and defines the opposite of corruption. “What state of behavior or affairs or central norms do we want people in public positions to uphold? And we settled for the idea of impartiality in the exercise of public power. We have checked, for example, many countries’ codes for the public administration or ethical codes for the civil service. And impartiality is the most common value in these codes.”

He finds support in the writings of American philosopher John Rawls, arguably the foremost 20th century thinker on the subject of justice, who was discussed in the second report of this series on moral philosophy. Rawls does not write about corruption directly, but he defines the sort of norm that the public sector should uphold. It is based, in part at least, on the idea of impartiality. “The opposite of justice is favoritism, and favoritism is, of course, anathema to impartiality,” says Rothstein. “Much of politics is partisan; you want more benefits for certain groups. But when policies are being implemented, you want this to be done in an impartial way.” His starting point is that government legitimacy depends on impartiality which is a central normative goal for the state.

Rothstein is not the only academic analyzing corruption through the back door, so to speak. Another prominent writer on corruption, Alina Mungiu-Pippidi, a Romanian-born professor at the Hertie School of Governance in Berlin, stresses “ethical universalism,”<sup>7</sup> meaning “where equal treatment applies to everyone, regardless of the group to which one belongs.” Government actions and institutions that violate these norms of impartiality and ethical universalism are therefore corrupt.

In the mid-1990s, Rothstein was conducting research around the concept of social trust, “which is a very important asset for any society because it lowers transaction costs.” He found that, based on opinion surveys of citi-

zens, social trust is derived from how people perceive the honesty and fairness of public officials. “In a society where people perceive public officials are discriminatory, corrupt or unfair, they will make three inferences: one is that if they cannot trust such officials, why should they trust people in general; another is that they begin to realize that people generally have to engage in shady deals to obtain the public services they are entitled to, such as protection by the police; and third, they realize they, too, must engage in this kind of behavior, because corruption is the order of the day,” says Rothstein. “It doesn't mean that they think it's right, but that's how things get done.”

Based on this analysis, it is easy to see how a society could slide down a slippery slope of corruption, in which a lack of trust feeds on itself. If social trust is weakening, what can be done to strengthen it? Rothstein starts by distinguishing between what philosophers call moral norms and social norms. A hypothetical example would be somebody whose child is sick and needs to pay health personnel a bribe to obtain treatment. The person would pay the bribe, because it is the social norm in that country, even though it may contravene the moral norm that is commonly understood. There is much empirical evidence of the existence of a gap between social and moral norms. Corruption is common in many countries where surveys show a very high level of disapproval of such practices. This implies that the cultural factors behind corruption, which cannot be ignored in a discussion of corruption, do not necessarily help explain much for this reason: they do not adequately distinguish between moral and social norms.

If culture is not a strong explanatory variable, what is? One possible answer is offered by Elinor Olstrom of Indiana University and winner of the 2009 Nobel prize in economics, who distinguished between “rules in form” and “rules in use.” Organizational theorists have suggested that a type of informal set of directives, labeled “standard operating procedures” or rules in use, exists in between culture and formal institutions.

These are unformalized rules that are commonly understood by people but are not part of a society’s moral norms. They are, thus, similar to social norms. Unlike a national culture, these standard operating procedures can be changed through policies that promote collective action. This offers one possible framework for anti-corruption policy.

<sup>7</sup> “The quest for good governance: How societies develop control of corruption,” Mungiu-Pippidi, 2015.

*In any organization, public or private, people exercise power in a mutually accountable fashion, and corruption is a form of unethical behavior that subverts this accountability.*

The theory of collective action assumes the agents, acting on behalf of the principal, are not the utility-maximizing rent seekers suggested by neoclassical economics. Instead, they base what they do on reciprocity, “meaning that the agents are willing to do the right thing under the proviso that something can convince them that most other agents in their situation are also willing to do the right thing,” Rothstein says. A simple example is a neighborhood in which residents must sort their garbage into recyclable and disposable items, but they are only willing to do so if they are not the only ones who are sorting through them. “It would be pretty lonely to be the only honest police officer in Mexico, right?” Medical doctors, says Rothstein, are usually willing to stop taking bribes to allow patients to jump the queue if they can be convinced that most of their colleagues will also stop taking money under the table.

Based on this analytical framework, Rothstein has looked for empirical data that would indicate the sort of policy measures that might work. He has found five policies that show a high correlation between strong adoption and low corruption (although it should be noted that correlation does not prove causality). The first is to establish access for all children to a high-quality, basic education. Italy is a good example: In the 1860s, the newly unified country enacted education reforms that were fully implemented in the north of the country and hardly at all in the much more corrupt south. Second, enact a fair tax policy because “if people don’t pay taxes, they don’t care about corruption.” In countries such as Scandinavia, with high taxes and high public spending, corruption is low. The third item is to establish a meritocratic system for hiring people for the civil service. In most countries, people get public sector jobs through personal connections, so “if you break that principle and say now it’s actual competence that should count, it has a very strong effect,” says Rothstein. Fourth is gender equality. Research by his colleagues at the Quality of Government Institute in Gothenburg shows that the higher the proportion of women in the public sector, the lower the corruption. The

fifth policy is to establish a professional, independent, national audit system to go through the books of the public sector without fear or favor.

All this is rather simple on paper but fiendishly difficult in practice. Just imagine a meritocratic civil service where female job candidates are treated the same as male ones. “I would say that in most countries, this would be revolutionary,” he says. But even though these policies would be hard to enact and implement, attempts have been made to apply the principles of collective action to the problem. According to the nonprofit Basle Institute on Governance, which launched an international research center in 2012 to promote this approach, the focus should be on the “supply side” of bribery, because companies engage with other stakeholders to tackle corruption and cooperate to set industry standards for transparency and accountability. The World Bank has been a proponent, describing collective action as “a collaborative and sustained process of cooperation among stakeholders. It increases the impact and credibility of individual action.” It is not clear, however, whether such initiatives have had a big effect on corruption, some researchers say.

