PSIRU **Public Services International Research Unit**
www.psiru.org
University of Greenwich
School of Computing and Mathematical Sciences
30 Park Row Greenwich London SE10 9LS UK
Email: psiru@psiru.org Fax: +44(0)181-852-6259 Tel: +44(0)181- 852-6371
Director: David Hall Researchers: Steve Davies, Emanuele Lobina, Kate Bayliss

PSIRU Reports Report number: 9909-U-U-Corrup.doc

Privatisation, multinationals, and corruption

Author(s): David Hall

Date: July 1999

Commissioned by:

Funded:

Presented at:

Published: in Development in Practice Volume 9, Number 5 November 1999).

Notes:

The PSIRU was set up in 1998 to carry out empirical research into privatisation, public services, and globalisation. It is part of Greenwich University's School of Computing and Mathematics. PSIRU's research is centered around the maintenance of an extensive and regularly updated database of information on the economic, political, financial, social and technical experience with privatisations of public services worldwide.

This core database is finananced by Public Services International (PSI), the worldwide confederation of public service trade unions.

© This report is copyright Development in Practice. It is published on the PSIRU website with permission of the publishers.

Privatisation, multinationals, and corruption....1

Abstract....4

. 1 Corruption, contracting-out, and privatisation 5

. 2 Corruption and privatisation in Europe....6
. A United Kingdom....6
1. Contracting and privatisation: 6
2. Systematic: 'bribe-recovery' agents:....7
3. Government minister as broker:....7
. B France: delegated management and bribery....8
. C Other European countries and the EU....8
. D Weak sanctions: brief bans in Germany and the UK....9
. E Private sector problems with contracting....10

. 3 Institutional initiatives from OECD countries....10
. A Transparency International....10
. B OECD....11
. C World Bank....12
4. The privatisation problem....13
5. The auditors on trial: the case of SGS....13
. D Governments, embassies, chambers of commerce....14
6. Representing the investors....14
7. Official channels of corrupt payments....15
8. Resisting anti-corruption measures....15
. E Multinationals and judges: 'terrorists in robes'....16

. 4 Whose interests? three case studies....17
. A Uganda: AES, Norpak hydroelectric schemes....17
. B Jakarta: water concessions....18
. C Indonesia: the electricity contracts....19
. D Pakistan: Hubco....19

. 5 Effective responses....21
. A Economic deterrents: banning and penalties....21
. B Democratic transparency....21
. C Resistance to privatisation and the public sector option:....22

Notes....22

References....23

Table 1: Corruption convictions and admissions involving multinationals....24

Abstract

Recent initiatives from the OECD, the World Bank, and others on the subject of corruption have received widespread attention. However, the author argues that the incidence of corruption is closely connected with contracting-out, concessions, and privatisation, where multinationals based in OECD countries stand to gain profitable business. The encouragement of privatisation by the World Bank, and the economic benefit to OECD multinationals from this business, mean that action against corruption needs to involve effective sanctions by developing countries against multinationals which engage in corrupt practices; greater political transparency to remove the secrecy under which corruption flourishes; and resistance to the uncritical extension of privatisation. This article looks at empirical evidence on this subject.

. 1 Corruption, contracting-out, and privatisation

Recent initiatives from the OECD and others on the subject of corruption have received widespread attention. These initiatives, and the attendant publicity, have centred on developing countries rather than on corruption in the industrialised nations. However, the incidence of large-scale corruption is closely connected with contracting-out, concessions, and privatisation, where multinationals based in OECD countries stand to gain a lot of profitable business. The encouragement of privatisation by the World Bank, and the economic benefit to OECD multinationals from this business, mean that effective action against corruption has to involve effective sanctions by developing countries against multinationals which engage in corrupt practices; greater political transparency to remove the secrecy under which corruption flourishes; and resistance to the uncritical extension of privatisation. This article looks at empirical evidence on this subject.(1)

Corruption takes many different forms, from the routine cases of bribery or petty abuse of power that is said to 'oil the system', through to the amassing of spectacular personal wealth whether through embezzlement or through other dishonest means. In the lives of poor people, corruption may permeate almost every area of their lives - it may determine whether they get access to a school place for their children, whether the clinic nurse will find (and use) a clean needle, or whether they get a job. Clearly, it is the poor and the marginalised who are the worst affected by the daily grind of such corruption, but who are least able to do anything in the face of it. However, the focus of this article is on corruption on a vast scale that involves multinational companies and government agencies.

Corruption happens because bribery is a method by which companies can gain higher returns: either by winning contracts or concessions which they would not otherwise have won, or by gaining contracts or concessions on more favourable, and so more profitable, terms. This makes it a serious problem for public authorities and the public. First, because it makes the service far more costly than it would be otherwise. Second, because it perverts democratic processes and rational decision-making.

The incidence of bribery does not support the common thesis that it is solely a problem of politically lax cultures, especially in developing countries. On the contrary, it is increasingly driven by the powerful economic incentives which are created by contracting-out and privatisation; it is practised by multinational companies, in OECD countries and developing countries alike, and even on their fellow multinationals. The common practice by OECD governments of passive, and in some cases active, support for their multinationals' practices is a major problem of political culture, as is that of the World Bank's evangelical pursuit of privatisation, regardless of any consequent corruption. Since actions speak louder than words, the net result is to undermine the anti-poverty and good governance agendas put forward by donor governments and multilateral

agencies, while also giving out a powerful signal to governments in developing countries about what their real priorities are.

Globalisation of corruption
Though these are not the only causes, large-scale corruption is becoming a more global problem first because of the drive for privatisation, which increases both the scale of privatisation and the incentive for corruption; and second because of the globalisation of practices by multinationals seeking greater returns. Table 1 covers several reported cases of corruption in various countries since 1990 involving a range of multinationals in construction, water, energy, waste, defence contracting, and other public utilities.

INSERT TABLE ONE ABOUT HERE - NOT LANDSCAPED.

. 2 Corruption and privatisation in Europe

It is worth starting a consideration of corruption and contracting-out in Europe, because there are more long-standing privatisation practices, and more mature systems of corruption have therefore evolved.

