



SCHMIDT

By Skip Kaltenheuser

"Grease money" in international commerce may soon be drying up.

There's a hotel bar across the Potomac from the nation's capital with a splendid view of many of the markers that radiate the excitement of power and possibility. Plush and comfortable, the patrons well-dressed and well-behaved, the bar attracts an international clientele—not unusual in this international city. Frank Johns, who heads Pinkerton Global Intelligence Services for global security services firm Pinkerton Inc., considers the bar high-risk. Not just this bar, but many area upscale hotel watering holes. And not because of pickpockets or stickup clowns, but because of "extremely well-connected" patrons.

"Everyone is either a 'prince,' or closely related to a prince, or a general, or a minister of this or that," says Johns. They all have the inside track, and for a fee, they will run a company down that track, ahead of competitors, into the land of milk and honey and business escorted to your door—sole-source bidding, official or not. "We call them 10-percenters," says Johns. "When they start buying you drinks—or introducing you to women who find you oddly fascinating—it's time to leap for the door."

If fees given to Prince Baksheesh morph into payola for a foreign government official in order to obtain business, a U.S. company could be snagged and reeled in by the U.S. Foreign Corrupt Practices Act (FCPA). Transgressors reap serious criminal penalties and economic derailments. The act has worked well to keep most U.S. companies from taking the bait, but the 10-percent crowd fishes in all the world's power centers. Foreign competitors are so free with bribes that they routinely take legal tax deductions for them. It won't come as a shock that

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this is a sore point with American companies that feel they've unilaterally stripped while foreign competitors still sport overcoats bulging with bribe money.

But a new treaty promises to level the playing field, and U.S. business groups are out in force supporting it. Last year the 29 member countries of the Organization for Economic Co-operation and Development (OECD) and five nonmembers signed a breakthrough agreement—the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions—that heralds a sea change in the way business is conducted abroad. Like the FCPA, the OECD treaty criminalizes the supply side of the corruption equation, with prosecutions of companies by their home countries. In some respects, its scope even extends beyond that of the FCPA, from which the treaty draws its spirit and much of its letter. In other aspects, it falls a bit short and must be viewed charitably as a work in progress.

But if expectations are realistic and follow-up actions are aggressively pursued, the treaty offers a new tool that will enhance the prospects of U.S. businesses selling products and services abroad. To take full advantage, companies will have to become more knowledgeable about back-channel techniques of pressuring foreign governments—and even take on the role of whistleblowers.

Only a few years ago, most would have considered this treaty hallucinatory. The prevailing fatalistic view was expressed in the slang of Hong Kong when it was overrun with corruption in the 1960s, before it created its Independent Commission Against Corruption in the 1970s. One could “get on the bus” and embrace corruption, or “run alongside the bus” and not interfere. Only fools would “stand in front of the bus.”

Most observers believe that by the end of the year the treaty will be ratified by the threshold of major players needed to put it in play—nations that comprise the majority of world trade. The United States was edged out as first ratifier by Japan and Bulgaria, but on July 31 the Senate unanimously ratified the treaty and passed implementing legislation needed to modify the FCPA. The Clinton administration has long pushed the treaty, and even Sen. Jesse Helms, not known for his fondness for treaties, has sung its praises. The only remaining step is the House of Representatives' passage of administration-sponsored FCPA amendments to implement the convention.

At this writing, Japan is the only nation to

pass implementing legislation, and timetable goals in the other signatory countries may end up delayed until well into 1999.

Bribing Politicians Doesn't Count

Will the OECD treaty be enforced? “The worst that could happen,” says Stanley Marcuss, a partner with Bryan Cave LLP's Washington office, “is that the treaty might be viewed as having solved the problem. This is a game of chutes and ladders—two steps forward, one step back. That's why the monitoring phase is so critical: Each misstep is so hard and time-consuming to correct. If done right, the best-case scenario is four or five years to see real impacts.”

Perhaps the weakest aspect of the OECD agreement is that, unlike the FCPA, the convention does not prohibit bribery of foreign political parties, party officials, or candidates for political office. The United States was alone in supporting this objective, with some countries arguing that political-party officials were not public officials, so the convention shouldn't cover them. Additionally, some countries have insufficient legal definitions for parties, party officials, or candidates.

As the U.S. public has come to know, largesse to politicians, even in the guise of legal campaign contributions, often appears to be thinly disguised bribery. Indeed, foreign governments resentful of U.S. criticism often point to the hypocrisy of U.S. campaign oddities like tobacco companies' alleged offers to run ads supporting cooperative candidates. If allowed to remain, the loophole allowing direct bribery to foreign political entities will draw in money like a black hole. However, the OECD expects to address this loophole next spring.