Even if it is hard to translate these ideas into effective action, they do provide important insights into the problem of corruption by showing that top-down policies such as education reforms can eventually lead to bottom-up improvements. This approach shares certain elements in common with themes that philosophers are discussing as they try to discern the essential elements of corruption and to explore the idea that corruption can be bad even when you can’t measure its impact. Emanuela Ceva, a philosopher at the University of Geneva in Switzerland, examines what she calls “the pathology of institutions.” She seeks to identify a sense in which corruption is a wrong in and of itself, even if it has no dire consequences or the results cannot be measured. In her view, in any organization, public or private, people exercise power in a mutually accountable fashion, and corruption is a form of unethical behavior that subverts this accountability.



A hypothetical example is a manager who hires somebody owing them money on the condition that part of the salary is used to repay the debt. The person hired is fully qualified; nobody else applies for the job; and she performs her tasks well. Ceva says this is an example of corruption even if the harm may not seem severe or, at least, may be difficult to measure. In her view, “The manager should lose their job, because they used their power in ways that were not appropriate and would undermine the smooth functioning of an institution, which is based on accountability.”

Such a case illustrates a division in moral philosophy between consequentialist theories, such as utilitarianism, which hold that a good outcome justifies the right procedure, and non-consequentialist theories, such as deontological ethics, which focus on the right kinds of principles to select procedure for making ethical decisions. (The report on moral philosophy explored this difference of view.) In the hypothetical case just described, consequentialists would say that an effective worker was given the job with little harm done. Non-consequentialists, such as Ceva, would focus on the corrupt principle behind the job decision. “If you only look at consequences, both in theory and in practice, you can come up with all sorts of excuses and justifications for this kind of behavior,” she says.

This discussion points at a fundamental reason why corruption can often be so difficult to eradicate. The actual harm may be hard to quantify, allowing people to make excuses for not blowing the whistle on corrupt behavior. If people only think of the consequences of becoming a whistleblower, they are likely to conclude that the costs to them outweigh the possibly nebulous benefits to the organization of reporting the hiring manager, says Ceva.

From a deontological standpoint, there is always a duty to blow the whistle if a corrupt act is observed, a duty derived from what Ceva calls “office accountability.” The key to a properly functioning institution is that office holders, whether they are public officials or company managers, are mutually accountable to one another in the organization. To perform their work in this way requires

them to use their powers in keeping with the mandate of their office, irrespective of seniority. Corruption is “an internal enemy”, because it undermines this mutual accountability. By contrast, to instill this kind of responsibility to do the right thing, “you must work to improve the ethics of the organization by making office holders aware that they are both the sources and the cure of the problem,” Ceva says. Everybody’s role in an organization is interrelated, and to function properly, everybody should perform their job in keeping with their mandate.

Ceva thinks it is possible to regulate the internal workings of organizations in ways that make people more answerable to one another. An example of this idea is to create or strengthen rules governing whistleblowing, not only to protect people from possible retaliation, which is very important, but to create incentives for people in good faith to cry foul when they observe wrongdoing. Ceva cites the House for Whistleblowers Act in the Netherlands, which came into force in 2016. “This not only regulates whistleblowing but makes organizations more hospitable for whistleblowers. They have consultants, psychologists and other professionals who can help whistleblowers to decide whether they have the level of evidence they need to act. This changes the culture because whistleblowers don’t have to feel like isolated heroes acting in the name of some higher cause, but just ordinary people who are working in the interest of their organization.”

These ideas show the lengths to which society may have to go to make people feel safe to complain about wrongdoing to the authorities. They will not only have to feel that their position will not be jeopardized, but that the authorities they complain to will deal with their complaint fairly and effectively. It is a good example of an approach that combines the need for good leadership with attitudinal change among ordinary people. In the absence of official support and protection, how can an individual stand up against the system? Having considered the interplay of institutional and individual corruption, the next sections look at how these factors can form a combustible mix that varies from country to country. ■

## A Political Football

It began as a money laundering investigation focused on the comings and goings at the Posto da Torre, a gas station in Brazil's capital. But it soon became clear that the target of Operation Car Wash was no ordinary scheme to launder the profits of crime. Federal police learned in 2014 that the owner of the business and an associate were funneling billions of dollars from Petrobras, the big New York-listed state oil company, and construction companies to some of the country's top politicians.

Petrobras executives were deliberately overpaying on contracts with various companies for office construction, drilling rigs, refineries and exploration vessels. The contractors had agreed to ensure they were guaranteed business on lucrative terms if they channeled a share of between 1% and 5% of every deal into secret slush funds. The money in these funds was passed along to Petrobras directors, political parties and politicians. A 2013 law that expanded the use of plea-bargaining led a number of businessmen to implicate senior politicians and other executives.

One of these businessmen was Marcelo Odebrecht, the grandson of the founder of Odebrecht, among the world's largest construction companies. In 2016, he was sentenced to 19 years in prison for kickbacks paid to Petrobras. His company admitted to bribing officials in 12 countries and was fined a total of \$2.6 billion by Brazil, the U.S. and Switzerland. The network of bribery extended to Africa and was especially strong in Latin America, stretching deeply into Venezuela, Argentina, Panama and Mexico. In Peru, President Pedro Kuczynski resigned in March 2018 after being impeached over allegations he covered up payments received from Odebrecht. Thirteen months later, President Alan Garcia committed suicide when police came to arrest him for his alleged links to the scandal.

*Odebrecht...admitted to bribing officials in 12 countries and was fined \$2.6 billion.*

The repercussions went furthest in Brazil, where the corruption began. By April 2019, 908 people had been accused by the Brazilian authorities of crimes in the scandal, 202 had been convicted, of whom 15 are politicians. They face a total of 3,281 years of prison time.<sup>8</sup> The investigations, which are ongoing, have reached the top. Former President Luiz Inacio Lula da Silva is serving a 12-year sentence for corruption and money laundering. His successor, Dilma Rousseff, was impeached and removed from office after being charged with manipulating the federal budget, her position weakened by the fact she had served as chairwoman of Petrobras from 2003 to 2010. And her successor, Michel Temer, was arrested in March 2019 for allegedly embezzling more than \$400 million over three decades.