. A United Kingdom

One of Margaret Thatcher's ministers, Lord Young, former chair of Cable and Wireless plc, publicly claimed that:

> …when you're talking about kickbacks [bribes] you're talking about something that's illegal in this country [the UK] and that, of course, you wouldn't even dream of doing. I haven't even heard of one case in all my business life of anybody in this country doing things like that. But there are parts of the world I've been to where we all know it happens and, if you want to be in business, you have to do.(2)

But Lord Young was badly wrong. The UK has regrettably extensive experience of corruption, involving the cultures of leading institutions and the economic incentive provided by large public sector contracts being issued to the private sector. The chief of the Metropolitan Police publicly stated in 1997 that corruption was a major problem in London's police force. A number of Conservative politicians have been found guilty of improperly accepting cash from businesses - a major issue in the 1997 general election defeat of the Conservative government.

1. Contracting and privatisation:

Public sector contracts and concessions are the single greatest source of corruption in the UK which has been fuelled by government privatisation initiatives. Police estimated that in 1996 there were 130 cases of serious public sector fraud, and stated that 'the overwhelming majority of corruption cases in Britain are connected to the award of contracts. Compulsory contracting-out in local government, and the new Private Finance Initiative have produced an

explosion in the number of such deals' *(Guardian,* 3 October 1996*).* A rash of court cases from 1990 to 1996 confirm this (PSPRU 1994; PSPRU 1996). The Confederation of Construction Specialists has also said that the use of illegal payments for contracts is widespread, and a university report estimates that this costs the UK construction industry £539m *annually (H&V News*, 23 March 1996). The phenomenon is not new: the 1960s Poulson case, involving public works contracts, led to the resignation of a government minister.

2. Systematic: 'bribe-recovery' agents:

Bribery appears to be such normal practice for some UK companies that they employ investigators to recover bribes if the recipients have failed to deliver the promised 'benefit'. A 1996 BBC radio programme included an interview with a man who makes a living from such enforcement:

> '…DAY: Let's get an insider's view of the problems bribery causes from Vincent Carratou, formerly of the Fraud Squad and founder of the corporate investigators Carratou International.
> *CARRATOU: We investigate fraud, which includes - and mainly includes - corruption, kickbacks, where money is paid to oil wheels, to get things moving. It's what's done today I'm afraid…*
> *…*
> DAY: Carratou's investigators have a particular view of this. They don't look at bribes that work; it's their job to get back bribes that have failed to deliver.
> *CARRATOU: It sounds very peculiar that we should be called in, but we're called in where people have paid for certain things to happen, to be done, and they aren't done. So we are brought in rather than the police, or rather than officials, because they say Well wait a minute, we have paid a lot of money for something to be done and it hasn't happened. We want our money back or we want what we paid to happen to happen. It's as simple as that*'. (*Bribes*, 28 April 1996, see note 2 above)

3. Government minister as broker:

Recent reports have shown that UK multinationals routinely pay commissions to gain contracts from other governments - and at least one UK government minister has assisted them in this process. Jonathan Aitken, former Minister for Defence Procurement, was jailed for perjury in June 1999. He had lied about his visits to France and Switzerland in 1993 in order to conceal a secret meeting which involved arms contracts being obtained by UK companies as a result of paying bribes:

> Ayas negotiated secret commissions on British arms deals potentially worth millions to be paid into a Swiss bank, while Aitken, as a minister, lobbied for the arms sales to go through. Ayas, on behalf of his boss, Prince Mohammed, son of the Saudi king, entered into secret commission agreements with three leading British defence contractors at a time when Aitken was promoting the sale of the companies' weapon systems. The commissions, to be paid into an account at the Union Banque Suisse, ranged from three to 10 per cent on orders worth hundreds of millions.

> The arms contractor GEC, who also own two of the other firms involved, Marconi and VSEL, confirms to the Guardian that they signed these commission deals around the time of Aitken's secret 1993 trip. (*Guardian*, 5 March 1999)

These practices did not relate only to Saudi Arabia:

> [T]he arms giant GEC, which made secret agreements to pay commissions into a Swiss bank, confirmed that it had agreed to sign a further similar commission deal only last year, this time relating to Poland. It was to pay 10 per cent of the value of possible howitzer sales to an account controlled by Jonathan Aitken's solicitor. (*Guardian*, 6 March 1999)

. B France: delegated management and bribery

In the field of public utilities, France pioneered the system of privatisation by contracting-out or *gestion déléguée* - delegated management. But this has led to widespread corruption, reflected in recent convictions and investigations, as well as over-charging and weak control over the private companies.(3) For example, in Grenoble in 1996, a former mayor and government minister and a senior executive of Lyonnaise des Eaux (now Suez-Lyonnaise) both received prison sentences for receiving and giving bribes to award the water contract to a subsidiary of Lyonnaise des Eaux. In Angoulème, the former mayor and one-time minister was jailed for two years, with another two suspended, for taking bribes from companies bidding in public tenders, including Générale des Eaux (now Vivendi) (Reuters, 1 July 1997). Executives of Générale des Eaux were also convicted of bribing the mayor of St-Denis (Ile de Réunion) to obtain the water concession.

Suez-Lyonnaise and Vivendi, together with Bouygues, are also the largest construction companies in France and as such have been the subject of recent investigation, in a scandal described as 'an agreed system for misappropriation of public funds' (*Le Monde*, 10 December 1998). The companies ran a corrupt cartel over building work for schools in the Ile-de-France region (around Paris) between 1989 and 1996. Contracts worth FF28 billion (about US$500m) were shared out by the three groups. The system involved systematic, almost bureaucratised, political corruption: a levy of two per cent on all contracts was paid to finance all the major political parties in the region.(4) A director of one of the companies was indicted on 22 October for corruption, bribery, favouritism, and anti-competitive practices *('corruption, trafic d'influence, recel de favoritisme et pratiques anticoncurrentielles'*).(5)

. C Other European countries and the EU

The UK and France are not alone.(6) Other European countries have also seen leading politicians accept bribes from major companies - for example Austria, Belgium, Spain, and Italy. In Germany, according to the district auditor for Hesse, there is an 'established system of illegal acquirement and excessive allowances for public contracts' (*Süddeutsche Zeitung*, translated in the

Guardian 23 February 1995). And in 1999 the entire European Commission (EC), the highest political body in the EU, resigned because they had lost the confidence of politicians and public as a result of corruption scandals. One central case involved the security contract for all the EU's buildings in Brussels, including the Commission's headquarters, which was held by a private contractor, Group 4 Securitas. According to press reports, the contract 'was apparently obtained by the above-mentioned firm in an irregular manner, as it had prior knowledge of the bids made by rival firms so that it could adjust its own bid' (*Agence Europe,* 21 August 1997).

