



## Getting the Focus Right: U.S. Leadership in the Fight against Global Corruption

by Dennis de Tray and Theodore Moran

The United States has played a leadership role in the fight against global corruption, and there are many reasons to be hopeful about this effort. Nonetheless, corruption continues to seriously impede development efforts around the world, and the critical task of combating it will require both long-term commitment and strong support from the next U.S. administration.

The international community has made important advances in passing international anticorruption laws, improving transparency in some industries, setting up tribunals that are increasingly rejecting the validity of contracts or permits obtained by corrupt means, and making foreign aid more transparent by increasing local accountability for outcomes. Yet corruption continues to impede the development of the private sector in many countries, legal loopholes still allow for nepotism and cronyism, publicly-backed gatekeepers continue to seek bribes in some of the world's poorest countries (setting back development as a result), and corrupt institutions have made states more vulnerable to terrorist networks and drug cartels. In short, global corruption continues to have detrimental impacts on development, businesses, economic growth, and poverty reduction in ways that affect not only poor countries but the entire world.

There are, however, practical, solution-oriented steps that the next administration can take to lead the battle against this global scourge, to improve transparency, to ensure that aid dollars are used effectively, and to leave a legacy of reform. The next administration should focus on three areas:

- 1. Private-sector development.** Reduce corruption's drag on the capacity of international and national private-sector development to create jobs and reduce poverty.
- 2. Effective development assistance.** Increase the "value for money" of U.S. foreign assistance through a focus on transparency and outcomes.

### Ten Steps to Reduce the Global Consequences of Corruption

#### To reduce corruption in international transactions

1. Broaden the definition of corrupt payments.
2. Reform international arbitration procedures.
3. Enhance transparency in payments made by international companies.
4. Open up rich-country clubs such as the OECD to all the world's biggest economies.

#### To reduce corruption in domestic investment for poor countries

5. Lead the fight to get developing countries to remove "gates."
6. Support the multilateral system, especially the World Bank, in its effort to improve local business environments.

#### To make development assistance more effective

7. Ensure that developing-country citizens have the information necessary to take up the fight against corruption.
8. Insist on results even in weak and fragile states.

#### To slow the spread of "global bads"

9. Launch a commission to review the U.S. approach to the war on drugs.
10. Get serious about combating money laundering.

**3. Slowing the spread of "global bads."** Lead the effort to dampen the corrosive effects of global bads such as terrorism, illegal drugs, and global crime.

### Is the United States positioned to lead?

The United States was the first to pass a serious international anticorruption law (the 1976 Foreign Corrupt Practices Act) and has been an active participant in the key conventions, symposiums, and international bodies on corruption, including the United Nations Convention against Corruption. The Millennium Challenge Corporation (MCC) holds good governance as a key criterion for access to its aid (see Box 1),



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## The White House and The World

Each day brings fresh evidence that Americans' well-being is linked to the lives of others around the world as never before. Accelerating advances in technology and the creation of new knowledge offer undreamed-of opportunities. Yet global poverty, inequality, disease and the threat of rapid climate change threaten our hopes. How will the U.S. president elected in November 2008 tackle these global challenges?

*The White House and the*

*World: A Global Development Agenda for the Next U.S. President* shows how modest changes in U.S. policies could greatly improve the lives of poor people in developing countries, thus fostering greater stability, security, and prosperity globally and at home. Center for Global Development experts offer fresh perspectives and practical advice on trade policy, migration, foreign aid, climate change and more. In an introductory essay, CGD president Nancy Birdsall explains why and how the next U.S. president must lead in the creation of a better, safer world.

*The White House and the World Policy Briefs* present key facts and recommendations drawn from the book in a succinct form designed for busy people, especially senior policymakers in the executive and legislative branches of government. This brief is drawn from "Getting the Focus Right: U.S. Leadership in the Fight against Global Corruption" by Dennis de Tray and CGD non-resident fellow Theodore Moran.

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## Box 1. The Millennium Challenge Corporation: A Good Start

The Millennium Challenge Corporation (MCC) is, in the words of *Washington Post* commentator Michael Gerson, "grown up foreign aid."<sup>2</sup> The MCC provides aid to countries that meet criteria for need, capacity, and good governance. The World Bank's "Control of Corruption" index is one of the hard hurdles that countries must pass to qualify for MCC aid.

Have the incentives created by the MCC borne fruit? Possibly. Eight out of fifteen countries that have threshold programs targeting corruption have improved their scores from 2006 to 2007. However, as a working paper by the Center for Global Development notes, "many programs have not been underway long enough to show results, and even for those that have, it is extraordinarily hard to attribute improvement in governance—particularly when defined as complexly as this indicator is—to any particular donor intervention."<sup>3</sup>

Although the jury may still be out on the overall effectiveness of MCC's incentives, there have been notable results in encouraging countries to get rid of obstacle to private-sector development. There is clear evidence that countries are responding to the cut-and-dried performance measure of how many days it takes to start a business. Countries are eager to change policies to meet eligibility requirements, but these policy changes work better when requirements are clearly articulated and simple to understand. On the basis of this experience, it is possible to imagine a reworked governance eligibility indicator that focuses on transparency issues. An indicator that reports the types of information a government makes public, such as national, regional, and local budgets, would be a good start.

and the U.S. Senate Foreign Relations Committee has pushed the multilateral development banks to reduce corruption and fraud in their operations.