One reason for the vigor of the Brazilian authorities' crackdown is that, in recent decades, the judiciary has become more activist, partly in response to earlier corruption scandals. Armed with international agreements to share information on money laundering, a 2010 ban on politicians with corruption convictions from running for office, and the plea-bargaining law, judges led by Sergio Moro have used their independence to pursue several big investigations, including Operation Car Wash, to their logical conclusion.

The question is whether these prosecutions will lead to fundamental reforms in Brazil. Yale's Susan Rose-Ackerman says that one of the reasons why corruption is so intractable there is because of the way the political system is organized. Having a presidential system and a separately elected legislature can lead to the sort of back-room deals that are corrupt, rather than just the usual give-and-take of politics. And a plethora of parties, five major ones and 27 minor ones, jostles for influence and cash. "The only thing some of these parties want is either money for their political campaign or some resources for themselves personally," she says.

The Brazilian office of TI worked with other NGOs to produce a list of 70 laws and regulations that needed to be introduced or changed in order to curb corruption. This includes a rule making it mandatory for political parties to explain how they are using the money they receive and how they elect their leader. Another is a stipulation that executives must give back their bonuses, which are tied to winning public contracts, if it is subse-

<sup>8</sup> The Economist, April 11, 2019.

*In a highly politicized atmosphere, individualized prosecutions will not produce real reform. Only structural changes...can accomplish lasting change.*

quently found that the contract was won by means of a bribe. The list was published four months before the October 2018 election. Despite popular anger at corruption in Brazil, only 45 members of parliament who supported the list were elected to office, out of a total of 584.

Fabiano Angelico, a senior adviser at TI Brazil, says that “the anti-corruption agenda became politicized, and we did not find space for a more profound discussion of the proposals.” Many on the left rallied around Lula, arguing that he had been made into a scapegoat. On the right, supporters of President Jair Bolsonaro, who took office in January 2019, said that corruption was the fault of their political opponents who should be imprisoned for their alleged misdeeds. After winning the election, Bolsonaro appointed Moro as justice minister, to popular approval. For Angelico, the lesson is that “civil leaders must stop depicting corruption only as bribery and ill-gotten gains in the form of yachts and jewelry. Corruption is also about harmful policies that damage the country. This is the narrative we need to engage on. Otherwise it’s just about good versus evil and the issue can be hijacked by both sides.”

Eduardo Saad-Diniz, a law professor at the University of São Paulo in Brazil, says that there is a strong resemblance between the corrupt business network involved in the Car Wash scandal and its forerunner that operated during Brazil’s military dictatorship of 1964-85. The problem is deeply rooted. “More than policy reform, Brazilian companies need to be held accountable for their decades-long engagement in oligopolies and regulatory capture. If reforming anti-bribery policies is hard to be approved and the justice system is vulnerable to political

manipulation, maybe it is time for the Brazilian private sector to take the lead in improving ethical behavior in public life and strengthening democratic values,” he says.

In their book *Corruption and Government*<sup>9</sup>, Rose-Ackerman and Palifka make the point that “in a highly politicized atmosphere, individualized prosecutions will not produce real reform. Only structural changes in the underlying corrupt incentives built into the operation of government can accomplish lasting change.” This observation certainly holds true in Brazil, but in other countries, too. Anger over corruption has, in recent years, helped fuel the rise of populism in countries as diverse as the Philippines, the Czech Republic and Mexico. President Donald Trump won office in the U.S. in 2016 partly on a vow to “drain the swamp,” by curbing the influence of money in politics.

“While the denunciations of corruption can often be considered valid, populist leaders, rather than effectively fighting corruption, use the populist rhetoric as a smoke screen to redistribute the spoils of corruption amongst their allies,” TI has declared. Democratic elections can have the effect of weaponizing corruption if reforms are not undertaken in an impartial fashion. But, as the next section shows, authoritarian rulers in non-democracies also use anti-corruption campaigns to cement their hold on power. When companies enter a country for the first time to do business, they need to go in with their eyes open and coolly assess the risks, not least at being hit up for bribes. How should they react? TI’s Corruption Perceptions Index is one tool companies can use to assess the risk and is discussed on the next section. ■

<sup>9</sup> Corruption and Government: Causes, consequences, and reform, 2d edition, 2016.

## Snakes and Ladders

Given the fact that TI's country rankings are so influential, it is worth dwelling a little on their methodology. TI publishes two main indices, each with a different purpose. The better known one is the Corruption Perceptions Index (CPI), which has been published annually since 1995. It was revamped in 2012 so that the league table in one year can be compared with another. Before then, it was not possible to say with confidence whether a country's standing was improving or worsening over time. For this index, TI does not conduct an opinion poll but collects data on corruption from 13 different sources, including the World Bank, the African Development Bank, the World Economic Forum, the Economist Intelligence Unit and the main risk-rating agencies. It publishes confidence intervals to show the level of agreement among the various sources..

"The benefit of having the CPI based on external data sources is it gives us a degree of independence from the results," says Coralie Pring, the lead researcher on the index. "It's not just TI saying this about different countries; there are other reputable sources that can corroborate what we are saying. This is important, because we, and some of our 100 national organizations, have been attacked by governments that are unhappy with their ranking." Because the CPI is based ultimately on the perceptions of experts, it tends to take a top-down approach to corruption.

At the opposite end of the telescope is TI's Global Corruption Barometer, an opinion survey of more than 162,000 citizens in 119 countries and territories that has been conducted regularly since 2002. It asks them whether they had to pay a bribe in the previous year (in 2017, one in four said they did) and what they paid it for, such as health care or their children's education. TI and others can then press governments to focus reforms on sectors where corruption is rife. The two rankings correlate well, although a big scandal in a country may cause the barometer to spike, whereas the organizations feeding data into the CPI generally take the long view. The experts in the latter may also know more than ordinary people about high-level corruption that has gone under the radar, possibly because the country lacks a free press to keep citizens informed.