. D Weak sanctions: brief bans in Germany and the UK

The scale of the problems in Europe are not always matched by strong action against the firms involved. Despite the prison sentences imposed in France, the companies in question still hold concessions covering over two-thirds of the water industry, although some local authorities have taken the opportunity to insist on 'savage' renegotiations of these contracts.

In Hesse, in Germany, the local authority took corruption seriously enough to apply bans, but only for six months. The auditor argued that it should go even further:

> Bribes do not flow of their own accord. Corruption begins in the chief executive office's in the private sector, and there is a stronger measure to fight it than legal prosecution. Corrupt companies shouldn't get any more public contracts. In the state of Hesse, 60 companies and consultant's offices are currently banned - although the six-month ban is still far too short. So far, the state has concentrated far too much on those who are corrupt. And too little on those who try to corrupt others. (*Süddeutsche Zeitung*, translated in the *Guardian* 23 February 1995)

In the UK, three firms that were named in court in 1993 as paying £1.5million in bribes to a Ministry of Defence official remained on the government's list of approved tenderers *(The Times,* 20 November 1995).

The EU's directives on public procurement provide every public authority in Europe with the power to exclude a company from bidding from any contract if it is known to have engaged in corrupt behaviour. The Directive on Public Service contracts (EC 92/50) states that:

> Any service provider may be excluded from participation in a contract who: … (c) has been convicted of an offence concerning his professional conduct by a judgement which has the force of *res judicata*; (d) has been guilty of grave professional misconduct proven by any means which the contracting authorities can justify… (Article 29)

There is little evidence, however, that this provision is much used by public authorities.

. E Private sector problems with contracting

The private sector faces similar problems with corruption by contractors, especially with infrastructure projects. For instance, the German car manufacturer Volkswagen has uncovered systematic bribery by firms seeking lucrative construction contracts with the company. The head of purchasing at Chrysler identifies big, one-off contracts as the worst problem: '"The risk is always greatest with things which are non-repetitive," he says. "One-off projects do not offer the chance to make comparisons, especially on a regular basis"'. (*Financial Times,* 12 June 1997)

The company is also seeking to deal with its own executives' behaviour in a way familiar to government services around the world:

> General Motors shocked its staff and suppliers with a draconian new code of ethics…. Employees were forbidden from accepting hospitality of all but the most mundane nature, and from accepting gifts. Even an invitation from a supplier to play golf was considered potentially compromising. (*Financial Times*, 12 June 1997)

The oil industry has experienced the same problems with firms seeking big contracts offering bribes to UK oil company executives in the early 1990s. Police investigations uncovered a network of multinationals behind the bribes:

> The trail led to a series of firms including Thyssen, Mannesmann, Sulzer and giant Japanese trading houses Itochu and Marubeni. An Itochu employee was subsequently cleared of conspiracy despite admitting the charges. It was common practice at Itochu and other Japanese firms to pay middlemen to gain a contract edge, the court heard, and the employee, Shigeki Furatate, only inherited established practice. The trial meanwhile of a Marubeni executive was cancelled after he skipped bail and fled to Japan. One of the largest contracts was a £33.5m one for the replacement of BP's Forties export pipeline, which Thyssen's steelmaking subsidiary Thyssen Stahl Union won after allegedly paying £1.4m of commissions. (*Independent on Sunday*, 4 August 1996)

Unlike public authorities, the oil companies have no compunction about taking punitive legal action against the bribe-givers. In the UK, BP is suing individuals and multinationals, including Thyssen and the Swiss company Sulzer, for compensatory and exemplary damages resulting from these bribes. BP say that they are doing this for two reasons: '"First, to recover money which we believe we have lost and also to deliver a message that we are not prepared to allow illegal information brokers to intervene in our business. They subvert what is considered to be the fairest way of doing business, through sealed bids", said the BP spokesman' (*Lloyds List*, 26 August 1996).

. 3 Institutional initiatives from OECD countries

. A Transparency International

Transparency International (TI) was set up with company and government backing to campaign against corruption. This has had the welcome effect of

making discussion of corruption more possible, but there are serious limitations to their approach.

The greatest problem is that in effect TI focuses largely on the 'passive' corruption of government officials who accept bribes, rather than the 'active' corruption of the corporations who pay them. This is reinforced by two factors: first, multinationals have a propensity to use legal action against any statement which could harm their business interests, but politicians rarely do so; second, TI is bound to find it hard to criticise its own supporters in public.

TI produces a league table of countries that are perceived as corrupt by business executives, which is widely publicised. This has been the subject of bitter criticism for being 'unjustly biased against developing countries' in the words of TI's own newsletter (*TI Newsletter*, December 1998). The same newsletter said TI would examine producing a 'bribery' index , but there has been no mention of this since.

TI does not deal with the fact that the growth of privatisation creates far greater incentive for corruption. These problems are well illustrated in its March 1999 newsletter (the latest at the time of writing). Under the heading 'Corporate News', it reports three cases of companies' ethical policies, and the only case where a multinational's behaviour has already been exposed by the US congress. It apparently did not notice the reports in the French press of systematic corrupt cartels operated by three multinationals, for example.(7)

The section 'Corruption News', by contrast, consists of a series of items arranged by country, including the most tenuous allegations against politicians (such as a précis of an article in an Egyptian newspaper, which accuses South Africa's then president-elect Thabo Mbeki of being soft on corruption, with no substantiating evidence, is reported prominently under the headline 'South Africa: Mbeki protects allies'). Public sector companies accused of corruption are named, as in a report on Japan; multinationals, however, are not. For instance, the newsletter fails to mention that the largest quoted company in Pakistan, partly-owned by the multinational National Power, faces prosecution for corruption – something frequently reported even by the *Financial Times* (22 February 1999) - but does report relatively minor cases of passive corruption by public officials.