Also discouraging is the reluctance of countries like France to disallow tax deductions before ratification or implementation of law. And Germany has so far resisted hot criticism that it intends not to disallow tax deductions until after there's been a criminal conviction.

Even the United Kingdom has drawn fire, with its Home Office position that an act of 1906, together with an ancient common-law offense of corruption, provides sufficient legal implementation. Indeed, the fact that no one has ever been prosecuted for the bribery of a foreign public official indicates that a little something else might be handier than lessons in legal history.

Marcuss, who was on the staff of the Senate committee that produced the original FCPA, has comprehensively identified other problem areas, including the substantial wiggle room that results when strict uniformity is not required across 34 legal systems and the potential for prosecution confusion over conflicting laws with different definitions. These are issues that need to be watched and

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worked out over time.

"A key element of the FCPA is the requirement that companies keep accurate books and records and strict internal controls regarding assets," says Marcuss. "It is worrisome that the OECD doesn't address this more concretely."

One difficulty: proving a bribe has been offered and taken. How easily will bribes surface? "Adequate proof in court is often elusive," notes Pinkerton's Frank Johns. "In the late '80s, an international airport sent out requests for proposals, seeking a multidisciplinary firm involved from the ground up. A U.S. company was approached for a kickback and refused. After the contract went elsewhere, the losing company obtained the winner's proposal and found the boilerplate language was nearly identical to their own proposal. A connection also surfaced between the bribe solicitor and the winner. Someone in the government had shared the U.S. company's proposal, allowing the winning company to barely underbid it. But it couldn't be proved."

Additionally, companies rarely take a publicly accusatory position. "They may have to deal with the same players down the road," says Marcuss. "Also, there's always a risk of drawing attention to themselves. Even if they are not guilty of anything, they don't want to deal with the burdens of a government investigation."

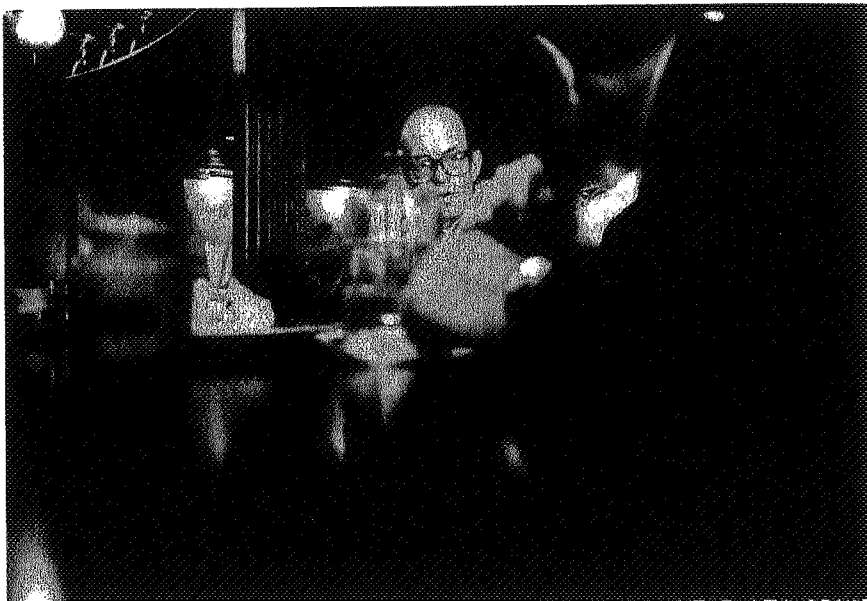
But if these challenges make a victory celebration sound premature, there are multiple reasons experts like Johns are optimistic. For one, while the United States is already pastured within the fence of the FCPA, foreign companies are wild and free-roaming. Charles S. Levy, a partner with Washington firm Wilmer, Cutler & Pickering, expresses a popular sentiment, that "anything is better than what we have now. I'd rather be arguing with the Germans about how they're living up to their obligation than over if they should accept the treaty. If we move backward, we get nothing."

Banks Get on Board

One fortunate circumstance is that the OECD treaty is not as lonely as the FCPA once was. Eleanor Lewis, chief counsel for international commerce at the U.S. Department of Commerce, has worked on corruption issues for 15 years, and she notes the encouraging sign that, after the Asian crisis broke, representatives from several nonsignatory nations in that region showed up in an unofficial capacity to study the substance and process of the treaty. Her office now provides an Anti-Corruption Review ([202] 482-0937 or www.ita.doc.gov/legal) that tracks anti-cor-

ruption initiatives around the world. Lewis believes the uncertainty of the new economic climate further drives the desire for "consistent, morally defensible standards," to which the OECD treaty is a response.