In all of these ways, the United States has taken a leadership role in the fight against corruption, but it can continue to do so only if the rest of the world sees that the United States holds its own firms, citizens, and politicians to high standards of conduct. To that end, the next administration must take a strong stand on rooting out corruption in the U.S. government itself, including activities that could be considered "legalized" corruption, such as unwarranted special-interest earmarks, agricultural subsidies to a few rich agribusiness corporations, or publicly funded contracts that never face competition.



The United States will also be more successful in its efforts if it appreciates that good governance and the fight against corruption must be homegrown—not forced by outsiders—and that anti-corruption institutions that work in rich countries seldom do in developing ones. Building institutions to reduce corruption can be a very slow process—in Chile, a partial reform of the judicial system took fifteen years. Therefore, to be effective in helping to fight corruption, the United States must be prepared to be involved for the long haul.

Finally, if the United States is to make any progress on battling corruption, it must engage the multilateral system and bilateral partners and ensure that the effort is not seen as political or ideological. Rebuilding alliances with traditional rich-country partners remains important, but so does bringing rapidly growing developing countries to the table.

### Corruption and private-sector development

Private-sector growth is widely recognized to be crucial to sustainably reduce poverty. But private investment can be significantly hampered by international and domestic corruption. Internationally, U.S. leadership will be essential in limiting the impact of corruption in foreign direct investment; domestically, the United States can encourage the removal of unnecessary regulatory gates that create opportunities for seeking bribes.

### Reduce corrupt payments in international investment

Corrupt international business transactions harm developing countries in many ways, not least by often awarding contracts to less efficient companies or by covering up abuse of workers. But how much progress is the international community really making in tackling this problem? On the legal front, passing the Foreign Corrupt Practices Act in 1976 was followed by the adoption of the Anti-Bribery Convention by the Organization for Economic Cooperation and Development (OECD) in 1999.

Adopting these laws has increased the number of cases brought before judicial bodies, but recent research also points to some problematic loopholes. Namely, U.S., European, and Japanese companies are using sophisticated payment schemes in which the relatives and friends of connected parties gain monetary benefits without the arrangements being technically at risk of violating anti-bribery laws. International anti-corruption laws target direct payments to officials but not necessarily deferred gifts (like loans) or payments to business associates, employees, business partners, or relatives (see Box 2).

There are three steps the next president can take to build a genuinely effective international regime against corrupt payment in international investment:

**1. Broaden the definition of corrupt payments.** Pushing to enlarge the definition of “corrupt payments” to apply to family members and personal associates—in both of the legal instruments cited above—would help wring corruption out of transactions by firms that must abide by U.S. or OECD laws.

**2. Reform international arbitration procedures.** To ensure that U.S. firms are not operating at a disadvantage vis-à-vis competitors in emerging market economies (like Russia, China, and India), international arbitration procedures must be strengthened. Of course, no U.S. president can dictate terms for independent tribunals, but the country can build on increasing acceptance of the principle of rejecting the validity of any contract or permit obtained by corrupt means.

**3. Enhance transparency in payments made by international companies.** The Extractive Industries Transparency Initiative (EITI), which aims to hold the leaders of resource-rich countries accountable to their citizens, offers one model for promoting the transparency of investor payments. But more countries need to sign on to the EITI, with concrete plans and timetables for implementation put in place. The United States can lead that effort. The next president can also instruct the Overseas Private Investment Corporation and the Export-Import Bank of the United States to refuse to provide capital, guarantees, or political risk coverage to projects that do not pass the “smell test” of propriety.

### Give local businesses a break

On the domestic front, government-backed gatekeepers in developing countries—petty and sometimes not-so-petty

#### Box 2. Outbid by Bribery

More than 40 percent of businesses in some of the world’s leading economies believe they have lost a deal in the past five years because a competitor used bribery. According to a survey, businesses in these countries also see themselves as largely powerless to deal with bribery by their competitors.

The most widely used means to hide bribes and circumvent the law was by using intermediaries, a number of those surveyed said. The survey also found that about a third of the executives surveyed believed that the use of bribery to obtain contracts was likely to rise over the next decade.

The survey, “International Business Attitudes to Corruption,” involved interviews with 350 firms based in Brazil, France, Germany, Hong Kong, the Netherlands, the United Kingdom, and the United States on the pervasiveness of corruption to obtain deals abroad.

Source: Katzenellenbogen, “Outbid by Bribery, Say Firms,” *Business Daily* (October 9, 2006).



officials—often squeeze small business owners by eliciting bribes as a cost of doing business. Tax authorities, customs officials, police, and health inspectors may all be involved. Complex registration processes for new businesses and excessive regulation multiply the opportunities for corruption-induced gate keeping.