. B OECD

In 1998 the OECD agreed a Convention on Combating Bribery in International Business Transactions. This initiative has been widely publicised and some countries have begun to change their laws as a result. Like the TI initiatives, it has undoubtedly helped to focus attention on the problem.

The OECD initiative is essentially an attempt to generalise the USA's Foreign Corrupt Practices Act (FCPA), under which it is an offence in the USA for a company to engage in bribing officials of a foreign government. This was perceived as having put US companies at a commercial disadvantage, as their

European competitors have no such legislation to deter them from using bribery to obtain business. US companies figure disproportionately little in corruption reports, and, as a routine legal precaution, also research the international practices of potential partner companies. As a result, the US government and business community have taken a forceful lead in pressing the OECD, the World Bank, and the EU to apply a similar regime to other companies.

It is too early to see any hard results from the Convention's adoption and any consequent changes to national laws. However, its origins, as a measure designed to 'equalise' competition among OECD-based multinationals, suggest that OECD governments do not routinely enforce laws against their own multinationals, if they perceive there is a commercial disadvantage in doing so. The value of these new stronger provisions must depend therefore on initiatives from the countries in which the offence takes place. And the practical response of OECD governments to such initiatives has been less than enthusiastic, as the cases below illustrate.

. C World Bank

The World Bank acknowledges that corruption exists and that it aims to curb it. The Bank's president, James Wolfensohn told the Annual Meeting in October 1996 that:

> … we will support *international* efforts to fight corruption and to establish voluntary standards of behavior for corporations and investors in the industrialised world. The Bank Group *cannot* intervene in the political affairs of our member countries. But we can give advice, encouragement and support to governments that wish to fight corruption and it is these governments that will, over time, attract the larger volume of investment. Let me emphasise that the Bank Group will not tolerate corruption in the programs that we support; and we are taking steps to ensure that our own activities continue to meet the highest standards of probity. (Wolfensohn's address to World Bank Annual Meeting, October 1996)

A year later, he repeated the message: 'My bottom line on corruption is simple: if a government is unwilling to take action despite the fact that the country's development objectives are undermined by corruption, then the Bank Group must curtail its level of support to that country.' (Wolfensohn's address to World Bank Annual Meeting September 1997)

Like TI, the Bank's approach is unbalanced. For corporations, the Bank seeks 'voluntary standards of behaviour' while for the countries where corruption occurs, it 'must curtail its level of support'. In practice, the World Bank had imposed sanctions on only seven small companies by June 1999. Its own appointed auditor SGS has been convicted of corruption (see below). Moreover, the Bank's policy of encouraging privatisation is also creating greater incentives for corruption.

4. The privatisation problem

The growth of privatisation itself, encouraged by the World Bank and others, places far more lucrative contracts and concessions on offer - and so companies have more frequent, and greater, incentives to offer bribes. The Bank is aware of this. A discussion paper points out that:

> *...the privatization process itself can create corrupt* incentives. A firm may pay to be included in the list of qualified bidders or to restrict their number. It may pay to obtain a low assessment of the public property to be leased or sold off, or to be favored in the selection process ...firms that make payoffs may expect not only to win the contract or the privatization auction, but also to obtain inefficient subsidies, monopoly benefits, and regulatory laxness in the future. (Rose-Ackerman 1996)

Yet the Bank is sponsoring and encouraging privatisation and public-private joint ventures by providing guarantees for projects, especially infrastructure projects, which may be extremely valuable to the companies concerned. As we have seen, it is not uncommon for companies to offer bribes to obtain these contracts and concessions.

The Bank's position is even more contradictory in projects where it partners with companies which have been convicted of corruption. One example is Aguas Argentinas, where the Bank, through its International Finance Corporation (IFC), is an equity partner alongside Lyonnaise des Eaux and Générale des Eaux, both of which have had executives convicted of bribing French public officials to win contracts (see Table 1). The same incentives for corruption exist with smaller contracts. The Bank itself finances about 30,000 such contracts each year, and states that '[t]he US$2 billion of that which goes on consultancy contracts for banks, accountants and others is among the most open to abuse.' *(Euromoney,* 30 September 1996)

5. The auditors on trial: the case of SGS

The World Bank's chosen corruption investigator was itself convicted of paying bribes - in one of the countries it had been asked to investigate.

In September 1996, the World Bank announced a number of 'spot audits' in selected countries, to try to uncover any corruption that might have been involved in Bank-sponsored projects:

> A June memo from Bank President James Wolfensohn announced that henceforth there would be spot audits of countries' programmes ... 'We want to put the fear of God in them', says Raghavan Srinivasan, the Bank's chief procurement adviser. The World Bank would not carry out these audits themselves, however: Wolfensohn had already selected a private company to do the job: 'he had hired the independent accounting firm of Société Générale de Surveillance (SGS) of Switzerland to handle the first set of audits. The three countries announced after the memo was circulated were Poland, Kenya and, most recently, Pakistan'. (*Euromoney,* 30 September 1997)

A month later, it emerged that SGS had paid bribes in 1992 to obtain a government contract for inspection services in Pakistan. SGS admitted the payment:

> SGS, the world's biggest inspection and testing company, has admitted that it paid a substantial commission to a Geneva lawyer to enable it to start up a pre-shipment inspection programme for the government of Pakistan. The admission came ahead of today's meeting of OECD ministers in Paris which is expected to sign a new convention making it a criminal offence to pay bribes to foreign officials in order to secure contracts… Jean Pierre Meau, SGS senior vice-president, told the *Financial Times* that his company had paid a 'success fee' to Jens Schlegelmilch, a Geneva-based lawyer, for 'assistance' in negotiating a pre-shipment inspection services contract with Pakistan. Mr Schlegelmilch yesterday refused to comment. (*Financial Times*, 17 December 1997)