The CPI only covers public sector corruption; it does not include such things as illicit financial flows or enablers

of corruption. These kinds of indicators are not available for a lot of countries and currently cannot be included in the index. "A number of those countries that tend to do quite well in the index, that are appearing at the top, are actually enabling corruption via banks, accountancy firms and lawyers. They're allowing the flow of money away from countries lower down the index and into bank accounts in offshore havens or into the London property market, for example," says Pring. An example of this phenomenon is Danske Bank, which admitted that it had channeled more than \$200 billion of suspicious payments through its Estonian branch between 2007 and 2015. Paradoxically, Danske Bank is the largest financial institution in Denmark, the top-ranked (i.e., least corrupt) country in the CPI.

These kinds of details hint at the difficulty of comparing corruption in countries around the world and the challenges of measuring malfeasance. But several organizations now compile their own global league tables of corruption and good governance, so researchers can check how TI's rankings correlate with other sources. Some critics of attempts to measure corruption say these techniques may be counter-productive, because potential donors may pull back from countries where aid money ends up in the hands of a few powerful people, thus hurting the poorest who need it most. But, on balance, partial transparency is better than opacity. "At the end of the day, imperfect but constantly improving measurement is better than no measurement at all, which plays into the hands of the corrupt," writes Leslie Holmes, a professor of political science at the University of Melbourne.<sup>10</sup>

One of the most important findings of the CPI is that there has been very little change in the overall corruption score for the 180 countries in the index since 2012. In fact, two-thirds of the countries have not improved or have seen their score decline significantly. As TI said in January 2019, "It reveals that the continued failure of most countries to significantly control corruption is contributing to a crisis in democracy around the world." Pring says that battling corruption takes a long time. "It needs sustained political will to fight corruption over many years. It requires, as well, a strong societal consensus against corruption. And it needs investigative powers to actually

<sup>10</sup> "Corruption: a very short introduction", 2015.

*A prime reason why the fight against corruption is so protracted is that corrupt countries do not have the political will to change.*

uncover corruption and a strong judiciary to punish the corrupt when they are caught.”

Among the notable decliners in recent years are Mexico, Hungary and Turkey. A common thread among them is a waning of what Pring calls “a vibrant civic space, which allows NGOs to freely investigate and journalists to be able to write freely. If they are fearing for their lives when they report on a case of corruption, this really does limit the number of cases that are ever going to make it into the public domain.” A well-functioning democracy is crucial as well, she says.

The picture is not entirely bleak. There have been some notable climbers up the CPI league table, including countries as diverse as Senegal, Belarus, Guyana and Myanmar, which currently rank between 67th and 132nd out of 180. In Europe, climbers include Italy and Greece (53rd and 67th, respectively), which introduced significant anti-corruption legislation following the sovereign debt crisis that began in 2009. The UK (in 11th place) also has made strides to crack down on illicit payments as a result of the Bribery Act of 2010. A scandal involving the misuse of allowances and expenses permitted to members of parliament fueled public outrage and demands for more accountability. “Those countries that tend to do best in fighting corruption not only have the legislation, but they also enforce it. And what we see is that a number of countries lower down the index have anti-corruption legislation, but it’s not enforced,” says Pring.

One region with a decidedly mixed picture is the Asia-Pacific, home to some of the least (New Zealand, Singapore) and the most (North Korea, Afghanistan) corrupt countries. According to TI, the region has seen little improvement in anti-corruption efforts in recent years due to an overall weakening of democratic institutions and political rights. The paucity of progress mirrors global trends, it says. A prime reason why the fight against corruption is so protracted is that corrupt countries do

not have the political will to change, according to Jon S T Quah, a former professor of political science at the National University of Singapore and now a consultant, who has devoted much of his career to analyzing corruption trends in the Asia-Pacific countries.

Singapore offers a distinctive vantage point because it is one of the most spectacular examples of how corruption can be reduced and then kept low, albeit under the watchful eye of the People’s Action Party, which has dominated the city-state since 1959. Thanks to clean government, pragmatic economic policies, a meritocratic civil service and political stability dominated by a single party, Singapore has gone from one of the poorest and most corrupt places in the world to one of the richest—if not the most democratic. From the outset, the late prime minister, Lee Kuan Yew, had no tolerance for corruption. He wrote in his memoirs: “We were sickened by the greed, corruption and decadence of many Asian leaders... We had a deep sense of mission to establish a clean and effective government.” Lee and his ministers wore white shirts and white slacks to symbolize purity and honesty. From the day they took office, they made sure “that every dollar in revenue would be properly accounted for.”<sup>11</sup> The political will to stamp out corruption existed in abundance.

It should be noted, though, that the government’s close supervision of the Singaporean media does raise the possibility that instances of official corruption may go unreported. Singapore’s political leaders would argue that the city-state did not need an independent press to uncover instances of official malfeasance, because the government ensured that the country’s anti-corruption agency, the Corrupt Practices Investigation Bureau, inherited from the British colonialists, was armed with strong legal powers to investigate bribery in all forms, in both the public and private sectors. Although under the jurisdiction of the Prime Minister’s Office, the agency has

<sup>11</sup> “From third world to first, the Singapore story: 1965–2000”, published in 2000.



operated without political interference. It is well-staffed and adequately funded. And it has enforced the Prevention of Corruption Act impartially, investigating five PAP leaders and eight senior civil servants from 1966 to 2014.<sup>12</sup>

Quah has applied his analysis of Singapore's success to other countries in the Asia-Pacific, where the need for anti-corruption reform remains as strong as ever. In Asia, the only territory that comes close to Singapore's achievement is Hong Kong, and for somewhat similar reasons. In 1974, when it was a colony of the UK, the governor, Sir Murray MacLehose, formed an anti-corruption agency that was independent of the Hong Kong police "to root out corruption and to restore public confidence in the government."<sup>13</sup> The agency was provided with the resources and the legal powers to pursue its investigations rigorously and impartially.