Most international financial institutions—including the World Bank, the International Monetary Fund, and most regional develop-



IN 1996, THE COMMERCE DEPARTMENT reported that firms that pay bribes win 80 percent of contract decisions.

ment banks—either have formal anti-corruption policies or are soon to adopt them. Lewis also has high hopes for a WTO Transparency Initiative, which aims "to increase the transparency of processes related to government procurement around the world."

Besides zapping any part of a deal in which corruption is revealed, World Bank president James Wolfensohn has also set up a special internal fraud team and hired outside specialists, including the accounting firm PricewaterhouseCoopers, to root out ethical lapses on the part of individual staff. In September, two staffers were fired for "misuse of funds for their own personal gain." The World Bank put it in a press release.

Meanwhile, institutions are spawning subgroups to tackle particular hardcases. Former World Bank president Robert McNamara and former ambassador to Senegal Herman Cohen work with the Global Coalition for Africa, making agreements with contractors and government officials regarding conduct and transparency on particular projects, therefore rooting out corruption one segment at a

time in an "islands of integrity" approach.

Michael Skol, who served as U.S. ambassador to Venezuela from 1990 to 1993, points to a shift in government attitudes. "This movement has long been under way in Latin America. With its Inter-American Convention Against Corruption, which the United States should also ratify soon, much of Latin America is already further along than the OECD. Anti-corruption is the most important politi-

cal issue in most of Latin America—just look at the key articles in their newspapers. It's the theme in most of this hemisphere."

The New Realpolitik

Given that corruption has enjoyed a long run since biblical times and still has many fans, why are recent reform efforts making headway? "What you have to realize is that the world has changed," observes Mike Gad-

Corruption by the Numbers

An effective grass-roots force is Transparency International, a Berlin-based NGO formed to curb corruption in international transactions. Founded in 1993 by Peter Eigen, formerly the World Bank's resident director for east Africa, the organization now has more than 70 national chapters working toward anti-corruption legislation. Eigen, who had seen his African territory devastated by corruption, was impressed by Amnesty International's successful use of the klieg lights of publicity and thought he'd try it.

All reformers count heavily on enhancing the role of the press. For example, the "corruption query" Website now being tooled up by South Africa's chapter of TI uses media reports to classify corruption in specific categories, including locales and government levels; sectors such as religion, civil service, business, political parties, sports, and media; allegations such as bribery, nepotism, and money laundering; anti-corruption measures; trend analyses; the status of investigations; and specific actions and punishments. Tools like this will enable the citizenry to lock in quickly to see if local and national governments are following through on anti-corruption promises.

Another TI initiative is an annual "corruption perception index," a ranking of 85 countries based partly on the perceptions of businesspeople, experts, and the general public. After Pakistan received an unenviable ranking, Benazir Bhutto's regime came under intense scrutiny and un-

raveled. Now Switzerland may charge the former prime minister with money-laundering crimes. Anyone who has seen a missing billion dollars of public money should get in touch.

According to this year's index, released late last month, Cameroon is the country perceived to have the most corruption, followed by Paraguay, Honduras, Tanzania, and Nigeria (the last two are tied). Most corruption-free: Denmark, Finland, Sweden, and New Zealand. The United States tied with Austria for 17th least corrupt—falling behind, among others, Germany, which placed 15th.

Others of note: Canada ranked sixth least corrupt, the United Kingdom 11th, Hong Kong 16th, Israel 19th, France 21st, Spain 23rd, Japan 25th, South Africa 32nd, Italy 39th, Brazil 46th, China 52nd, Mexico 55th, India 66th, and Russia all the way down at 76th.

Two years ago, Malaysia's Prime Minister Mahathir Mohamad initially condemned the survey as another example of cultural imperialism, but he ultimately used the index to underpin a national awareness program. Mahathir also called for a monitor of the corruption being exported from the west, and indeed TI is exploring how to rank nations such as Belgium, France, and Italy that have unusually high levels of trade with notoriously corrupt regimes. In September, Malaysia was host to an international TI conference on strengthening integrity, based on the lessons learned in Asia.

TI doesn't shy from challenges.

The chairman of TI's advisory council is former Nigerian head of state Olusegun Obasanjo, a general who once shocked the corrupt military by handing power over to a civilian government. Obasanjo was framed in 1995 for a coup plot and, after a secret trial, thrown into Nigeria's horrific prison system, from which he was only recently released. Contrast this TI knight with the late Mobutu Sese Seko of the former Zaire, who, according to the *Financial Times*, stashed \$4 billion of bribe money and foreign aid.

