



# TRANSPARENCY INTERNATIONAL

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## **TI RECOMMENDATIONS FOR OECD WORKING GROUP AGENDA**

The OECD Working Group on Bribery in International Business Transactions is meeting in late August to consider plans for future activities. This memo provides TI's recommendations for the Working Group's agenda.

In TI's view, the Phase II monitoring program is faltering. Without a strong Phase II monitoring program there is little prospect of effective enforcement and the Convention is likely to fail. Reinvigorating Phase II should have the highest priority. However, Phase II monitoring is not enough. To assure that the Convention achieves its objective a number of other issues must also be addressed. Action on these issues is needed to close serious loopholes and to promote enforcement and compliance. These include several of the "unresolved issues" on which action has been deferred since 1997.

Section 1 of this memo assesses the current status of the Convention, accomplishments as well as shortcomings. Section 2 discusses what is required to reinvigorate the Phase II monitoring program; most importantly securing adequate funding and scheduling prompt reviews of the G-7 countries. Section 3 deals with the "unresolved issues"; assuring adequate coverage of foreign subsidiaries and of bribe payments to foreign political parties and party officials is especially critical. Section 4 discusses other steps required to promote enforcement and compliance; these include promoting increased awareness of the Convention, encouraging adoption of corporate compliance programs, cooperation with developing countries, and programs to assist companies to avoid extortion by foreign officials. Section 5 comments on accession of other states; this should be deferred until the present signatories are enforcing the Convention.

The challenge facing the Working Group will be to make realistic decisions regarding priorities and timing and determining what steps should be taken to secure the required resources.

### **1. Assessment of Current Status of Convention**

The adoption of the OECD Convention in December of 1997 was widely hailed as a watershed event in the fight against international corruption. Because the signatories include the world's leading exporting states, their commitment to stop bribery of foreign public officials raised hope for a quantum reduction of the supply side of international corruption.

After almost five years, that hope remains unfulfilled. Even though almost all of the signatories have ratified the Convention and enacted implementing legislation, there has been

little or no enforcement, outside the US.<sup>1</sup> TI's 2002 Bribers Payers Index (BPI) indicates that business communities in 15 major emerging market countries are barely aware of the Convention and that foreign bribery remains widespread.

The lack of awareness revealed by the BPI is serious because businessmen do not obey prohibitions of which they are unaware. The lack of prosecutions is doubly serious. First, bringing cases is the best remedy for lack of awareness: nothing will make companies pay attention to the Convention more quickly than effective enforcement. Second, until prosecutions are brought, there will be uncertainty whether the Convention is only a statement of good intentions, or whether exporters will really be required to stop bribing.

The Working Group deserves high marks for the way it conducted Phase I of the monitoring process. The laws enacted by over thirty countries have been reviewed to assess whether they meet the requirements of the Convention. About one-third of the laws, were found to have serious shortcomings; another third had smaller deficiencies. By sharply criticizing Japan and the UK, two of its most important members, the Working Group showed courage rarely displayed by international institutions! To their credit, the member countries, including the UK and Japan, have corrected many of the shortcomings identified by the Working Group.

The Working Group also deserves credit for welcoming civil society and private sector involvement in the monitoring process, even though some countries opposed non-governmental participation. The Working Group invited TI to make detailed presentations in 2000 and again in 2001 identifying deficiencies in national laws and practices dealing with accounting, auditing and corporate controls. TI also had the opportunity in 2001 to present the case for prohibiting bribery of foreign political parties and party officials. ICC presented its observations on bribery in the private sector in April 2002.

However, Phase II of the monitoring process, review of national enforcement programs, is off to a disappointingly slow start. Reviews were scheduled to begin in 2001, and were to be carried out at a rate of 7-8 reviews per year, with the objective of completing all 35 signatories by the end of 2005. In the first year and a half only four countries have been reviewed; and no other reviews have yet been scheduled.

The Phase II reviews that have taken place were well prepared and were conducted in a thorough and professional manner. However, these reviews made clear that Phase II reviews require substantially greater resources than were required for Phase I. With existing funding only two or three reviews per year can be conducted. At that rate it would take 12-15 years to review the enforcement programs of the present signatories. Until the Working Group can secure additional funding and staff, Phase II remains in jeopardy. Without effective monitoring of enforcement, the success of the Convention is imperiled.