In Quah's analysis of corruption controls in many Asian countries<sup>14</sup>, he finds three patterns: anti-corruption laws without an anti-corruption agency; multiple anti-corruption agencies; and countries with a single anti-corruption agency, as in Singapore and Hong Kong. Of these, the last pattern is the most effective, if there is political will to ensure that the agency has the capacity to enforce the anti-corruption laws impartially without political interference, he says. The first is highly ineffective: Japan has still not ratified the United Nations Convention Against Corruption (UNCAC), which it signed in December 2003, because the government is reluctant to establish the anti-corruption agency required by the UNCAC's articles 6 and 36 to minimize the structural corruption of the politicians, bureaucrats and business persons in the country. Both India and China fall into the second pattern. In both cases, multiple agencies have the job of cracking down on corruption, are poorly

coordinated and compete for limited resources. India's anti-corruption strategy lacks the political will to provide adequate resources to the enforcement agencies.

Quah is pessimistic about the prospects for curbing corruption in China. With political power monopolized by the Chinese Communist Party, he says, it is unrealistic to expect the CCP to introduce the necessary reforms by establishing a single, independent anti-corruption agency with the budget to enforce anti-corruption laws impartially, while avoiding the use of the law against political opponents. "It is highly unlikely that President Xi Jinping and his colleagues would be willing to pay the exorbitant price required for minimizing corruption in China, because the implementation of the necessary anti-corruption reforms could lead to the CCP's demise," writes Quah. In other words, China lacks the political will to combat corruption.

How does a country nurture the political will to act against corruption? Quah outlines six strategies to do so, of which the first is to elect competent and honest persons to political office<sup>15</sup>. Clearly, this is by no means an easy task. As a former anti-corruption commissioner in Hong Kong puts it, political will is "a candle flame" that can be "extinguished by any passing political breeze."<sup>16</sup> Yet an anti-corruption program requires years, if not decades, to carry out successfully.

Until this point in the report on corruption, much of the focus has been on legal, political and philosophical aspects of bribery and extortion. The picture is certainly complex and hard for companies to navigate. The discussion now turns to business. The next sections look at corruption in some industries and the ways that have been tried to stamp it out. The final section digs a bit deeper into how international organizations and companies are dealing with compliance issues. ■

<sup>12</sup> "Why Singapore works: five secrets of Singapore's success", Jon S T Quah, 2018.

<sup>13</sup> "The ICAC and its anti-corruption measures", Jeremiah Wong, 1981.

<sup>14</sup> "Combating corruption in Asian countries: what lessons have we learnt?" 2013.

<sup>15</sup> The others are: Establish an independent anti-corruption agency instead of multiple agencies; holding political leaders and senior civil servants accountable for their corrupt behavior; corruption should not be used by the government as a weapon against its political opponents; those found guilty of corruption must be punished according to the law, regardless of their status; rely on civil-society organizations and mass media to curb corruption when the government lacks the political will to do so.

<sup>16</sup> Bertrand de Sperville, Interview by Gabriel Kuris, 2013, <https://successfultsocieties.princeton.edu/>

## Industrial Illegality

**N**eill Stansbury co-founded the Global Infrastructure Anti-Corruption Centre, a nonprofit based in England, in 2008. He is a longtime construction lawyer who has witnessed the damage caused by corruption. He says he has seen improvements in the global anti-corruption regime in his industry. There is now a certificate for companies that implement anti-bribery management systems (ISO37001), a global standard that he helped draft. Government agencies that order the construction of a road, a power station or a bridge, for example, may stipulate that only companies with an independently certified ISO37001 can bid for the project. In addition, there are the international anti-corruption treaties and laws that criminalize bribery domestically and overseas. This has led to prosecutions of many companies, including Brazil's Odebrecht, one of the biggest firms in Stansbury's sector, as well as other big corporations, such as Siemens, ABB, Alstom and Rolls-Royce, the aircraft engine manufacturer.

In all, anti-corruption efforts in the construction industry have made tremendous strides, yet Stansbury is blunt: "There's been a ground-shift in the way corruption is dealt with, thanks to improved laws, procedures and stronger corporate controls, but the outcome hasn't changed. Corruption is, if anything, worse internationally than it was." The changes in the regulatory environment have produced what he calls a "two-speed industry." Some engineering and construction firms are taking an ethical approach and are committed not to pay bribes. "But some companies disregard the law and carry on as before," he says.

The dichotomy between the ethical companies and the unethical ones has reached the point where the infrastructure sector will go in one of two directions. Stansbury thinks that either the unethical firms will change their ways and behave ethically, or companies that are following international anti-bribery law will press their governments to loosen regulations so that they can compete in markets where corruption is prevalent. The core of the problem is that public officials responsible for approving, placing or managing contracts in many countries are corrupt; it is therefore difficult for ethical companies to win and undertake business in these markets. Contracts will normally be awarded to companies that are willing to bribe, he says.

Any attempt to count the cost of corruption in the infrastructure sector is just "a wild guess," he says. But it is safe to say that construction is among the most corrupt sectors because the projects are so costly and complex, often involving several tiers of subcontractors and hundreds or thousands of suppliers. "Everyone in that structure is a corruption risk," Stansbury adds. Before the global anti-corruption regime was set up, the standard operating procedure to win a contract from a corrupt infrastructure minister was to appoint a commission agent who would be paid a percentage of the value of the project if the bid was successful. That money would be passed on to the minister. But nowadays, the commission agent structure is known about and targeted by prosecutors of corruption cases, so the illicit payoffs have been driven further down the supply chain to subcontractors and suppliers, where it is very hard to detect.