In 1998 a Swiss judge started proceedings:

> Daniel Devaud, a Geneva judge, told Reuters news agency he was formally asking Pakistan to charge Ms Bhutto with money laundering, linked to kickbacks from two Swiss companies - Société Générale de Surveillance (SGS), the world's biggest testing and inspection company, and Cotecna, formerly a subsidiary of SGS… The same magistrate indicted three Swiss citizens, including a former senior executive of SGS, in June'. (*Financial Times*, 20 August 1998)

In April 1999, Benazir Bhutto and her husband were found guilty of accepting bribes worth US$9m from SGS, were sentenced to five years in prison, and banned from holding seats in parliament for seven years (the defendants are appealing against this judgement) (*Australian Business Intelligence*, 26 April 1999). However, the multinational escaped with no punishment. A group in Pakistan had to apply to the Lahore High Court complaining that SGS 'was still operating in the country despite the fact that the court had convicted one party as being the guilty of the corruption'; and obtained a ruling barring the government from 'allocating any business to SGS' (*Business Recorder*, 17 May 1999 and 30 May 1999).

. D Governments, embassies, chambers of commerce

6. Representing the investors

Multinational companies maintain good connections with the governments and political parties of their home country. In many cases, including the USA, France, and the UK, these are major funders of political parties. These relations reflect the role of governments as important representatives of business interests on the international scene. Governments provide this support in financial, political, and legal forms by providing export credit guarantees; by promoting their country's multinationals against others in bidding for major contracts; and by providing diplomatic and legal representation in case of problems. These interests are likely to dominate over other considerations

which are less central to the country's own interests, such as opposition to corruption, a critical approach to privatisation, or a commitment to development.

7. Official channels of corrupt payments

In some cases, governments of OECD countries act as 'official channels' for payments which could be considered corrupt. A different example of government involvement is the case of the shopping trip to Norway for Ugandan MPs (see below).

8. Resisting anti-corruption measures

One consequence of their relationships with multinationals is that OECD governments respond with marked lack of enthusiasm to anti-corruption measures if these affect their multinationals' interests.

France and Canada in Mexico: The 1997 local elections in Mexico City resulted in a landslide victory for the opposition, which had campaigned on an anti-corruption platform. The party promised to review all contracts awarded by the outgoing administration, and cancel those in which irregularities were detected. One casualty was a US$400m contract for rolling stock for the Mexico City metro, which had been awarded to a French-Canadian consortium. The response of the French and Canadian governments, at the highest possible level, showed little interest in the question of corruption:

> President Jacques Chirac of France and Jean Chretien, the Canadian prime minister, have sent strongly worded letters to Ernesto Zedillo, the Mexican president, protesting at the way a French-Canadian consortium was disqualified from a US$400m tender to provide rolling stock for the Mexico City metro… A new tender for the metro rolling stock is expected only after Cuauhtémoc Cardenas, the mayor-elect, takes office in December and appoints a new management for the Mexico City metro… In his letter to President Zedillo, Mr Chretien lamented Mexico's inadequate legal safeguards for foreign investors'. (*Financial Times*, 3 October 1997)

USA in Czech Republic: In the Czech Republic in 1998, the US embassy responded to public accusations of corruption not with encouragement to investigate but with a bland statement:

> The US embassy told CTK today that it had no information to suggest that the US computer firm EDS had bribed the former Christian Democrat (KDU-CSL) government in order to win lucrative defence contracts for the new army command information system… The embassy also said that it could not confirm claims that EDS had been warned on at least two occasions by embassy officials that it was under suspicion of corruption. (*Czech News Agency*, 24 July 1998)

Indeed, the embassy invoked the existence of the FCPA as evidence that a US company would not be corrupt:

> The embassy added that US firms operating abroad were bound by the 1977 Foreign Corrupt Practices Act, which clearly bans offering of bribes in order to win contracts. If an American firm was found guilty of offering bribes in the Czech Republic it would also have to face responsibility back home in the US, and would at least lose the right to compete for US government orders, it went on. (ibid.)

Other examples can be seen in the behaviour of the British and US governments in Pakistan and Indonesia (below).

. E Multinationals and judges: 'terrorists in robes'

The lack of enthusiasm for anti-corruption investigations echoes the readiness of the multinationals and their business associations to undermine the authority of judicial institutions when they rule against the companies' interests.

Early in 1997, for example, trade unionists and environmentalists in the Philippines brought court cases against the proposed water privatisation in Manila. Formal protests by the entire business community of OECD countries were used to insist that the courts should not rule against western business interests:

> The foreign business community in the Philippines yesterday criticised what it termed 'excessive challenges to public biddings', a reference to two privatisation contract awards which have been challenged in the courts in the past fortnight. A strongly worded 'statement of concern' issued by six chambers of commerce, including the US, Japanese, European Union and Australian-New Zealand bodies, warned of a loss of confidence in the bidding process among the international community. 'Do not change the rules after the game is played and expect to attract players for future biddings,' the statement says. 'They will go elsewhere unless the rules are clear, consistent and do not change to suit the losing bidders or other "aggrieved" parties'. (*Financial Times*, 6 February 1997)

The courts had already displeased the government with rulings which went against their privatisation policies. The reported reaction of the multinationals and their governments showed little respect for the due process of law: 'Loud complaints about "terrorists in robes" have resonated in government and business circles in the past month as the courts delivered a series of blows to investor confidence with controversial rulings against the state's privatisation programme.' (*Bangkok Post*, 14 February 1997)

This is part of a general unwillingness by multinationals to accept the authority of courts in developing countries. When the government of Maharashtra in India decided to end or renegotiate an energy deal with Enron, the company sought arbitration in London; when the province of Tucuman in Argentina terminated the water concession that had been awarded to Générale des Eaux, the company referred its dispute to the World Bank for arbitration.