## **2. Reinvigorating Phase II Monitoring Process**

In TI's view, lack of enforcement demonstrates lack of political commitment by member governments. Failure to provide adequate funding for Phase II monitoring suggests unwillingness to permit exposure of inadequate enforcement.

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<sup>1</sup> There have been more than a dozen enforcement cases in the US since it ratified the Convention in 1998. Canada has brought one case. No other country has brought a case.

TI recognizes that effective enforcement of the Convention depends on consistent multilateral action. Governments are reluctant to prosecute their own companies for foreign bribery until they are assured that other governments will prosecute their principal competitors. To overcome reluctance to prosecute a vigorous program of Phase II reviews is required. Reviewing only two or three countries per year is clearly insufficient to develop momentum for enforcement. The Working Group's original goal of scheduling 7-8 reviews annually was sound and should be reaffirmed.

Because enforcement by the largest exporters is most important for reciprocal assurance, reviews of all remaining G-7 countries should be scheduled in the next twelve months. Announcing a schedule of reviews will provide impetus for enforcement because countries want to avoid criticism for lack of enforcement. In Phase I, the combination of peer pressure and public embarrassment resulted in the enactment of strong laws. Phase II reviews can bring the same forces into play to assure that these laws are enforced.

Increased funding and staffing are needed to reinvigorate Phase II and achieve the goal of 7-8 reviews per year. We understand that the cost of Phase II reviews is in the range of \$120,000-140,000 per review. Thus, for \$1 million per year the enforcement programs of all signatories can be reviewed in the next five years. This is a modest cost to assure that one of OECD's most successful initiatives of the past decade achieves its objectives. It represents only 0.5% of OECD's annual budget of \$200 million. TI is convinced that a vigorous Phase II monitoring program would result in large reductions in the supply side of foreign bribery, which has been estimated to amount to tens of billions of dollars per year. The multiplier effect of expenditures for Phase II monitoring would be enormous!

We understand that the regular budget of the Working Group on Bribery is around \$500,000 per year, supplemented by modest voluntary contributions from a few countries. To place the Working Group's budget in perspective, the annual budget of the Council of Europe's GRECO program is about \$1.5 million. The annual budget for the Programme against Corruption of the UN's Vienna Office for Drug Control and Crime Prevention is also in the \$1.5M range. TI has endorsed both of these programs, and has participated in their work. We believe that raising the budget of the Working Group to the same level is amply justified.

TI has long regarded the OECD Convention as the single most promising anti-corruption initiative in the world. With an effective Phase II monitoring program, the Convention can produce impressive near-term results by substantially reducing the supply side of foreign bribery. This would be a triumph for the OECD. It would also strengthen support for other multilateral programs to combat corruption.

The additional funds needed to reinvigorate Phase II could be provided by increasing the Working Group's regular budget, or by special contributions from member countries earmarked for Phase II. We suggest that, in the interest of avoiding further delays, the G-7 countries agree to make special contributions to provide the \$1 million per year needed for the next five years. The alternative of increasing the Working Group's regular budget will almost certainly become ensnared in protracted disputes over which other OECD programs should have their funding reduced to provide the additional funds for Phase II.

While adequate funding is the most critical issue, it is important that Phase II reviews provide for adequate private sector and civil society participation, as was done in the reviews performed in the past year. Detailed attention must be given not only to law enforcement

programs, but also to corporate compliance programs and to accounting and auditing practices. The Convention cannot achieve its objectives unless corporate compliance programs are widely adopted by the business community. Reviewers cannot assess the adequacy of government enforcement programs without determining the level of corporate compliance: low levels of compliance clearly require increased enforcement. Direct interactions between the reviewers and knowledgeable representatives from the private sector and civil society are essential.

TI's reports to the Working Group in 2000 and 2001 on accounting and auditing laws and practices in fifteen OECD countries documented serious deficiencies and recommended that these issues be specifically addressed in Phase II of the monitoring process. Sound accounting and auditing practices are essential for corporate compliance programs and effective law enforcement. Current corporate scandals in the US re-emphasize the urgency of strengthening accounting, auditing and corporate controls. In these areas, too direct interaction between the reviewers and experts from the private sector is needed to enable the reviewers to make realistic assessments.

TI urges OECD governments to increase participation by officials with prosecutorial experience in their delegations to the Working Group. That would increase the ability of the Working Group to deal with Phase II reviews and with other issues important to the success of the Convention discussed in this memo.