Stansbury's work at the anti-corruption center is focused on publishing information and tools on corruption prevention, and in assisting governments and companies in the understanding, identification and prevention of corruption in the infrastructure, construction and engineering sectors. Other international organizations focus on specific approaches, such as the Infrastructure Transparency Initiative, which since 2012 has worked with government, industry and civil society to improve accountability by promoting the disclosure and validation of data from infrastructure projects. As U.S. Supreme Court Justice Louis Brandeis famously declared, "Sunlight is said to be the best of disinfectants,"<sup>17</sup> and the push for greater transparency of government transactions is central to the anti-corruption mission of TI and, in recent years, the World Bank.

These organizations and others have launched similar initiatives in health care, forestry, sport and in the global defense industry, "which is both enormous and highly vulnerable to corruption," says TI. Another is the Extractive Industries Transparency Initiative (EITI), which started an international secretariat in Oslo in 2007, covering the mining, oil and gas industries. These three industries were prominently portrayed in the third report in this series on Business and Peace, because they often operate in areas of conflict, such as the Democratic Republic of the Congo, where they can sometimes be a

<sup>17</sup> "Other people's money, and how the bankers use it", Louis Brandeis, 1914.

source of stability or the opposite. DRC is a signatory of the transparency initiative.

As of March 2019, 52 countries are required by EITI to publish information on key aspects of their natural resource management, including how licenses are allocated, how much tax, royalties and social contributions companies are paying and where the money ends up in the government, both nationally and locally. “EITI has had a significant impact in advancing transparency and a degree of accountability in resource-rich countries which have taken the initiative seriously. Has that translated into a significant decline in corruption? There the evidence is mixed,” says Daniel Kaufmann, a board member.

A global standard for transparency was established by EITI in 2016 and, since then, nine countries, including Madagascar and Afghanistan, have been declared to have made inadequate progress in meeting the standard and/or have been suspended. Azerbaijan, its civil society squeezed, withdrew from EITI almost immediately after it was suspended by the organization. In contrast, Colombia, Senegal, Mongolia and the Philippines have made “satisfactory progress.”

Kaufmann, who is president of the Natural Resource Governance Institute, a nonprofit organization in New York, has played a leading role in promoting the concept of “state capture.” This is defined as the efforts of individuals or firms to shape the formation of laws, policies and regulations of the state to their own advantage by unduly influencing or providing illicit private gains to politicians and high-level public officials. In contrast to more blatant forms of corruption, such as cash in a briefcase, industrialized countries, in particular, often fall prey to subtler types of influence-peddling: an expectation of a future job for a regulator in a lobbying firm, or a campaign contribution with strings attached. As Kaufmann points out, “In

many countries this may be legal, even if unethical. In industrialized countries, undue influence is often legally exercised by powerful private interests, which in turn influence the nation’s regulations, policies and laws.”

He sees this mechanism at work in the financial crisis, which began in the U.S. in 2008 and spread quickly to the rest of the world. There were many reasons for the meltdown in the financial services industry, Kaufmann says, including “the element of capture in the systemic failures of oversight, regulation and disclosure in the financial sector.” Instances of undue influence had catastrophic effects. The government-sponsored Federal National Mortgage Association and Federal Home Loan Mortgage Corporation spent millions of dollars lobbying members of Congress in exchange for looser capital reserve requirements. A derivatives unit of AIG, the insurance giant, found a lax regulatory regime to be supervised by, leading to risky practices that brought down the global company. Big mortgage lenders such as Countrywide Financial switched regulators to fall under the weaker oversight of the Office of Thrift Supervision. And in 2004, the largest investment banks in the U.S. persuaded the Securities and Exchange Commission to relax its regulatory stance and allow them to take on much larger amounts of debt.

The financial services industry might well have hit a wall without the loosening of regulatory oversight, but they did exacerbate the effects of the financial crisis. In the wake of the Great Recession, corporate misconduct and illicit dealings were uncovered in a range of industries in the U.S. and beyond, leading to “a new era of regulation and enforcement that goes far beyond the financial sector.”<sup>18</sup> Record fines and penalties were exacted for various kinds of malpractice at major financial institutions, as well as pharmaceutical companies and energy firms. Of the top 100 companies worldwide by revenue, 20 of them paid fines totaling \$72 billion in the 45 months ending in September 2015.<sup>19</sup>

Before the crisis, in 2004, Kaufmann compiled data from a survey by the World Economic Forum of 104 countries rated by “legally corrupt” manifestations, measured through the extent of undue influence on governments. The U.S. was ranked 53rd, far below most European countries, not to mention nations such as Botswana, Colombia and Chile. The survey has not collected data since then, but he continues to warn about

*Industrialized countries  
often fall prey to subtler  
forms of influence peddling.*

<sup>18</sup> “The new era of regulatory enforcement”, 2016.

<sup>19</sup> Ibid.

the dangers of state capture. “I think it’s the largest governance threat to transitional and more established democracies because it leads to inequality, disillusionment and populism, while non-democrats use the cynicism engendered by it for their own political purposes,” he says. State capture has certainly gained prominence in South Africa, where President Jacob Zuma was forced from office in 2018 as prosecutors investigated his ties to big business.

This is corruption on the grand scale, and it is a type that contains subcategories. There is a “huge difference” between corruptly bending the implementation of the rules governing society, Kaufmann says, and corruptly shaping the rules themselves. “The cost of the latter is orders-of-magnitude greater.” He refers to the Car Wash scandal and points out that the IMF has come to regard such corruption as a “macro-critical” issue in many countries. The fund now includes it as part of its country reviews and is a topic of discussion in regular meetings with governments around the world. Christine Lagarde, the Fund’s then-managing director, declared in 2017, “The Board [of the IMF] agreed that our members would benefit from an increase in granular policy advice, and a candid, even-handed assessment of the economic impact of corruption.”

This section has looked at a number of industries, including construction, mining, energy and financial services. In each, corruption rears its head in different ways. But this tour would not be complete without mentioning the trust and corporate service providers industry, which encompasses lawyers, financial advisers, tax specialists and bankers. The workings of this industry hit the headlines in 2016 after the German newspaper *Süddeutsche Zeitung* spent a year, with the help of the International Consortium of Investigative Journalists, analyzing documents it received from an anonymous whistleblower. At the center of the story was a Panamanian law firm and corporate service provider, Mossack Fonseca. In 40 years, it created 214,000 shell companies, mostly registered in other tax havens such as the British Virgin Islands, making their real owners untraceable through public records.