Experience shows that small businesses can thrive when layers of bureaucracy (and third-party involvement) are removed. In Vietnam, for example, the government removed burdensome licensing regimes. The process to register new businesses that once took months was cut to just a few days, and new business registrations rose from 6,000 in 1999 to 15,000 in 2000. The United States can support developing countries in their efforts to remove similar obstacles:

**1. Lead the fight to eliminate bureaucratic restriction and regulations.** Unnecessary restrictions provide fertile ground for corruption; removing them can produce rapid results. The proposed Regional Investment Standards Agreement for Latin America is a good example of how the United States can encourage such changes.<sup>1</sup>

**2. Support the multilateral system.** The U.S. voice on private-sector corruption is important, but that voice will be more effective if it is heard as part of the multilateral system. Supporting the World Bank's efforts to improve local business environments is a critical part of this agenda and very much in the interests of the United States.

### Corruption and development assistance

Americans are eager to help those who are less fortunate, but, understandably, they want assurances that aid dollars moving overseas are not being siphoned off through corruption. With strong U.S. backing, multilateral development banks have strengthened the “fences” that ring their projects, put more investigators in the field, and increased supervision. While these efforts help to ensure that aid-funded projects themselves are free of corruption, real success in the fight against corruption requires that developing countries themselves create institutions that promote transparency and accountability. Chile, Hong Kong, Singapore, and Botswana are among the developing countries that have strong records in government cleanup. For the poorest countries, though, the institution building needed to reduce corruption will be a long, hard effort that will span decades. In the meantime, however, there is much the next U.S. president can do to help jumpstart the process:

**1. Ensure that developing-country citizens have the information they need to fight corruption.** Studies show that the more information citizens have, the more the level and impact of corruption is reduced. Full disclosure about the

budgets and purposes of projects enable citizens to hold their leaders accountable. The next U.S. president can stipulate that U.S. aid recipients must meet a minimum standard of transparency as the price of receiving assistance. This quid pro quo can be an important starting point for strengthening citizen oversight.

**2. Insist on results, even in weak and fragile states.** Shifting the focus of accountability from donors to appropriate local levels—tailored to local approaches—encourages aid recipients to take responsibility for results. Furthermore, when funding is provided in stages, aid can be linked to clear evidence of progress on the ground. Projects in Indonesia, the Kyrgyz Republic, and the West Bank show that this approach works, and it has given more power to local communities to monitor corruption. For example, when members of a community know that money was received and that the next year's allocation depends on using this year's well, and when the outcome of audits is made public, the incentive for keeping corruption in check is greatly enhanced.

### Slowing the spread of “global bads”

“Global bads”—like international crime, illegal drug trafficking, terrorism, and smuggling—distort economies and markets and erode the social networks that hold societies together. But what is their link to corruption? Much of the money used to bribe officials and buy elections comes from these activities. As much as one-third to one-half of Tajikistan's economy, for example, is said to depend in one way or another on the drug trade—a trade that fuels corruption. The United States does not have a great record on fighting illegal trade; to make any real progress on international corruption, the United States must find ways to reduce the impacts of these “global bads.” Some immediate needs include the following:

**1. Launching a commission to review the U.S. approach to the war on drugs.** Finding a way to break the long-standing stalemate between those who insist on criminalizing illegal drugs and those who push for regulating them should be a priority for the next president. This effort could begin with the appointment of a credible, nonpartisan, high-level commission tasked with undertaking a thorough and objective review of U.S. and world anti-drug efforts. The aim of this commission would be to study what is working and what is not, and to report back to the new president one year after inauguration.

**2. Getting serious about dealing with money laundering.** Interagency initiatives to reduce the flow of ill-gotten money into the legitimate global financial system have had some notable successes, but billions of dollars stolen from poor countries or earned through the sale of illegal drugs continue to be processed through rich-country banks. Organizing an

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international review of bank secrecy laws around the world is one place to start. Efforts by the Federal Bureau of Investigation to track suspicious banking activity and by the World Bank and the UN Office on Drugs and Crime to repatriate ill-gotten gains are initiatives that need strong support from a new U.S. administration. To take just one example, General Sani Abacha of Nigeria should not be permitted to steal (and hide) some \$3–5 billion that belongs to the Nigerian people. Banks, too, need to step up to the plate.

## Conclusion

Although corruption is bad in its own right, measures to reduce it should ultimately be evaluated in terms of how much they improve people's lives in developing countries. There are few quick wins in this battle. If, however, the United States changes how it approaches corruption and takes a leadership role in getting the rest of the world to buy into these new approaches, a lot of progress can be made in creating environments where—without the drag of corruption—businesses and economic development have the opportunity to thrive.

## Endnotes

<sup>1</sup> Nancy Lee, "Integration in the Americas," in *The White House and the World: A Global Development Agenda for the Next U.S. President*, Nancy Birdsall, ed. (Washington, D.C.: Center for Global Development, 2008).

<sup>2</sup> Michael Gerson, "One Tool America Needs," *Washington Post* (August 1, 2007)

<sup>3</sup> Sheila Herrling and Sarah Rose, "Control of Corruption and the MCA: A Preview to the FY2008 Country Selection," *MCA Monitor Analysis* (Washington, D.C.: Center for Global Development, 2007).

## Further Reading

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