With grants from George Soros' Open Society Institute and other organizations, TI is forging chapters in the former communist bloc. It has already established one in Russia. Given the magnitude of Russia's problems, it wouldn't be fair to call it a day late and a dollar short. Russia was always a top index contender, along with Colombia, Bolivia, and frequent champ Nigeria.

Though empowered by the steam of political opposition attacking corrupt regimes, TI is nonpartisan. It's also not out to retroactively right every wrong. Instead, says TI-USA chairman and former GE official Fritz Heilmann, TI takes a "systemic approach," tightening the avenues down which corruption travels.

Consequently, companies that support TI include some that have been in the scandal soup before (GE among them, before considerable tightening of its internal ethics guidelines), and corporations are less afraid of its reform objectives. TI offers information at www.transparency.de, including contacts, best practices, and scandal updates.

—S.K.

baw, VP/senior counsel of international law and policy at General Electric Co. "Globalization in the movement of capital and trade exposes new areas to international standards. There is new political accountability. Corruption causes uncertainty as the new crowd immediately discredits the old crowd. Even repressive regimes are increasingly sensitive to pressure. Numerous studies indicate that corruption leads to bad government, to poor policies such as low education spending, and to downward spirals."

Michael Herschman, chairman of Decision Strategies/Fairfax International, an investigative consulting firm, agrees. "There's a new *realpolitik*, in which governments recognize that ethical issues are not separate from political and business ones. Essentially, bribery is an invisible tariff artificially boosting the cost of a contract, forcing prices up and stifling efficient free-market trade."

These economic and political pressures have governments around the world running scared. The '90s ushered in bribery scandals that collapsed governments in Japan, Italy, Brazil, and Venezuela and caused the resignation of important political figures in Germany, France, Spain, and Belgium. Mexico went dizzy trying to understand how its former president's brother upped his fortunes by more than \$100 million. Two former South Korean presidents drowned in scandal at a depth that defies imagination, and corruption allegations derailed the regime of a third. It's a long and growing list, as corruption scandals give opposition parties and reformers piles of ammo.

Downturns in Asia have sobered up many companies in developed countries who were willing to overlook the markers of corruption as long as there was double-digit growth. As Michel Camdessus, managing director of the International Monetary Fund, observed, "Many of the problems that lie at the heart of Asia's difficulties are bound up with poor governance. In Korea, for example, opacity had become systemic." Relationships among governments, corporations, and financial institutions were so "incestuous that in the long run they could only result in unclear accountability and disastrous investment and lending decisions." The lack of transparency, says Camdessus, concealed the extent of Korea's problems. Delays in corrective action helped collapse market confidence.

Most recently, emerging-market investors who counted on Russian caviar look as if they've been kissed by sturgeon as they wonder where all the money went. People are getting rid of rubles so fast, it seems like they're radioactive—and if they were, their trails would often lead to toys parked or floating near the Riviera. Russia's woes have deep roots in corruption.

Will China be far behind? The black market began devaluing the yuan months ago. In China, economic reforms are bedeviled by corruption as the rule of law lags behind the rhetoric. People forget that the Tiananmen Square debacle began as a protest against corruption.

Former ambassador Skol, now managing director for Latin America at Decision Strategies/Fairfax International, consults with entities like the new Argentine National Ethics Office and with companies on anti-corruption practices. He believes the new anti-corruption measures will succeed because of business economics. "People speak of a third wave," Skol says. "It's being driven by pure economic impetus. New democratic governments are under huge pressure to provide services in education, health, etc. . . . Where are they going to get the money? The biggest available immediate source, outside foreign investment, is recapturing the money that is lost to corruption. In some countries, the corruption share of a deal ranges from 5 percent to a third. Either the project doesn't perform as it is supposed to, or it costs a third more."

In developed countries there is another impetus for reform, based on the adage "what goes around comes around." In Germany, companies implicated in scandals abroad used to attract little attention at home. But the chickens came home to roost—in Siemens' case, when high-level managers were sentenced for creating a cartel in Munich that fixed prices for substantial public projects such as the subway system. Tax deductibility for bribes given abroad seems less clever, and doubly dumb when business is lost, as when Singapore banned Siemens' telecommunications division after allegations that Siemens, with four other firms, gave millions in bribes to a utilities official.