. 4 Whose interests? three case studies

. A Uganda: AES, Norpak hydroelectric schemes

There are two proposals to build private hydroelectric power schemes in Uganda - one at Bugali Falls, by a consortium led by US multinational AES - and one at Owen Falls to be built by the Norwegian company Norpak. Corruption allegations have arisen in respect to both. Ugandan MPs have repeatedly refused to authorise the schemes because they believe them to be against Uganda's interests; but the World Bank's intervention has focused on providing financial support and guarantees to AES, while insisting on yet more privatisation.

Minister resigns over Bugali Falls corruption allegations: Ugandan energy minister Richard Kaijuka, the key advocate of the AES deal at Bugali Falls, resigned in April 1999 after being accused of corrupt behaviour: 'Kaijuka had pushed for the signing of a power purchase agreement in which Uganda stood to lose huge sums of money to an independent power producer' (*Business Day*, 7 April 1999). Kaijuka's resignation speech argued that ' those who were accusing him of bribe-taking in his brokering of the power purchase agreement between the American/British AES and government suffer a poverty mentality' (*Monitor*, 18 April 1999).

MPs expenses-paid trip to Norway: In April 1999, six MPs were allegedly compromised by accepting a week's trip to Norway, arranged by Norpak. The politicians denied that they had been compromised: 'Six MPs who have just returned from a one-week trip to Norway to inspect Norpak projects yesterday said they have no apologies to offer over the trip. They defended their trip saying, "We were duly nominated by Parliament Speaker, Mr. Francis Ayume, following an invitation by Norpak"' *(New Vision,* 28 April 1999). The cost of the trip was reportedly not paid by the company, but by the Norwegian state: 'The bills, that include: first class accommodation, air tickets and shopping in Norway, were reportedly paid by the Norwegian embassy' (*New Vision*, 21 April 1998).

MPs: repeated rejections of proposals: By August 1998, the proposed power purchase agreement (PPA), under which the government would underwrite a guarantee to buy the power from the project for years, had been rejected almost unanimously by MPs, who said it did not safeguard the Ugandan interests. AES insisted, however, that this was crucial. In February 1999, the director of Nile Power was reported as saying that 'AES Nile Power will not build the hydropower station at Bujagali without a government guarantee that the Uganda Electricity Board will buy the power produced there' (*New Vision*, 5 February 1999).

Ten months later, Ugandan MPs rejected another proposal to authorise a government guarantee for AES. A parliamentary committee had said that the 'government is requesting authority to guarantee UEB's obligation to make annual capacity payments varying between US$11m to US$20m during the

term of the PPA "If UEB defaults on payment, then government has to make good"' (*The Monitor*, 17 June 1999).

World Bank: finance and guarantees for AES: Throughout this period the World Bank paid no public attention to the corruption allegations, but instead used its financial power and political influence to provide financial support for the multinational, while trying to promote further privatisation. AES, meanwhile, continued to insist on guarantees and tax-breaks from the Ugandan government.

The Bugali Falls project will cost US$500m, of which AES is putting up only US$100m in equity (20 per cent). The World Bank's IFC will finance the rest (*Euromoney*, 10 March 1999). The Bank has also agreed to guarantee the scheme against political and other risks (adding that its backing was conditional on the government agreeing to privatise the Ugandan Electricity Board) (*New Vision*, 2 March 1999). This enabled AES to reduce the tariff from 4.9 cents to 4.4 cents, half of the reduction that it offered in May 1999, according to Uganda's energy minister, who said that 'AES had accepted to further reduce their generation tariff from 4.9 cents to 3.9 cents in response to concerns that its tariffs rates were too high' (*New Vision*, 18 May 1999). AES also said that they would finance community projects around Bujagali to the tune of US$1m (*The Monitor*, 21 May 1999).

At the same time, however, AES asked for prompt reimbursement of its value added tax (VAT) claims by the Ugandan Revenue Authority (URA). The Minister of Energy told MPs that any delays in reimbursing VAT claims were likely to affect the project: 'The total VAT expected from AES is US$60m and if URA does not remit this money promptly then the company is likely to be crippled. These people have made many concessions and I think we should also listen to them' (*New Vision*, 18 May 1999).

. B Jakarta: water concessions

In 1997, while Jakarta was still under the control of president Suharto, its water supply was privatised, under the auspices of the World Bank. One concession went to a consortium led by Thames Water (UK), another to a consortium led by Lyonnaise des Eaux (France). Both consortia included partners which were owned by friends of the president. After Suharto's fall, even the consortia accepted that these concessions were no longer defensible. The multinationals moved rapidly with new 'clean' companies to negotiate new contracts with Jakarta City Council, to run from February 1999.

But these contracts have been subject to bitter criticism on the grounds that they were never properly advertised, that the prices contained in them are excessive, and that Suharto's son continued to hold five per cent equity in the new Thames Water venture. Court action has been taken to have the contracts declared void, and a trade union of water workers has demanded that the contracts be rescinded (*Asia Pulse*, 29 April 1999).

The original concession awards under the Suharto regime had been made under the auspices of a World Bank-supported tendering procedure, yet the Bank has made no public statement calling for investigation of the alleged corruption. On the contrary, three weeks before the June 1999 general election, it announced new loans of US$400m-US$300m for the water sector. Following criticism in Indonesia and Washington that '[i]t will be just the same as though the World Bank gives campaign funds to Golkar', Suharto's party, the Bank suspended the loans until after the election (*Jakarta Post*, 20 May 1999).