Defenders of shell companies say they are set up out of privacy concerns. But, as the so-called Panama Papers

demonstrated, Mossack Fonseca and others like it service the needs of people who wish to conceal conflicts of interest, receive or pay bribes, avoid sanctions, launder money and cheat tax collectors. Offshore companies established by Mossack Fonseca hid transactions involving more than 140 politicians and officials, including 12 government leaders and 33 individuals or companies blacklisted and sanctioned by the U.S. government for money laundering, terrorism and fraud.

At an Anti-Corruption Summit in London in 2016 in the wake of the scandal, 40 countries committed to reforms that included ensuring the transparency of companies’ beneficial ownership. But as of April 2019, half of the commitments had not been implemented. There is a continuing crackdown on corruption facilitated by the corporate services industry. In 2017, Mossack Fonseca’s two founders were arrested in Panama and the firm was eventually shut down. European banks became the focus of investigations for allegedly violating anti-money laundering rules, including Deutsche Bank, Swedbank and Danske Bank. “Despite the exposure, the key government players in the offshore industry—the British Overseas Territories, Panama, the United States and others—have yet to reform their financial systems and close important loopholes that allow abuse,” says TI.

TI’s Max Heywood expects the attention of his organization to be focused on searching for the cracks in the global economy where people and illicit practices can hide. “Large-scale corruption tends to be international and if there is a big case, whether it’s construction or health care or oil and gas, you will find an anonymous shell company at the heart of that. These systemic global gaps are where we have to focus our attention.”

This and previous sections show that there is a tug of war between governments and companies to expose wrongdoing on both sides of the economy. It is at least as complex as any military campaign. But where does all this leave business decision-makers? How can they establish an ethical program of compliance while steering their ship between the rocks? The next and final section examines some of the approaches that might work. ■

## Compliance and Beyond

This report has explained that, although corruption is an immense problem in the global economy, it is a vague term with no legal definition that is accepted around the world. Public awareness of corruption has never been greater, but its effects are hard to quantify, even though international organizations have sought to estimate the scale of the damage. Anti-corruption efforts have proliferated at both the international and national level. Laws have been tightened, more individuals have gone to jail, and anti-corruption agencies have become more numerous and more active. But despite the increased media attention and greater regulatory scrutiny, it is hard to know whether corruption is growing or receding.

All the experts on corruption interviewed for this report agree that little evidence exists about the effectiveness of anti-corruption policies. The most positive interpretation of the data comes from Wharton's Philip Nichols, who has been watching the trends reported by international organizations in the past 25 years. He says things are getting better overall, but concedes that it is very hard to measure the effects of individual programs designed to curb bribery and corruption. For its part, TI says there has been no improvement since 2012.

Despite (or because of) this, companies spend vast sums of money on their compliance programs. While the exact amounts are not known, it is possible to obtain a glimpse of the scale: Extrapolating from a survey of 150 financial services firms in 2018 in the U.S., the industry spends \$25 billion a year on anti-money laundering compliance, almost 1% of total assets. New technology can only go so far in driving efficiency improvements and investigating wrongdoers. Anti-money laundering activities are only one of several anti-corruption programs in one industry in a single country, so the total amount spent

worldwide by companies is likely to run into hundreds of billions of dollars a year.

This is a significant problem: Government regulators have steadily tightened the screws without knowing whether this is having the desired effect, and companies are not able to gauge the benefits of their investment in compliance. Until the gains can be estimated, compliance will remain a cost center outside the running of the business, a necessary burden, but a burden nonetheless. Given the amount of spending, it is worth dwelling on the challenge of measuring the effects of compliance programs.

For one thing, it is difficult to prove a negative, says Neill Stansbury. "Involvement in corrupt business can result in delays, cost overruns, nonpayment, extortion, reputational damage and prosecution. How can you prove the amount of money you saved through not being prosecuted for corruption because you didn't pay a bribe or through avoiding a corrupt contract, which could have caused loss and damage to the company? That's hard." For another, some analysts argue that corporations may not actually want to measure the efficacy of their compliance programs because it could create a liability for them. If they were to find their programs ineffective, they may have to disclose this to the regulators, opening themselves to demands for still-higher spending on compliance.

This is a big gap in people's understanding of the problem. A group of six academics, including William Laufer, professor of legal studies and business ethics at Wharton, reviewed 106 studies of the effect of various kinds of interventions, including prosecutions, to deter corporate crime. It found that they had only a small deterrent effect on noncompliance and that the quality of evidence was low. "Corporate crime is a poorly understood problem with little known about effective strategies to prevent and control it," the study concluded.

Laufer adds a long-standing concern about moral hazard: "If we incentivize corporations to spend money on compliance as evidence of due diligence and we don't look at the evidence associated with what those expenditures bring about by way of actual change in behavior, then corporations could spend to optimal levels, fend off regulatory scrutiny and still permit the same kind of wrongdoing. No one will be any the wiser."

And it is possible that prosecutors will not know better. At the Department of Justice (DOJ) in Washington, D.C., there was a short-lived experiment with having an experienced compliance counsel to determine the effectiveness of compliance programs. Two years after

*In the U.S., financial services firms spend \$25 billion a year on anti-money laundering compliance.*



being hired by the Fraud Section in 2015, Hui Chen, the first “and likely last” compliance counsel, resigned, according to Laufer. Determinations of compliance effectiveness are now the responsibility of assistant U.S. attorneys whose discretion is limited by April 2019 DOJ guidance on how to evaluate compliance programs. This guidance turns on three empirical questions that, Laufer says, are rarely answered with systematic evidence:

1. Is the corporation’s compliance program well designed?
2. Is the program being applied earnestly and in good faith? In other words, is the program being implemented effectively?
3. Does the corporation’s compliance program work in practice?