After signatories develop the laws to prosecute their own companies, how might U.S. companies proceed if other nations are slow to respond to abuses? Skol thinks companies will prove more active in blowing the whistle when the treaty opens new avenues, at least informally. He also believes governments will be more inclined to apply diplomatic pressures. "When I was ambassador to Venezuela, their navy refurbished six destroyers, at well over \$100 million each. We asked a U.S. company, Ingalls, why it wasn't bidding, and they said the fix was in. We found the Italians were bribing top navy officials. We knew such a bid was an expensive process, but I asked Ingalls, 'If I can promise our full support, will you bid?' They did, and we quietly exposed the bribery. It was too embarrassing for the Venezuelan navy to go ahead with the fix, and Ingalls received the contract. Today, the U.S. government gets similarly involved when

there is evidence that a U.S. company is disadvantaged. There's also some room to bluff a bit on what can be proved, and politicians don't want to gamble."

As agreements are fine-tuned, other mechanisms will appear. Since the best evidence always comes from inside, one innovation would involve linking strong whistleblower protections with rewards—a hefty percentage of fines and confiscated profits. All whistleblower data would also go to international monitors. Such measures are self-enforcing and low-cost, and would remove any doubt over whether nations are simply paying lip service while stalling.

An Inadvertent Benefit of Bribery

From mid-1994 to mid-1996, the U.S. government received significant allegations of bribery by foreign firms in 139 international commercial contracts valued at \$64 billion. In a 1996 report to Congress, the Commerce Department estimated that U.S. companies lost 36 of those contracts, valued at \$11 billion. Firms that pay bribes, said the report, "still win an estimated 80 percent of contract decisions."

Given the stealth nature of most bribery, and the salesman's temptation to blame it for a lost contract, one might well be skeptical of the various estimates. But it is undeniable that bribery cuts into U.S. firms' profits. The Commerce Department report noted that "although even relatively small bribes may be effective, recent examples exist of European firms offering agent commissions of 20 percent or more on a \$1 billion contract in an Asian market if a European aircraft was chosen."

However, the FCPA has also bestowed benefits. Not being able to rely on bribery forced U.S. firms to be tougher competitors, improving productivity and product quality. Conversely, relying on bribery has weakened

foreign competitors to the point where many lack confidence that they can compete against U.S. firms without payoffs.

Observes Frank Vogl, president of Vogl Communications in Washington and vice chairman of Transparency International, "Given the growth of U.S. investments and exports, it's hard to make the case that U.S. companies can't compete. Companies that believe strongly in integrity and transparency build credibility and reputations of excellence that ultimately attract new business worldwide. They also attract the top talent."

Skol points to another effect. "Bids by U.S. firms carry a higher value, as the FCPA prohibits siphoning resources into kickbacks. Companies that pay bribes—an open-ended cost—either deliver less or profit less."

Hershman sees business potential in anti-corruption activities, in that investigative and competitive-intelligence firms should profit as they are hired by companies seeking to detect bribery by competitors. Skol anticipates a boon to ethics officers, auditors, and others practiced in the segment of U.S. management created in response to the FCPA. In determining punishments for FCPA violations, courts look heavily at whether the companies have serious ethics programs.

Should we be impressed by company actions that are motivated by protective lip service? "Sure, that's part of the dynamic," admits Skol. "But the net effect of the FCPA is far less bribery by U.S. companies than by their counterparts abroad. That's what law is supposed to do—change behavior. The motivation doesn't matter as long as it changes corporate behavior. Eventually, even window dressing says something of what's in the store."

Indeed, some companies aren't awaiting international laws to cultivate their own gardens of reform. According to Tony Imler, an official with Merck & Co. Inc., in 1995 his company "informally decided to adopt corruption issues as a major focus in the ensuing decade, just as it had previously focused on intellectual property protection." The Merck Company Foundation supported the Ethics Resource Center, a Washington nonprofit, in developing an ethics center in the United Arab Emirates that assists the government and private sector.

Although business leaders opposed to corruption are certainly welcome, Marcuss has a caution. "It's easy for senior management to say they oppose bribery. The pressure is on the lower level, the guys who have to make the quotas, to bring in business to keep their jobs. The proof of company sincerity depends on how the senior-level statements filter down through the ranks, and on the internal control systems that are put in place." In other words, put your money where your mouth is—and keep it out of the greasy palms. ■

Who's Signed the Treaty

If five of the top 10 exporting nations, representing at least 60 percent of the 10's total exports, have ratified the treaty by Dec. 31, it becomes law, and does so with a symbolic show of force. If not, it still becomes law thereafter when any two countries ratify it, for them and for any subsequent ratifying countries. Once the OECD countries ratify, they will have jurisdiction over nearly all major international companies—the supply side of bribery.

Member-country signatories to the OECD Treaty: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. Non-member signatories: Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic.