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# FACING THE CHALLENGE: CORRUPTION, STATE CAPTURE AND THE ROLE OF MULTINATIONAL BUSINESS

NIKOLAY A. OUZOUNOV\*

“Let me tell you, Cassius, you yourself are much condemn’d to have an itching palm.”<sup>1</sup>

## I. INTRODUCTION

Corruption awareness has exploded in recent years.<sup>2</sup> Corruption as a phenomenon has emerged from the backstage of local socio-political concerns to the forefront of global economic, legal, and development debate.<sup>3</sup> One of the main reasons for the prevailing perception that corruption is on the rise<sup>4</sup> is the end of the Cold War and the following exponential integration of the world’s economy and open markets.<sup>5</sup> Local problems have become

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\* J.D. The John Marshall Law School, 2004.

1. WILLIAM SHAKESPEARE, *JULIUS CAESAR*, act 4, sc. 2.

2. See Demetri Sevastopulo, *US Delays Mobile Phone Contracts to Investigate Claims of Iraqi Cronyism*, *FIN. TIMES*, Nov. 11, 2003, at A1 (noting that the U.S. “authorities had been struck by the resilience of corrupt business practices in Baghdad”). In a prolonged corruption trial, a French court sentenced to prison twenty-nine top Elf executives and officials of the former state-owned oil company and issued fines totaling \$23 million. See *Elfs and Dwarfs*, *ECONOMIST*, Nov. 15, 2003, at 49.

3. See Patrick Glynn et al., *The Globalization of Corruption*, in *CORRUPTION AND THE GLOBAL ECONOMY* 7, 7-12 (Kimberly Ann Elliott ed., 1997) (noting that there have been “real and perceived increases in corrupt activity” in what the authors call a “revolution” in worldwide attitude towards corruption). Despite often culturally different perspectives on corruption, the authors find a uniform decrease in the desire to tolerate corrupt practices. *Id.* at 8. See also Michael A. Almond & Scott D. Syfert, *Beyond Compliance: Corruption, Corporate Responsibility and Ethical Standards in the New Global Economy*, 22 *N.C. J. INT’L L. & COM. REG.* 389, 391 (1997) (noting that “businessmen around the world are paying closer attention to the risks, costs, and consequences of bribery, graft, and other forms of corruption in international business”).

4. Whether *actual increase* in corruption takes place is inherently difficult to determine, however, perceptions that corruption is increasing may be explained to a certain extent by recent political and economic liberalization. Glynn et al., *supra* note 3, at 8.

5. *Id.* at 9-10. As the authors point out, the notion of national and personal security has been redefined after the end of the Cold War. *Id.* at 10. In the absence of two opposing military and ideological camps, the importance of

global, and it is no longer disputed that corruption in business transactions is a serious global problem.<sup>6</sup>

Recent years have witnessed international scandals that “have reduced tolerance for corruption and increased receptiveness to legal solutions that, until recently, commentators viewed suspiciously.”<sup>7</sup> Allegations of corruption seem to be present far too often, both in developing and transition economies,<sup>8</sup> as well as in Western Europe and the United States.<sup>9</sup> Commentators have almost universally acknowledged that high levels of corruption retard economic development<sup>10</sup> and undermine public trust in businesses, institutions, and governments.<sup>11</sup> In developing

interacting economic and political conditions has increased to the extent that “[t]he security of one nation can be radically affected by purely domestic developments in a seemingly distant state.” *Id.*

6. See Phillip M. Nichols, *Regulating Transnational Bribery in Times of Globalization and Fragmentation*, 24 YALE J. INT’L L. 257, 272-74 (1999) [hereinafter *Globalization and Fragmentation*] (arguing that transnational bribery of public officials has increased significantly in the last decade). According to Nichols, “there has been a tremendous deterioration in the last ten years, with grand corruption becoming the general rule, rather than the exception, in major government-influenced contracts in the South.” *Id.* at 273.

7. Steven R. Salbu, *A Delicate Balance: Legislation, Institutional Change, and Transnational Bribery*, 33 CORNELL INT’L L.J. 657, 658 (2000) [hereinafter *A Delicate Balance*].

8. See JEFFREY P. BIALOS & GREGORY HUSISIAN, *THE FOREIGN CORRUPT PRACTICES ACT: COPING WITH CORRUPTION IN TRANSITIONAL ECONOMIES* 9-12 (1997) (noting that although corruption is particularly severe in transition economies, corruption investigations make headlines in countries ranging from Germany and England to South Africa and Singapore).

9. Steve LeVine, *U.S. Bribery Probe Looks at Mobil*, WALL ST. J., Apr. 23, 2003, at A2. In a recent, and what many experts believe to be one of the largest, bribery allegation “the U.S. is investigating whether Exxon Mobil Corp. participated in a scheme to route \$78 million from U.S. and European oil” firms to the president of Kazakhstan and his circle. *Id.* See also *Norwegian Oil Chief Resigns in Fallout Over Iranian Deal*, N.Y. TIMES, Sept. 23, 2003, at C19 (noting that the chief executive of Norway’s largest oil company, Statoil ASA, resigned after a bribery scandal concerning the company’s expansion interest in Iran).

10. Susan Rose-Ackerman, *The Political Economy of Corruption*, in CORRUPTION AND THE GLOBAL ECONOMY 31, 45 (Kimberly Ann Elliott ed., 1997) [hereinafter *Political Economy of Corruption*]. The author comments that “cross-country research suggests a negative association between growth and high levels of corruption.” *Id.* at 45-46. See generally JOEL S. HELLMAN ET AL., *FAR FROM HOME: DO FOREIGN INVESTORS IMPORT HIGHER STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES?* 3 (The World Bank, Policy Research Working Paper, 2002) [hereinafter *STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES*], <http://www.worldbank.org/wbi/governance/pdf/farfromhome.pdf>.