Given the paucity of evidence with regard to government rules, are there any anti-corruption programs outside the purview of the state that are worth highlighting? Laufer offers the World Bank’s mechanism for debarring companies found to have engaged in corruption and fraud in the bank group’s projects, which he says is “arguably the most successful non-state regulatory regime combating corruption.”

Pascale Dubois, vice president of integrity at the World Bank, explains the process. Her office investigates cases where illicit dealings are thought to have occurred. The case then goes to an adjudicative phase at the Office of Suspension and Debarment. About a third of cases are appealed to a sanctions board made up of five judges from outside the bank, and their decision is final. If found to have behaved corruptly, the company may be debarred from bidding on World Bank projects for a period of time, depending on the severity of the misconduct and presence of any aggravating and mitigating circumstances. During this debarment period, the company is usually required to set up an anti-corruption compliance program as a condition for being allowed to bid once more. In the five years to June 2018, the bank debarred 320 firms and individuals. Regional development banks have followed the World Bank’s example and established debarment processes. Companies debarred by one multilateral organization cannot bid on projects tendered by others.

“We want to create an environment where businesses put in place compliance programs because they understand that if they do it in a clean way, it’s actually better for business,” says Dubois. In certain industries where there is a small number of competitors, they all tend to watch

each other and raise the alarm if they see something untoward. “Being in an investigative agency, we love that part, by the way,” she adds, with a laugh. But it must be said that although debarment may be an expensive embarrassment, it is a long way from a fine or a criminal prosecution. The World Bank does not have the authority to go after governments whose officials accept bribes. The bank is an important cog in the system, but it is still a cog. “You can’t fight corruption unless you actually have tools to go after both the givers and the receivers. And on the receiving side, it will very much depend on the situation in a particular country. Some countries have a healthier enforcement regime and will attempt to prosecute corrupt government officials,” she says.

As it happens, there is a certain symmetry in the anti-corruption measures that experts say need to be made in the public sector (the receivers) and the private (the givers). There are two common features of compliance that should be shared by both sides. Firstly, there needs to be a strategic approach to the problem that entails a comprehensive program of measures designed to curb corrupt behavior. In the realm of public policy, “you should not just be thinking about criminal law. You should also look at taxation, education, health and the environment. You should look at the regulation of public utilities where self-seeking individual behavior is doing the most harm,” says Yale’s Rose-Ackerman. TI’s Heywood cites Britain as an example of a country with a well-developed anti-corruption strategy. It may not be perfect, but it aspires to think long-term about the problem.

The second attribute of compliance that should be shared by the private and the public sector is that corruption needs to be tackled both from the top and the bottom. In the corporate world, the former is often described as setting the right tone at the top. Few believe that it is possible to create an effective, anti-corruption culture in a company without strong leadership from the chief executive. Similarly, official crackdowns on corruption rarely succeed for long if the head of government does not set an example of probity and ensures that anti-corruption laws are executed fairly and rigorously. In a nutshell, reforms require political willpower. But effective programs also need the support of ordinary citizens, from the bottom up. Countries might be able to eradicate grand corruption among the elite while turning a blind eye to petty bribery. Similarly, employees at all levels of the company must behave with integrity if there is to be a true culture of compliance, rather than a merely formulaic response to corruption.

Rose-Ackerman, who has been analyzing corruption around the world since the 1970s, recommends four ingredients of successful anti-corruption reforms.<sup>20</sup>

- Survey the public to find out how corruption affects their daily lives, thereby setting priorities that reflect popular grievances. For high-level corruption, poll company managers anonymously to find the hot spots of illicit deal-making. After vulnerable sectors have been identified, reformers should promote several changes at once.
- Next, reforms should modify incentives by reducing the benefits and increasing the costs of engaging in corruption, over and above the enforcement of antibribery laws. To tackle grand corruption, decision-makers need to be held responsible for their choices, buttressed by more transparency and stronger whistleblower protection. To reduce the demand for officials to bend the rules, business regulations need to be winnowed. The state must continue to play a central role in market regulation, supported by civil service reforms to professionalize the bureaucracy.
- On the legal side, criminal laws of corruption should be reviewed and, if necessary, strengthened in coverage and penalties. All branches of the judiciary should be made fully accountable. If an anti-corruption agency is established, it should have sufficient funding and power to act and do so impartially.
- Strengthen civil society's role in exposing corruption by educating ordinary citizens to report what they witness and to act as advocates for change. Even if the government resists scrutiny

from those below them, social media can overcome a lack of media freedom, as seen in Turkey, China and the Arab Spring of 2010-11.

Apart from these steps within a country's borders, the international community has an important part to play as well. Too often, countries sign on to an international commitment to curb malfeasance and then simply go through the motions of implementing their promises. More direct pressure can come from international cooperation among governments, agencies and companies. Furthermore, "reforms in the international arbitration system could make large-scale corruption cases more transparent and allow for the consideration of kickbacks and bribes in determining the enforceability of contracts," says Rose-Ackerman.

These are just some of the actions that should be taken to clean up the global economy. Many more are mentioned in the rest of this report. Indeed, the previous three reports in this series have explained the importance of companies behaving in an ethical manner. Their employees and executives are almost always on one side of a corrupt transaction, so they can have an immense impact on the problem if they refuse to be bribed. The fight against corruption is arduous and complicated and may take decades to eradicate, if ever.

Martin Luther King Jr. once said, "Let us realize the arc of the moral universe is long, but it bends toward justice." There is empirical evidence to support this thesis. Government-sanctioned slavery has ended<sup>21</sup> and Nazism was defeated. But some social evils, such as poverty, disease and war, seem unquenchable. Another is corruption. If it is ever vanquished, it will be because people regard it as immoral and as having no place in a civilized society. ■

<sup>20</sup> "Corruption and government", 2016.

<sup>21</sup> Institutional slavery continues to exist, with tens of millions undergoing forced labor in various parts of the world.