. C Indonesia: the electricity contracts

A similar problem exists in electricity, where independent power projects (IPPs) were agreed under the Suharto regime with a number of multinationals - invariably in partnership with companies connected with Suharto. The projects included guarantees by the public electricity authority, Perusuhan Listrik Negara (PLN) to buy the electricity produced by the IPPs. But PLN cannot afford to pay the prices written into the contracts, and has insisted on renegotiation:

> PLN has argued that most of the prices were marked up by the Suharto government in return for equity given to well-connected Indonesians, including the president's children. 'They got away with murder', a PLN adviser said. 'The penny will eventually drop that we are now talking of a new environment. There is no sense in saying "We signed these contracts in good faith"'. (*Financial Times*, 30 June 1999)

Despite the fact that many of the multinationals are from the USA, no investigation has been launched by the US authorities under the FCPA. On the contrary, US companies and agencies - including the US Export-Import bank - 'have insisted that their contracts are sacred, and some have gone to court... MidAmerican Energy has launched a precedent-setting suit against the government, which signed a letter of support for each power project, that MidAmerican takes to be a sovereign guarantee' *(Financial Times*, 30 June 1999). The possibility of corruption in these contracts has not been seen by OECD governments as their key concern. Rather, it is the threat to the contracts of their multinationals: 'Western diplomats argued that Indonesia needed a speedy resolution because export credit agencies would not be able to lend as long as they are facing defaults on projects', and an issue of investor confidence since the process 'is turning into a long and bitter court battle that could block future project loans to Jakarta' (*Financial Times*, 30 June 1999).

Once again, OECD countries are not offering support for investigations into the possibility of corruption involving their own multinationals - but they *are* supporting action to insist on these multinationals continuing to reap the economic benefit of these same contracts.

. D Pakistan: Hubco

The government of Pakistan has been pursuing cases of alleged bribery of members of the previous regime, especially in energy. Two contracts - one

involving Southern Company (USA) (reported in the *South China Morning Post*, 7 July 1997), and one involving National Grid (UK) (*Financial Times*, 24 April 1997) were cancelled on the grounds that they had been improperly obtained. The government has also taken proceedings against existing contracts, investigating alleged corruption, and stating that it would cut the price of electricity agreed under these contracts. The main target of these investigations was Hubco, the largest stock exchange quoted company in Pakistan, which is 26 per cent owned by National Power, a UK energy multinational.

World Bank: no loan unless contracts left alone: When the Pakistan government insisted that power tariffs should be reduced because of the evidence that corruption had led to inflated prices, this 'drew anxious reactions from many, including the World Bank. Senior government officials say the Bank has urged Pakistan to keep its so-called investigations into alleged corruption in Hubco's contract separate from the future of the company's tariff… The future of an International Monetary Fund agreement, currently under negotiation in Islamabad, is also partly tied to the extent to which Pakistan resolves its dispute with the power companies' (*Financial Times*, 18 November 1998). At the end of 1998, the Bank authorised the IMF to proceed with a US$1.3 billion bailout package for Pakistan, 'as it was satisfied with the government assurances for out of court settlement of two-year long row with the Independent Power Producers' *(The Nation*, 31 December 1998).

These positions have been criticised. S. H. Tehsin argued that '[i]t is strange that after having failed to help curb the practice of over-invoicing for kick-backs, the same institutions are always ready to support the culprits with alacrity if someone else unravels the corruption or makes allegations 'thereof' (*Business Recorder*, 4 December 1998). Dr Jassim Taqui held that the World Bank and IMF were making unacceptable demands, and that contracts should not be honoured if they were corruptly obtained : 'under no circumstances should the government succumb to the unjust conditionalities of the IMF and the World Bank that the contracts of IPPs would be honoured on the plea that the government gave them "sovereign guarantees". The fact of the matter is that no international law has ever permitted "sovereign guarantees" for contracts obtained through corrupt means' (*The Nation,* Pakistan, 26 April 1999).

UK government: At no stage does the UK government appear to have supported the Pakistan government's decision to prosecute Hubco for corruption. The company's chief executive is now living in the 'safe haven' of Cheshire, having 'fled Pakistan following threats that he might be arrested' *(Financial Times,* 27 October 1998*).*

The British and other governments actively supported the World Bank's position: 'Britain and the G7 group of countries are said to be exerting pressure on the international lending agencies to get the Kapco and Hubco impasse resolved before rewarding Pakistan with financial help' *(The Nation,* 30 December 1998*).* In February 1999, a UK government minister emphasised

that the action against Hubco was a step backwards for 'investor confidence', rather than a step forward in the fight against corruption: 'Minister of State for Foreign and Commonwealth Affairs Derek Fatchett told a news conference in Karachi that the longer the row continued the more it would damage Pakistan's prospects for attracting foreign investment. "Let me say this is an issue in my opinion that has gone on for much too long. It is an issue that needs to be resolved. It is an issue that is damaging investor confidence in Pakistan," he said at the end of a three-day trip' (Reuters, 10 February 1999).

. 5 Effective responses

These experiences lead to some clear conclusions. The OECD Convention is welcome in that it may reduce the propensity of multinationals to compete by bribery. Nevertheless OECD countries do not, and cannot realistically be expected to, take the lead in applying sanctions against their own multinationals for winning contracts corruptly.

Similarly, the World Bank's statements against corruption, and such sanctions as it has taken, are also welcome, as they can only increase the risks associated with acting corruptly in Bank contracts. However, it appears that the Bank's encouragement of privatisation is given far greater priority than acting against the corruption which has been stimulated by this very policy.

The most effective actions are thus those initiated in developing and OECD countries themselves. They include three elements:

- economic deterrents
- democratic transparency
- resistance to privatisation

. A Economic deterrents: banning and penalties

***Singapore - bans*:** Singapore has adopted tough policies on companies involved with bribery. In 1996 a middleman was convicted of paying bribes totalling US$9.8m, paid for by his multinational clients. The government reacted by banning all five companies - Siemens, Pirelli, BICC, Tomen, and Marubeni - from bidding for any government contracts for five years: 'The ban applies to all government projects. Firms associated with the five companies, any new company that the firms may jointly set up, and firms that share the same directors as the five are also debarred' *(Reuters*, 16 February 1996).

. B Democratic transparency

***Thailand*:** Thailand's electricity privatisation programme now has to convince local people to get approval. In 1997 Thailand passed a new constitution, of which a principle is decentralisation and local participation. Big development projects are subject to public hearings, and elected local councils must give their consent. This places the emphasis on transparency and accountability.