11. See IVAN KRASDEV, *THE INFLEXIBILITY TRAP: FRUSTRATED SOCIETIES, WEAK STATES AND DEMOCRACY* 17-18 (United Nations Dev. Programme, Issues Paper, 2002), <http://www.ceu.hu/cps/bluebird/pap/krasdev1.pdf> (noting an increased public sensitivity to corruption and its negative effect on the democratic process in South-East Europe). See also Steven R. Salbu,

countries and transition economies, corruption has been rightly blamed for lack of foreign investments,<sup>12</sup> slow economic growth,<sup>13</sup> governmental inefficiency and shaky institutions.<sup>14</sup> Earlier arguments that bribes may grease the wheels of state bureaucracies, and therefore are beneficial, have been largely refuted.<sup>15</sup>

Regardless of its various definitions, corruption has been mostly studied from the perspective of state control and intervention in the economy, as well as according to the degree of bureaucrats' discretionary power.<sup>16</sup> Restraining the "grabbing hand"<sup>17</sup> of the government has been the major thrust of recent

*Information Technology in the War Against International Bribery and Corruption: The Next Frontier of Institutional Reform*, 38 HARV. J. ON LEGIS. 67, 70-71 (2001) [hereinafter *The Next Frontier of Institutional Reform*].

12. Corruption reduces incentives to invest because of the uncertainty that prevails in a corrupt regime. Paolo Mauro, *The Effects of Corruption on Growth, Investment, and Government Expenditure: A Cross-Country Analysis*, in CORRUPTION AND THE GLOBAL ECONOMY 83, 86-87 (Kimberly Ann Elliott ed., 1997). Foreign investors may see payment of bribes as a form of taxation (i.e., when the issuance of a license requires the payment of a bribe) that discourages them from doing business in the country. *Id.* See Joel S. Hellman et al., *Are Foreign Investors and Multinationals Engaging in Corrupt Practices in Transition Economies?*, TRANSITION: THE NEWSL. ABOUT REFORMING ECONOMIES (World Bank/William Davidson Inst./Stockholm Inst. for Transition Economies/Bank of Finland Inst. for Economies in Transition, Washington, D.C.), May-June-July 2000, at 4 [hereinafter *Foreign Investors and Corrupt Practices*], <http://www.worldbank.org/html/prddr/trans/pdf/MayJunJuly20.pdf> (noting "significant negative association between per capita [foreign direct investment] and the extent of administrative and 'grand' corruption").

13. *The Next Frontier of Institutional Reform*, *supra* note 11, at 70-71.

14. See Ibrahim F.I. Shihata, *Corruption—A General Review with Emphasis on the Role of the World Bank*, 15 DICK. J. INT'L L. 451, 454-55 (1997) (noting an emerging consensus" among economists that corruption has disruptive effects on "political and bureaucratic stability and efficiency").

15. See Kimberly Ann Elliot, *Corruption as an International Policy Problem: Overview and Recommendations*, in CORRUPTION AND THE GLOBAL ECONOMY 175, 186 (Kimberly Ann Elliott ed., 1997) (noting that "[w]hile positive effects in certain situations have been claimed for corruption, most scholars agree . . . that widespread corruption is detrimental to economic and political development"). Even in the rare occasions when corruption may increase efficiency, because corrupt transactions are secret and non-transparent, it is impossible to ensure that the public interest is preserved. *Id.* at 187.

16. JOEL S. HELLMAN ET AL., MEASURING GOVERNANCE AND STATE CAPTURE: THE ROLE OF BUREAUCRATS AND FIRMS IN SHAPING THE BUSINESS ENVIRONMENT 4 (European Bank for Reconstruction & Dev., Working Paper No. 51, 2000) [hereinafter BUSINESS ENVIRONMENT], <http://www.ebrd.com/pubs/econ/workingp/51.pdf>.

17. See generally ANDREI SHLEIFER & ROBERT W. VISHNY, THE GRABBING HAND: GOVERNMENT PATHOLOGIES AND THEIR CURES (1998). I will explore the notion of the government's "grabbing hand" in more detail in Part III of this Article.

anti-corruption debate.<sup>18</sup> The purpose of this Article, however, is to shed some light at the reverse relationship, where powerful, multinational businesses attempt to shape the business climate in a dominated state, a situation particularly prevalent in some developing and transition economies.

Part II of this Article gives a general overview of corruption as an economic and legal phenomenon. This section draws an important distinction between grand and petty corruption. Part III introduces the concept of state capture and distinguishes state capture from other forms of corruption, such as procurement kickbacks and facilitation payments. This Part also analyzes the negative effects of corruption and state capture on development, economic growth, and political stability. Part IV proposes a modified approach for battling corruption that necessitates not only the involvement of governments through legislation and enforcement, but also requires active assistance from business enterprises, non-governmental organizations ("NGOs"), and the general public. Part V concludes.

The purpose of this Article is not to propose a "miracle cure" in the efforts against corruption and state capture in particular. Rather, drawing on research and analysis from various experts in the field, I intend to link corruption and state capture with a comprehensive, "portfolio" anti-corruption approach, emphasizing the important role of multinational business enterprises in reducing corruption. Such an approach presents a middle ground between the rigidity of extraterritorial legislation on one hand, and the need for decisive, yet culturally-conscious, anti-bribery measures on the other.

This Article primarily will discuss the transition economies of the former communist bloc and South-East Asia, as examples of two areas that have recently yielded abundant data. Because the goal of this article is to address state capture and grand corruption in general, I will use the terms corruption and bribery interchangeably, although as commentators note, studies of corruption should not be limited solely to the payment of bribes.<sup>19</sup>

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18. Joel S. Hellman et al., *Beyond the "Grabbing Hand" of Government in Transition: Facing up to "State Capture" by the Corporate Sector*, TRANSITION: THE NEWSL. ABOUT REFORMING ECONOMIES (World Bank/William Davidson Inst./Stockholm Inst. for Transition Economies/Bank of Finland Inst. for Economies in Transition, Washington, D.C.), Apr. 2000, at 8 [hereinafter *Beyond the Grabbing Hand*], <http://www.worldbank.org/html/prddr/trans/pdf/MarApr2000new.pdf>. According to the traditional understanding, "behind this definition of corruption lies an image of a predatory state seen as a large 'grabbing hand,' extorting firms for the benefit of politicians, high officials and bureaucrats." *Id.*

19. BUSINESS ENVIRONMENT, *supra* note 16, at 4. Many corruption surveys are inadequate because they are limited to bribery. *Id.*

## II. CORRUPTION IN PERSPECTIVE

This section examines various definitions of corruption, distinguishes between grand and petty corruption, and explains the different motives behind the two. I also present a few reasons why anti-corruption efforts need to be directed primarily at instances of grand corruption. Apart from “defining” corruption, I also examine the detrimental effects that corruption has on the economic, political, and legal development of the affected countries.

### A. *Corruption and How Do You Define the [Not So] Obvious?*

Although corruption is a universally recognized phenomenon, “[t]he challenges facing corruption analysts begin with how to define it.”<sup>20</sup> To some people corruption may seem deceptively obvious. As Elliott observes, “[m]ost people know corruption when they see it. The problem is that different people see it differently.”<sup>21</sup> Perceptions of corruption vary depending on factors such as the industry where it is observed,<sup>22</sup> the governing laws, and the local culture.<sup>23</sup> Experts define corruption differently depending on the field of their expertise.

Some economists consider corruption to be the “exploitation of economic rents which arise from the monopoly position of public officials.”<sup>24</sup> Other authors note that “[w]henver a public official has discretionary power over distribution to the private sector of a benefit or cost, incentives for bribery are created.”<sup>25</sup> Shleifer and Vishny consider government corruption to be “the sale by governmental officials of government property for personal gain.”<sup>26</sup>

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20. Elliot, *supra* note 15, at 177.

21. *Id.*

22. *Political Economy of Corruption*, *supra* note 10, at 31. Corruption may differ widely within a country, where “some industries, governmental departments, and lower-level governments are very corrupt while others are not.” *Id.*

23. See *Globalization and Fragmentation*, *supra* note 6, at 258 (comparing anti-bribery laws from around the world). Relying on the understanding that “corruption is the misuse of public power for private gain,” Susan Rose-Ackerman correctly points out that in many societies there is no clear distinction between a person’s public and private life. SUSAN ROSE-ACKERMAN, *CORRUPTION AND GOVERNMENT: CAUSES, CONSEQUENCES, AND REFORM 91* (1999) [hereinafter *CORRUPTION AND GOVERNMENT*]. Additionally the understanding of what constitutes a bribe and what is considered simply a gift can vary from country to country. *Id.* Often there is no clear line distinguishing a gift as an altruistic gesture and a bribe aiming to derive an illegal benefit. *Id.* at 96-104.

24. Shihata, *supra* note 14, at 453. Shihata also offers the interpretation that corruption arises in cases where the benefit of acting contrary to the public good and public expectation out-weighs the costs of doing so. *Id.*

25. *Political Economy of Corruption*, *supra* note 10, at 31.

26. SHLEIFER & VISHNY, *supra* note 17, at 91.

Legal experts tend to view corruption as the disregard and violation of established rules in order to acquire personal gain, which leads to “arbitrary exercise of discretionary powers and the illegitimate use of public resources.”<sup>27</sup> Regardless of the definitional differences, the predominant view is that corruption involves a transaction where a governmental official<sup>28</sup> abuses a position of trust for personal gain and enrichment.<sup>29</sup>

Even though every one of the elements in the above “definition” may present an interpretational challenge,<sup>30</sup> I will focus only on the size of the gain the corrupt official realizes. Research in this area often addresses corruption without sufficient distinction among its various forms. In that sense, Mauro writes that available indicators of corruption are plagued with generality; “they do not distinguish, for example, between high-level corruption (such as kickbacks to a defense minister for the purchase of expensive jetfighter aircraft) and low-level corruption (such as that of a minor official accepting a bribe to expedite issuance of a driver’s license).”<sup>31</sup> The following sub-section divides corruption in two distinct categories, based not only on the size of the bribe, but also on the motive behind the bribe.

*B. Greed, Need, and the Distinction Between Grand and Petty Corruption*<sup>32</sup>

The most obvious distinction between bribes is their size and the motives for paying or accepting them. We are all well aware that bribes may vary enormously in scale. Examples abound. In a current investigation under the Foreign Corrupt Practices Act (“FCPA”),<sup>33</sup> authorities are considering allegations that Exxon Corporation has engaged in a scheme to pay \$78 million to the highest-ranking official in Kazakhstan, the country’s president.<sup>34</sup> Payments of that magnitude are not an exception. The Securities Exchange Commission recently commenced a civil action against Montedison for alleged payments to various Italian officials that amounted to almost \$400 million.<sup>35</sup> Grand corruption that involves bribes in the millions differs substantially from bribery in the form of gifts, entertainment, or minor “grease payments” in the

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27. Shihata, *supra* note 14, at 455-56.

28. See *Political Economy of Corruption*, *supra* note 10, at 31-33 (noting the central role of the public official in corrupt practices).

29. Shihata, *supra* note 14, at 459.

30. See Elliott, *supra* note 15, at 177.

31. Mauro, *supra* note 12, at 84.

32. For a more in depth discussion of this distinction, see generally A *Delicate Balance*, *supra* note 7.

33. Foreign Corrupt Practices Act of 1977 (codified as amended in scattered sections of 15 U.S.C. § 78 (2000)).

34. LeVine, *supra* note 9.

35. A *Delicate Balance*, *supra* note 7, at 667.

amounts of a few hundred dollars. But where does one draw the line between grand and petty bribery? As Steven Salbu points out, “[a] bribe valued above \$1,000 is relatively large; a bribe valued below \$100 is relatively small [and a] demarcation point in the buffer zone is rationally impossible to choose, but pragmatically necessary.”<sup>36</sup> Salbu decides to use \$1,000 as a threshold number—bribes valued in excess of that number can be considered grand bribery, while bribes valued at \$1,000 or less may be defined as petty bribes.<sup>37</sup> The FCPA and the more recent Organisation for Economic Co-Operation and Development (“OECD”) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions<sup>38</sup> (the “OECD Convention”) unfortunately do not distinguish between grand and petty bribery, but refer to bribery in general.<sup>39</sup>

Grand and petty bribery differ not only in their size, but also in the resulting level of negative social effects, as well as the motives behind them.<sup>40</sup> Compared to grand bribery, petty bribes are very difficult to qualify as corrupt, a judgment which is often culture-specific.<sup>41</sup> Petty bribery often takes the form of minor payments, gifts, tips, hospitality, or entertainment, which seem to many a natural part of doing business.<sup>42</sup> Petty corruption is also often caused by low pay in the public sector and the resulting poverty of public officials.<sup>43</sup> Taking petty bribes may be caused by the lack of basic necessities, which small bureaucrats in poor states cannot afford.<sup>44</sup> Petty bribery is often the result of need rather than greed.<sup>45</sup> The reasons for giving or taking a bribe, in some countries, may seem trivial to a person in a developed country. For example, petty bribes are often paid to get “a telephone, a passport or a driver’s license, [which] cannot be

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36. *Id.* at 663.

37. *Id.*

38. Convention on Combating Bribery of Foreign Public Officials in International Business Transactions, Dec. 18, 1997, S. TREATY DOC. NO. 105-43 (1998), 37 I.L.M. 1 [hereinafter OECD Convention].

39. *Id.* at art. 1(3).

40. *A Delicate Balance*, *supra* note 7, at 663-66.

41. See CORRUPTION AND GOVERNMENT, *supra* note 23, at 91-110 (noting that “the distinctions between prices, bribes, gifts, and tips are difficult both to draw and to evaluate normatively”).

42. *Id.* See also Steven R. Salbu, *Extraterritorial Restriction of Bribery: A Premature Evocation of the Normative Global Village*, 24 YALE J. INT’L L. 223, 234-240 (1999) [hereinafter *Global Village*] (discussing gift giving).

43. *A Delicate Balance*, *supra* note 7, at 669-71. Salbu points out taking bribes may arise from the lack of basic necessities such as food and shelter. *Id.* at 669.

44. Elliot, *supra* note 15, at 184; *A Delicate Balance*, *supra* note 7, at 669-71.

45. *A Delicate Balance*, *supra* note 7, at 669-71.



obtained expeditiously without a payoff."<sup>46</sup>

On the other hand, the motives behind engaging in grand corruption and paying thousands or even millions of dollars are often to gain a competitive advantage over other market participants in contract bidding.<sup>47</sup> A firm may pay off an official in order to be included in a list of bidders, to have the bidding qualifications apply only to it, or even to be selected as the winning bidder.<sup>48</sup> Unlike cases of petty bribery, grand bribery is the hallmark of major multinational corporations dealing at the highest governmental levels.<sup>49</sup> Rose-Ackerman notes that "[c]orrupt payments to win major contracts and concessions are generally the preserve of large businesses and high-level officials."<sup>50</sup> Such incidents of corruption "represent a substantial expenditure of funds" even for powerful businesses.<sup>51</sup> The nature of these large payments and the position of their recipients suggests that the motives for requesting and taking such significant sums is greed rather than daily need.<sup>52</sup>

Why is such a distinction important? Legislative efforts and corporate codes of conduct need to focus primarily on instances of grand corruption for two primary reasons. First, extraterritorial prosecution of petty practices such as gift-giving, tipping, and hospitality is largely ineffective<sup>53</sup> and runs the risk of cultural imperialism.<sup>54</sup> In many cultures such practices are not considered corrupt, but rather they are means of building lasting business relationships and establishing mutual trust.<sup>55</sup> In countries such as Japan, South Korea, China, and Malaysia, gift-giving is of significant importance and serves various purposes, including expressing gratitude and loyalty, expressing understanding, being a part of a formal etiquette, and being a part of hospitality in general.<sup>56</sup> From that perspective, change in attitudes about gift-

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46. CORRUPTION AND GOVERNMENT, *supra* note 23, at 15.

47. *A Delicate Balance*, *supra* note 7, at 664.

48. *Political Economy of Corruption*, *supra* note 10, at 35. Additional motives may be to avoid qualifying requirements, to get access to needed credit, or to qualify for certain favorable tariff classification. *Id.* at 35-36.

49. *See generally* LeVine, *supra* note 9.

50. CORRUPTION AND GOVERNMENT, *supra* note 23, at 27.

51. *Id.*

52. *See The Next Frontier of Institutional Reform*, *supra* note 11, at 69 (pointing to instances where governmental officials in some African countries have become much wealthier than the local businesspeople as a result of taking bribes).

53. *See generally* *Global Village*, *supra* note 42.

54. *Id.* at 240.

55. *Id.* at 234-36.

56. *Id.* at 234-40. The South Korean concept of *chonji*, for example, is highly important for establishing relationships with teachers, bankers, or bureaucrats. *Id.* at 235. *Chonji* is often expressed through material gifts for favorable treatment by the recipient. *Id.* at 235-36.

giving or tipping should be left to the local society and government, rather than being forced from the outside.<sup>57</sup>

Second, instances of grand corruption, although less frequent, are far more damaging economically and socially.<sup>58</sup> Grand corruption is also universally condemned and therefore much easier to target.<sup>59</sup> Another consideration is that once the efforts against grand bribery are successful it will be much easier to address issues of petty bribery.<sup>60</sup>

Instances of grand corruption are particularly harmful in the economies of the former communist bloc, where the rule of law is still developing, public institutions are young and the democratic process is fragile.<sup>61</sup> And although grand corruption usually appears in its "traditional" form (pay-offs in contract procurement, for example), researchers have begun to focus on a somewhat under-researched form of corruption with far-reaching negative implications, which has been increasingly known under the term "state capture."

### III. THE EFFECTS OF STATE CAPTURE & CORRUPTION: SLOW DEVELOPMENT, WEAK STATES AND STRUGGLING DEMOCRACIES

The transition from planned, socialist economy to a free market economy required the state to release numerous businesses and institutions from its suffocating grip. After the end of the Cold War, former communist countries engaged in a painful process of privatization and deregulation. Naturally, during this period of transition, researchers focused on the often predatory role of the state and the state's level of control over private businesses.<sup>62</sup> Attention was on the government because in the

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57. *Id.* at 235.

58. A Delicate Balance, *supra* note 7, at 665.

59. See Philip M. Nichols, *The Myth of Anti-Bribery Laws as Transnational Intrusion*, 33 CORNELL INT'L L.J. 627, 629-30 (2000).

60. See Fritz F. Heimann, *Combating International Corruption: The Role of the Business Community*, in CORRUPTION AND THE GLOBAL ECONOMY 147, 154 (Kimberly Ann Elliott ed., 1997) (noting that currently the main goal should be "to stop large bribes to politicians and senior officials").

61. BIALOS & HUSISIAN, *supra* note 8, at 13. Grand corruption undoubtedly retards the formation of democratic institutions, economic development, and the rule of law in many societies. The problem is perhaps most acute in post-communist societies. After decades of communist dictatorship, with law serving as an instrument of, rather than a check on, arbitrary state power, the rule of law is fragile and largely undeveloped in these countries.

*Id.*

62. JOEL S. HELLMAN ET AL., SEIZE THE STATE, SEIZE THE DAY: STATE CAPTURE, CORRUPTION, AND INFLUENCE IN TRANSITION 1-5 (The World Bank/European Bank of Reconstruction & Dev., Policy Research Working Paper No. 2444, 2000) [hereinafter SEIZE THE STATE], <http://www.worldbank.org/wbi/governance/pdf/seize.pdf>.

countries of the former Soviet bloc corruption was often associated with the “grabbing hand”<sup>63</sup> of the state, where bureaucrats (often former communist apparatchiks) extorted payments from local and foreign businesses.<sup>64</sup> This focus, however important, diverted the experts’ attention away from the actions of many foreign and domestic firms that were gaining strength and influence. After more than a decade of transition, the fear of the leviathan state<sup>65</sup> has been replaced by the fear of powerful oligarchs<sup>66</sup> who rival in power the state itself.<sup>67</sup> Such oligarchs have the capability to “manipulate politicians, shape institutions, and control the media to advance and protect their own empires at the expense of social interest.”<sup>68</sup>

Joel S. Hellman, Geraint Jones, and Daniel Kaufmann are

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63. See generally SHLEIFER & VISHNY, *supra* note 17. Shleifer & Vishny introduce the “grabbing hand” model of government as an alternative to the “invisible hand” or the “helping hand” models. *Id.* at 2-7. The invisible hand model “is the laissez-faire view of the state” grounded in the belief that markets work best without any government intervention. *Id.* at 3. According to the model, the government’s role is limited to the “basic functions needed to support a market economy, such as the provision of law, order, and national defense.” *Id.* The authors note that the invisible hand model is not useful for generating policy advice for its failure to examine the reasons for government intervention and the role of politics in government regulations. *Id.* The helping hand model is mostly a post World War II “cure” to perceived market failures. “According to this model, unbridled free markets lead to monopoly pricing, to externalities such as pollution, to unemployment, to defective credit supply to firms, and to failures of regional development.” *Id.* at 2. What the model proposes as solutions is “corrective taxes, regulations, and aggregate demand management to price controls, government ownership, and planning.” *Id.* The authors note that the helping hand model “has failed as both a descriptive and a prescriptive model of government.” *Id.* at 3. One of the major shortcomings of the model, according to the authors, is that it falsely “presumes that the government will maximize social welfare.” *Id.* The grabbing hand model shares some basic understandings with both models. *Id.* It has a skeptical view of the government, but unlike the invisible hand model it follows more accurately what governments do. *Id.* Its similarity with the helping hand model is that they both share “activist interest in reforming government” although in very different ways. *Id.* at 3-4. At the core of the grabbing hand concept “are models of political behavior that argue that politicians do not maximize social welfare and instead pursue their own selfish objectives.” *Id.* at 4.

64. *Beyond the Grabbing Hand*, *supra* note 18, at 8.

65. This characterization is particularly appropriate for the former authoritarian governments in Central and Eastern Europe. See SEIZE THE STATE, *supra* note 62, at 1.

66. *Id.* To some observers oligarchs dominate the state to such an extent that they directly influence a country’s most vital functions: “[t]hey wrote laws [and] appointed ministers, often entire cabinets, and made sure that their interests were served.” *Beyond the Grabbing Hand*, *supra* note 18, at 1.

67. See generally SEIZE THE STATE, *supra* note 62 (examining in detail the nature of state capture and the extent to which firms engage in state capture practices).

68. *Id.* at 1.

three researchers who have focused their attention on the problem of state capture. In a series of papers, these authors analyzed the results of a Business Environment and Enterprise Performance Survey ("BEEPS")<sup>69</sup> that examines different kinds of corrupt transactions and the way these transactions affect the performance of a pool of sampled firms. Hellman, Jones, and Kaufmann define state capture as "the extent to which firms make illicit and non-transparent private payments to public officials in order to influence the formation of laws, rules, regulations or decrees by state institutions."<sup>70</sup> The fundamental difference between state capture and the type of grand corruption already discussed<sup>71</sup> is that state capture involves "shap[ing] and affect[ing] the formation of the basic rules of the game" through control over the law-making process, rather than over the award of contracts or the implementation of regulations.<sup>72</sup> The authors distinguish between state capture on one hand, and administrative corruption<sup>73</sup> and public procurement kickbacks<sup>74</sup> on the other. The analysis of state capture is based on a comprehensive survey developed jointly by the World Bank and the European Bank for Reconstruction and Development ("EBRD").<sup>75</sup> The results of the survey are based on interviews with owners and firm managers of approximately 3,600 firms across twenty-two transition economies.<sup>76</sup>

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69. STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10, at 3.