We also recommend that the Working Group arrange for public release of reports on Phase II reviews promptly after they have been adopted by the Working Group. The practice, begun during Phase I, of deferring publication until after the next Ministerial, results in delays of many months. This serves no useful purpose because Ministerial agendas are crowded with so many issues that Phase II reports will not be reviewed.

TI recognizes that adequate funding for Phase II monitoring and effective enforcement will require stronger political commitment by member governments. To that end, TI and its national chapters in OECD states will step up their efforts to promote public and political support.

### **3. Tackling Unresolved Issues**

When the Convention was adopted in 1997 a list of unresolved issues was identified for future action. Notwithstanding the need to reinvigorate Phase II monitoring, work on the unresolved issues should not be deferred any longer because they involve serious loopholes for evading the Convention's prohibitions against foreign bribery. Progress on these issues will require substantial lead times. Action plans should be developed for those issues that, if left unresolved, could undermine the success of the Convention. TI recommends action on the following:

#### Coverage of Foreign Subsidiaries

There have been widespread allegations that MNEs use bribe payments by their foreign subsidiaries to evade the Convention, and the Working Group has sent out a questionnaire to obtain information on treatment of foreign subsidiaries. Concerns about bribery by foreign subsidiaries undermine confidence in the Convention. That makes it essential that OECD take action to overcome such concerns.

The Convention, and national laws passed to implement it, may not be able to deal directly with foreign subsidiaries that do not do business in OECD states. However, parent companies based in OECD states can be required to direct their controlled subsidiaries to adopt anti-bribery compliance programs. Parent companies can also take steps to assure that such programs are enforced. Leaders of the corporate governance movement have urged MNEs to adopt and enforce consistent compliance programs for all parts of their business. The foreign subsidiary issue can be addressed without amending the Convention. The “Commentaries on the Convention” provide a practical vehicle to assure that existing provisions<sup>2</sup> are interpreted to require parent companies take reasonable steps to restrict bribery by their foreign subsidiary.

Proposals to deal with bribery by foreign subsidiaries may raise objections about disregard of “corporate separateness” and “piercing the corporate veil”. The practical validity of these concepts has been largely eroded in an age when all parts of an MNE are electronically interconnected, resulting in close communications and centralized surveillance over fund flows and numerous other matters. Lawyers are reluctant to give up traditional defenses. However CEOs and directors have learned that scandals at foreign subsidiaries damage companies’ public image and hurt stock prices. They understand that establishing effective controls is more effective than relying on antiquated legal fictions.

#### Bribery of Foreign Political Parties and Party Officials

The Convention covers bribery of foreign public officials but does not adequately cover bribery of political parties and party officials. In October 2000 TI sponsored a meeting of 28 distinguished persons from nine OECD countries that developed recommendations for OECD action. These recommendations were presented to the Working Group in February 2001.

There are compelling reasons why OECD should take action in 2003, or 2004 at the latest. Payments to political party officials, who can influence public officials, can be used to circumvent the prohibitions of the Convention. Political party corruption is a major problem around the world and there should be broad support for closing a serious loophole in the Convention.

#### Private Sector Bribery

In April 2001 the ICC presented detailed observations to the Working Group regarding bribery in the private sector. Three considerations make clear why private sector bribery should be addressed.

First, privatization and related developments have obscured the dividing line between the public sector and the private sector. That provides opportunities for evading prohibitions applying only to bribery of public officials.

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<sup>2</sup> Paragraph 1 of Article 1, dealing with bribes paid through intermediaries, and paragraph 2 of Article 1 dealing with complicity, aiding and abetting, and authorization, can readily be used as the basis for an interpretive commentary dealing with foreign subsidiaries.

Second, in a global economy, bribery within the private sector has become transnational, just as bribery of public officials has done. The ICC study indicates that commercial bribery laws in most OECD countries do not cover cross-border bribery.

Third, the private sector is substantially larger than the public sector in most industrialized and developing countries. Thus dealing only with public sector bribery leaves large areas of foreign bribery uncovered. The OECD is the most desirable forum for addressing transnational private sector bribery because the member states are the home bases for most major international companies.

#### **4. Other Steps to Promote Enforcement and Compliance**

The Working Group should also plan action on the following other steps which would contribute to enforcement and compliance with the Convention. These steps can be taken in cooperation with other organizations and governments and would not require substantial Working Group resources.