Kerala: The 'people's plan' of the Left Democratic Front Government in Kerala has been praised even by the World Bank: 'Kerala's decentralisation programme is probably the largest of its kind in the world. Three million people (ten per cent of the state's population) take part in meetings. This is a far-reaching, innovative and courageous new approach to rural development' (*The Hindu*, 24 May 1999). This unique programme to strengthen decentralisation has become an integral part of people's lives in 990 village panchayats, 152 block panchayats, 14 district panchayats, 55 municipalities, and three corporations. Decentralisation alone is not enough, however:

> Total transparency is the only way to check the danger of decentralisation degenerating into decentralisation of corruption. All documents on beneficiary selection, reports and minutes of meetings and all documents on works undertaken by the local bodies through contractors and beneficiary committees including bills and vouchers are public documents. Copies are available on payment of a fee. Essential facts about any public work are exhibited in simple language at the work site. (*The Hindu*, 24 May 1999)

. C Resistance to privatisation and the public sector option:

It is a well-established principle that a public sector provision of a given service is an effective way of removing the economic incentive for corruption. This was a key part of the original rationale for placing services under municipal or national control. Successful opposition to privatisation in a number of countries - for example, the rejection of water privatisation plans in Panama and Brazil - is one way to remove a potential source of corruption.

Where work is put out to tender, it remains critical to ensure that there is always an 'in-house bid' from the public sector, to set against any private contractors' bids, something that the UK Office of Fair Trading recommends as a key method for avoiding being cheated by a cartel (OFT 1995). It is equally effective at making it difficult for a contractor to buy a contract at an artificially inflated price. Such an option is, however, repeatedly ignored by those governments - and the World Bank - which are pursuing privatisation.

Notes

1 This paper is based on a number of years of research by the Public Services International Research Unit (PSIRU) and the former Public Sector Privatisation Research Unit (PSPRU), principally sponsored by Public Services International (PSI). The views expressed herein are those of the author and are not to be attributed to the publishers. The PSIRU website < www.psiru.org > contains regularly updated news on all aspects of privatisation in public services, including corruption.

2 Speaking on BBC Radio 4, *Talking Politics*, in 1994; quoted from official transcript of *Bribes*, transmitted by BBC Radio 4 on 28 April 1996.

3 The French water system is critically appraised in a report by France's state auditor, the Cour des Comptes: 'La Gestion des Services Publics Locaux d'Eau et Assainissement' (Paris, January 1997).

4 The full political spectrum of French political parties was covered, according to the reports (*Le Monde*, 10 December 1998).

5 Jacques Durand, commercial director of the Vivendi construction company GTM (*Le Monde*, 10 December 1998).

6 Recent books indicating the prevalence of the problem include Robert 1996 and Rugemer 1996.

7 'Un système d'entente mis au jour dans l'affaire des lycées d'Ile-de-France' (*Le Monde*, 10 December 1998).

References

Cour des Comptes (1997) 'La Gestion des Services Publics Locaux d'Eau et Assainissement', Paris: Cours des Comptes.

The Office of Fair Trading (1995) *Cartels, Detection and Remedies*, London: OFT.

Public Services Privatisation Research Unit (1994) *Private Corruption of Public Services*, London: PSPRU.

Public Services Privatisation Research Unit (1996) *The Privatisation Network*, London: PSPRU

Robert, Denis (1996) *Pendant les Affaires, les Affaires Continuent*, Paris: Stock.

Rose-Ackerman, Susan (1996) *The Political Economy of Corruption: Causes and Consequences*, World Bank Public Policy for the Private Sector Note No. 74, Washington DC: The World Bank.

Rugemer, Werner (1996) *Wirtschaften ohne Korruption?*, Frankfurt: S. Fischer Verlag.

The author

David Hall is Director of the Public Services International Research Unit (PSIRU) which is based at the University of Greenwich in London. The PSIRU maintains a large database on privatisation, including reports of corruption associated with privatisation. Contact details: PSIRU, 9 Eliot Hill, London SE13 7EB, UK. Fax: +44 (0)20 8852 6259. E-mail: <psiru@psiru.org>

Table 1: Corruption convictions and admissions involving multinationals

Year	Country	Company	Sector	Details	Source
1999	Pakistan	SGS	Inspection services	Former prime minister of Pakistan convicted of receiving bribes worth US$9m from SGS subsidiaries for inspection contract.	*ABIX 26.04.9*
1999	UK	GEC	Defence	GEC admit paying commissions for arms contracts from two countries.	*Guardia 5.03.99 6.03.99*
1998	Belgium	Agusta, Dassault	Defence	Willy Claes, former Nato secretary-general, given a suspended three-year prison sentence yesterday after being found guilty of accepting bribes totalling more than £2 million paid by the Italian helicopter manufacturer Agusta and the French firm Dassault to secure contracts to supply the Belgian armed forces in the 1980s.	*Guardia 24.12.9*
1997	Europe	Group 4 Securitas	Security	European Commission admits that Group 4 obtained BFr600m security contract for Brussels EU buildings in an irregular manner.	*Agence Europe 21.8.97*
1997	USA	SmithKline Beecham	Healthcare	SmithKline paid US$325m damages to US government insurers Medicare and Medicaid for overcharging between 1989 and 1995. Private insurers also sue alleging corruption.	*Indepen 22.8.97*
1996	Singapore	Siemens, Pirelli, BICC, Marubeni, Tomen	Utilities	Singapore's bans five multinationals from bidding for any government projects for five years after their consultant is convicted of paying bribes for utilities contracts.	*FT 16.2*
1996	France	Generale des Eaux	Water	Two Generale des Eaux executives admitted making payments to elected officials on the French island of La Reunion in return for a water deal.	*FT 10.1*
1995	France	**Lyonnaise des Eaux**	Water	Prosecuted for paying bribe to mayor of Grenoble to get water contract. Also investigated for other allegations of corruption.	*Various*
1993	Taiwan	**Brown & Root (Halliburton)**	Waste water	Seven people sentenced to prison for up to 15 years for corruption over a US$173 million waste water plant contract. Brown & Root sacked from contract, lose performance bond.	*China E News Service 27.11.9 6.4.94*