70. SEIZE THE STATE, *supra* note 62, at 5-6.

71. See *supra* notes 47-52 and accompanying text.

72. SEIZE THE STATE, *supra* note 62, at 3.

73. *Id.* at 5. This is a more traditional type of corruption, where "firms make illicit and non-transparent private payments to public officials in order to alter the prescribed implementation of administrative regulations placed by the state on the firm's activities." *Id.*

74. This form of corruption is "defined as illicit private payments to public officials to secure public procurement contracts." STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10, at 6. Another concept analyzed by Hellman, Jones, and Kaufman was that of influence. "Influence" is a variation of state capture in the sense that firms still exert influence over the formation of laws, rules and regulations, but without making direct payments to governmental officials. SEIZE THE STATE, *supra* note 62, at 6.

75. SEIZE THE STATE, *supra* note 62, at 5.

76. *Id.* The survey was conducted through on-site visits and personal interviews with the managers or owners of the sampled firms. *Id.*; STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10, at 4-5. Most of the sampled firms were private enterprises, although there was a representative quota for state-owned firms. *Id.* The countries included in the BEEPS survey were Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Poland, Romania, the Russian Federation, the Slovak Republic, Slovenia, Ukraine, and Uzbekistan. *Id.*

### A. Corruption and State Capture: Economic Effects

By now most researchers have agreed that corruption in its various forms is detrimental to sound economic development and the operation of free and open markets.<sup>77</sup> Corruption is harmful because it “sets prices not through supply and demand, but through self-serving, inefficient preferences”<sup>78</sup> that act against the laws of free competition. Corruption results in waste, resource misallocation,<sup>79</sup> market distortion, lack of foreign investment, and unfair competition<sup>80</sup> because it relies on a decision-making process that favors a corrupt agent rather than the superior quality of products and services.<sup>81</sup>

Corruption, in combination with a weak legal system (which is usually the case), results in lower tax revenues for the state.<sup>82</sup> High levels of corruption tend to drive legitimate businesses underground, which leads to a situation where “countries with more corruption have a higher share of unofficial economy.”<sup>83</sup> The result is a self-perpetuating problem with corruption: when firms go underground, “tax revenues fall, and the quality of public administration declines accordingly, further reducing a firm’s incentives to remain ‘official.’”<sup>84</sup>

Similar results emerge from the more narrow study of state capture. Captor firms purchase laws that give them tax breaks that deprive the state of revenue. A recent study of a sample of regional firms in Russia showed “a strong negative statistically significant association between regional tax revenues and all capture measures.”<sup>85</sup> The study also found that an “increase in persistent preferential treatment concentration decreases regional tax revenues as well as total net tax revenues.”<sup>86</sup> State capture also impedes the growth of small businesses in the short run,<sup>87</sup> although in the long run captor firms are not expected to outperform non-captor firms.<sup>88</sup> Because of their relationship with

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77. Almond & Syfert, *supra* note 3, at 434.

78. *Id.*

79. See *The Next Frontier of Institutional Reform*, *supra* note 11, at 70-71; Mauro, *supra* note 12, at 104 (noting that corruption has an adverse effect on economic growth through lowering private investment).

80. *The Next Frontier of Institutional Reform*, *supra* note 11, at 70-71.

81. Nichols, *supra* note 59, at 631.

82. ERIC FRIEDMAN ET AL., DODGING THE GRABBING HAND: THE DETERMINANTS OF UNOFFICIAL ACTIVITY IN 69 COUNTRIES 2 (1999), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=194628#PaperDownload](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=194628#PaperDownload).

83. *Id.* at 20.

84. *Id.*

85. Irina Slinko et al., State Capture in the Russian Regions 12 (Nov. 14, 2002), <http://www.colbud.hu/honesty-trust/zhuravskaya/pub01.pdf>.

86. *Id.*

87. *Id.* at 11-13.

88. See generally STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10.

captor firms, authorities often create obstacles for the development of small businesses that are trying to compete with large incumbents.<sup>89</sup> Such obstacles, on the other hand, often cause small firms or newcomers to engage in state capture themselves in order to stay in the market.<sup>90</sup> Thus, state capture becomes a choice strategy<sup>91</sup> for newcomer firms entering a market dominated by powerful incumbents, a vicious cycle that is difficult to interrupt when entrenched interests are at stake.<sup>92</sup>

In addition, state capture also reduces foreign direct investment (“FDI”) inflows and “attracts lower quality investment in terms of governance standards.”<sup>93</sup> Interestingly, many FDI firms in high-capture countries appear to increase the level of corruption and state capture instead of remedying the problem.<sup>94</sup> These findings confirm the concerns of some commentators that extraterritorial legislation, such as the FCPA, has not resulted in higher standards of corporate ethics in firms affected by its provisions, even though the FCPA has been in effect since the 1970s.<sup>95</sup>

#### *B. Corruption & State Capture: Effect on Institutions and Commitment to Reform*

Instances of corruption and state capture have a negative effect on the public’s commitment to economic and democratic reforms in many transition economies. Perceptions that corrupt businesses and lawmakers dominate the social landscape has resulted in disillusionment and has turned people away from active participation in the democratic process.<sup>96</sup> Such disillusionment and even cynicism can be harmful for the reform process in these countries.<sup>97</sup> Achievements in anti-corruption efforts and new government programs against corruption are often dismissed as empty promises and posturing.<sup>98</sup> The danger is that “blindness to success’ could undermine even successful market reforms.”<sup>99</sup>

Lack of trust in public institutions and the government is not

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89. Slinko, et al., *supra* note 85, at 16.

90. *Beyond the Grabbing Hand*, *supra* note 18, at 10.

91. *Id.* at 8.

92. *Id.* at 10; SEIZE THE STATE, *supra* note 62, at 16.

93. STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10, at 21.

94. *Id.*

95. *Id.*

96. See generally KRASTEV, *supra* note 11.

97. *Id.*

98. *Never Had It So Good*, ECONOMIST, Sept. 13, 2003, at 69 (noting that policies targeted at “predatory elites” in transition economies are hard to implement because of low levels of public support).