##### Promoting Awareness of Convention

The Working Group should encourage the development of communications programs designed to overcome the lack of awareness of the Convention revealed by Phase II reviews and by TI's 2002 Bribe Payers Index. Such programs should enlist the cooperation of member governments, as well as BIAC, TUAC, ICC, and TI. Communications programs are needed in both OECD and non-OECD countries and should be directed to the business community as well as to government officials responsible for procurement, customs, export credits and other programs involved with international trade. Diplomatic posts of OECD countries should be able to make a real contribution by assisting with communications programs in non-OECD countries and there would be significant advantages in cooperation among these diplomatic posts in each country. (See also below re: joint working groups in developing countries.)

##### Promoting Corporate Compliance Programs

The Convention will be successful only if the majority of companies comply voluntarily with its prohibition against foreign bribery. Enforcement programs can then deal with a manageable number of violators. OECD should consult with organizations promoting corporate compliance programs, including TI and ICC, as well as with BIAC and TUAC, on steps to encourage wider adoption of compliance programs. In addition to generic efforts such as the ICC Rules and TI's Business Principles, compliance initiatives for specific industries, as well as TI's Integrity Pacts, should be encouraged.

OECD can also encourage wider adoption of corporate compliance programs by encouraging international financing institutions and export credit agencies to condition financing and export credit on assurance that effective compliance programs are in place.

##### Cooperation with Developing Countries

The Working Group should promote the establishment of joint working groups in developing countries to assist in reducing foreign bribery. Such working groups should include representatives of local government bodies, representatives from OECD states stationed in the

country, and representatives from civil society and the private sector. Participation could also be sought from representative of international financing institutions active in the country.

The scope of cooperation could include procurement and customs reforms, as well as joint efforts to investigate and prosecute foreign bribery. Work on strengthening mutual legal assistance and assisting companies to resist extortion, discussed below, can also be performed under the aegis of joint working groups. TI national chapters in developing countries could assist in organizing such initiatives.

#### Strengthening Mutual Legal Assistance

Among the biggest obstacles to prosecuting foreign bribery are the difficulties encountered by prosecutors in obtaining evidence from other countries. The Convention provides for mutual legal assistance from signatory states, but does not deal with assistance from other countries where foreign bribes are paid. The joint working groups in developing countries, proposed above, could assist in establishing channels of communication between prosecutors in OECD states and in developing countries. OECD should consult with the UN and other organizations such as the African Union, OAS, and APEC to promote broader mutual legal assistance.

#### Assisting Companies to Resist Extortion

Compliance with the Convention would be encouraged by helping companies resist extortion by foreign officials. The US government has long provided help lines that US companies can use to obtain assistance from US government representatives in countries where they are pressed for bribes. The Working Group could organize a workshop where the US experience with help lines can be made available to other governments.

After other governments have established help lines, OECD could promote the establishment of a network of help lines. That would make possible multilateral intervention in countries where extortion is common. Such multilateral action would be more effective, and would be particularly helpful to companies from small countries whose diplomatic representatives may be less influential than representatives from bigger countries.

### **5. Accession by Additional States**

TI has closely followed the operation of the Working Group for almost ten years. We are convinced that the progress of the Convention is attributable to the fact that the membership of the Working Group consists largely of countries accustomed to working together on OECD programs. Because they are also major participants in international trade, their joint action can control the supply side of foreign bribery.

Even though TI, with its network of national chapters in over ninety countries, is strongly committed to combating corruption around the world, we urge that the issue of accession to the Convention be approached with caution. The effective functioning of the Working Group, particularly peer group monitoring, requires reasonable compatibility of interests and legal systems among the signatories. Increases in signatories will complicate the management of the Working Group and could aggravate the present financial problems.

While additional countries could benefit from accession to the Convention, until the Convention is functioning successfully, measured by effective enforcement by the major

trading states, accession should be restricted. For the present, consideration for accession should be limited to states that are important participants in international trade, such as China, Israel, Malaysia, and South Africa. Accession by such states would enhance the ability of the Convention to control the supply side of international corruption, and thereby facilitate compliance by the present signatories.

After the Convention has been successful in combating foreign bribery by the present signatories, a more flexible approach to accession becomes possible. At that time, it would be timely to consider how the techniques and experience developed by the Working Group can be applied to a broader group of signatories.

Even though accession should be limited for the present, OECD can significantly contribute to combating corruption in developing countries through the joint working groups recommended in Section 4 of this memo.

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