99. *Id.*

a problem reserved solely for transition economies. In parts of Italy, for example, lack of trust in the Italian state have led people to seek protection by the Mafia. As Rose-Ackerman notes, “[t]he state failed to provide a reliable method of resolving disputes and managing private property transfers. The Mafia arose as substitute.”<sup>100</sup> Similarly, people in former communist countries tend to be suspicious of their governments due to long years of governmental oppression and propaganda. Such societies are characterized by “[low levels] of respect for the law inherited from centuries of foreign domination (i.e., Ottoman, Tzarist Russia), imperial bureaucratic structures (i.e., Austro-Hungarian), and decades of communism.”<sup>101</sup> Considering the rather fragile public commitment to governmental reform, high levels of state capture can be extremely damaging. Lack of trust in governments also exemplifies why corporate codes of conduct and multinational businesses not associated with the totalitarian past may enjoy higher credibility in the public arena.

#### IV. RECOMMENDATIONS: THE ROLE OF THE OECD, MULTINATIONAL CORPORATIONS AND BROAD PUBLIC SUPPORT IN ERADICATING CORRUPTION

Efforts in eradicating corruption may be successful only if they become a part of a broad effort that addresses corruption from all possible sides.<sup>102</sup> As Dunfee and Hess comment, what is needed is a comprehensive, “portfolio approach” in combating corruption.<sup>103</sup> No single solution exists and “none of the individual strategies [such as] the FCPA, the OECD convention, NGOs, [and] corporate principles . . . by themselves will be sufficient to eliminate corruption.”<sup>104</sup> An effective anti-corruption portfolio requires the active participation of corporate players, governmental players, and civil society involvement.<sup>105</sup>

##### A. *The OECD Convention and treatment of foreign subsidiaries*

A simple example of governmental involvement is the implementation of legislation in accordance with international anti-bribery agreements. In this regard, the role of the OECD Convention, as a part of a portfolio approach, is of extreme

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100. CORRUPTION AND GOVERNMENT, *supra* note 23, at 97.

101. United Nations Development Programme, *Fighting Corruption in Post-Communist States—Lessons from Practice* 7 (Jan. 15, 2002) [hereinafter UNDP], [http://www.transparency.org.ru/CENTER/DOC/book04\\_eng.pdf](http://www.transparency.org.ru/CENTER/DOC/book04_eng.pdf).

102. Heimann, *supra* note 60, at 147.

103. Thomas W. Dunfee & David Hess, *Getting from Salbu to the “Tipping Point”*: The Role of Corporate Action Within a Portfolio of Anti-Corruption Strategies, 21 NW. J. INT’L L. & BUS. 471, 471-73 (2001).

104. *Id.* at 472.

105. *Id.* at 482-83.

importance. The OECD Convention is probably the most powerful legislative weapon in combating corruption in international business transactions, considering its extraterritorial implications and the large number of country participants.<sup>106</sup> Similar to the FCPA, the OECD Convention criminalizes the bribery of foreign public officials in international business transactions, specifically bribery for purposes of obtaining and retaining business.<sup>107</sup> The prohibitions of the OECD Convention, however, do not reach bribery of foreign public officials that is carried out by the foreign-incorporated subsidiaries of companies covered by the Convention.<sup>108</sup> While it is true that the language of the Convention allows for some flexibility by requiring that parties take measures “to establish that complicity in, including incitement, aiding and abetting, or authorisation [sic] of an act of bribery of a foreign public official shall be a criminal offense,”<sup>109</sup> such language still allows firms to circumvent the Convention and engage in bribery through their foreign subsidiaries.<sup>110</sup> One of the reasons why the drafters did not extend the Convention’s reach to foreign subsidiaries may have been concern over the intrusiveness of the extraterritorial application of such laws.<sup>111</sup>

Despite these concerns, it is important to address foreign subsidiaries because of their role in corruption and state capture. The research done by Hellman, Jones, and Kaufmann, although not dealing specifically with foreign subsidiaries, is of significant relevance. Hellman and his colleagues suggest that in countries with significant state capture levels, FDI firms are almost twice as likely to engage in state capture as their domestic counterparts.<sup>112</sup> The FDI firms subject to the study can be divided into two groups: FDI firms with local headquarters and FDI firms with foreign headquarters (mostly multinational corporations).<sup>113</sup> The data, as analyzed by the survey, shows that FDI firms with foreign headquarters engage in state capture to a lesser extent than firms

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106. Parties to the convention are the OECD member states, plus five non-member states: Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic. Keith Loken, *The OECD Anti-Bribery Convention: Coverage of Foreign Subsidiaries*, 33 GEO. WASH. INT’L L. REV. 325, 325 n.2 (2001).

107. OECD Convention, *supra* note 38, at art. 1.

108. Loken, *supra* note 106, at 331-33.

109. OECD Convention, *supra* note 38, at art. 1(2).

110. Loken, *supra* note 106, at 333. Loken presents a hypothetical, where a parent corporation is a national of a party signatory to the Convention, but its foreign subsidiary is a national of a non-party. *Id.* In cases where the foreign subsidiary engages in bribery on the territory of a country not a signatory to the convention, and the corporate agents are nationals of a non-member state, the acts of bribery most probably will not be covered by the Convention. *Id.*

111. See *supra* notes 52-55 and accompanying text.

112. STANDARDS OF GOVERNANCE IN TRANSITION ECONOMIES, *supra* note 10, at 12.

113. *Id.* at 15.



with local headquarters.<sup>114</sup> One reason is that larger multinationals have greater resources for training and implementation of compliance procedures than their smaller counterparts located in transition countries.<sup>115</sup> At the same time, multinationals often work with local partners through joint-ventures and local subsidiaries, which are more prone to engage in state capture.<sup>116</sup>

In this sense, corporate codes of conduct and compliance programs may be very suitable to address corruption by foreign subsidiaries, especially since they are not covered by the OECD Convention.<sup>117</sup> Corporate codes that extend to foreign subsidiaries and require compliance with the prohibitions of the Convention could be very effective in curbing corruption.<sup>118</sup> In this way, the often rigid extraterritorial laws will be supplemented with more flexible internal corporate regulations.

The need for more flexibility and for coverage of areas that were left out by the Convention leads us to the second important element of an anti-bribery “portfolio approach,” the role of corporate action.

#### *B. Corporate Action: Codes of Conduct, Guidelines and Principles*

Many commentators favor corporate action over governmental involvement through legislation, which in essence is inherently coercive.<sup>119</sup> In comparison to governments, corporations are less likely to be charged with moral imperialism,<sup>120</sup> as they are less coercive and more flexible in the application of their guidelines and codes of conduct.<sup>121</sup> Corporations are limited to less compelling sanctions—an employee can be demoted, suspended or dismissed for violating a corporate policy, but will not be incarcerated for an offence against the corporate guidelines.<sup>122</sup> This softer approach may be preferable in the international field, because of its less intrusive nature and greater flexibility.

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114. *Id.* at 15-17.

115. *Id.* at 15-16.

116. *See id.* (noting that multinationals rely on local businesspeople who know “how to get things done” in their country).

117. Loken, *supra* note 106, at 336.

118. *See generally* Loken, *supra* note 106.

119. Steven R. Salbu, *Transnational Bribery: The Big Questions*, 21 NW. J. INT'L L. & BUS. 435, 454 (2001) [hereinafter *The Big Questions*].

120. *Id.* Not according to all. Some U.S. corporations have been targeted for bringing in “western” or “American” cultural domination. *See* Elaine Sciolino, *Prison Looms for French Farmer, An Anti-Globalization Gadfly*, N.Y. TIMES, Nov. 20, 2002, at A9 (noting that Jose Bove, the French farmer who became known for his attacks on McDonald’s restaurants in France, has been sentenced to serve fourteen months in prison).

121. *The Big Questions*, *supra* note 119, at 454.

122. *Id.*

### 1. *The OECD Guidelines for Multinational Enterprises*<sup>123</sup>

The OECD has not limited its anti-corruption activities to the requirements of the Convention, but has rather promoted a broader set of instruments for combating corruption.<sup>124</sup> One particularly important instrument is the OECD Guidelines for Multinational Enterprises (“Guidelines”).<sup>125</sup> Although the Guidelines do not focus exclusively on combating corruption, chapters II, III, and VI address bribery and practices of corporate disclosure.<sup>126</sup> The scope of the Guidelines in addressing corruption is substantially broader than the scope of the OECD Convention. While the OECD Convention deals exclusively with the bribery of foreign public officials, the Guidelines reach public and private parties serving as active or passive participants in corrupt practices.<sup>127</sup> Chapter VI of the Guidelines specifically states that “[e]nterprises should not, directly or indirectly, offer, promise, give or demand a bribe or other undue advantage to obtain or retain business or other improper advantage.”<sup>128</sup> Furthermore, chapter VI refers to private actors in corrupt practices by naming “employees of business partners” as possible recipients or sources of bribes.<sup>129</sup> The language in chapter VI allows for a much broader treatment of corruption. Since the identity of the other party in the transaction is not restricted, the other party may be a government official, a private business person, or a political figure.<sup>130</sup> Addressing bribery of public officials, as well as of political figures, is of extreme importance in reducing instances of state capture, which have political implications since captor firms seek to purchase laws that will favor them over other market participants.<sup>131</sup>

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123. ORG. FOR ECON. CO-OPERATION & DEV., OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES (2000) [hereinafter OECD GUIDELINES], available at <http://www.oecd.org/dataoecd/56/36/1922428.pdf>.

124. See OECD DIRECTORATE FOR FIN., FISCAL & ENTER. AFFAIRS, ANTI-CORRUPTION INSTRUMENTS AND THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES 4 (2003) [hereinafter ANTI-CORRUPTION INSTRUMENTS], available at <http://www.oecd.org/dataoecd/0/33/2638728.pdf>. Other broad anti-bribery instruments include The Recommendations of the Council on Improving Ethical Conduct in the Public Service Including Principles for Managing Ethics in the Public Service; The OECD Principles of Corporate Governance; and The Draft Guidelines for Managing Conflicts of Interest in the Public Service.

125. For a comparison between the Guidelines and other multilateral anti-bribery instruments (including the above mentioned OECD instruments) see *id.* at 14-16.

126. *Id.* at 12.

127. *Id.* at 11-12.

128. OECD GUIDELINES, *supra* note 123, at 24.

129. *Id.*

130. ANTI-CORRUPTION INSTRUMENTS, *supra* note 124, at 11.

131. See generally SEIZE THE STATE, *supra* note 62.

The Guidelines also address the treatment of foreign subsidiaries, which was left open by the OECD Convention and, as already discussed, allows a possible escape route for corporations that are willing to go around the OECD Convention's prohibitions. The question of subsidiaries is generally addressed in chapter II, where the drafters state that corporations need to "[e]ncourage, where practicable, business partners, including suppliers and subcontractors to apply principles of corporate conduct compatible with the *Guidelines*."<sup>132</sup> Although the Guidelines are only in the form of recommendations and do not legally bind business entities,<sup>133</sup> such references to corporations and their business partners are an important first step toward establishing a broad standard covering foreign subsidiaries.

Although chapter III of the Guidelines does not specifically deal with corruption, its focus on corporate transparency is extremely important in combating bribery and state capture. Chapter III, entitled "Disclosure," encourages the adoption of practices that promote transparency<sup>134</sup> in corporate policies, auditing, and accounting practices.<sup>135</sup> Chapter III focuses on disclosure of "timely, regular, reliable and relevant information [regarding corporate] activities, structure, financial situation and performance."<sup>136</sup> Further, the Guidelines promote the application of "high quality standards for disclosure, accounting, and audit."<sup>137</sup> Making transactions transparent is essential for reducing the instances of bribery, since many commentators agree that secrecy is a necessary element in transactions involving bribery.<sup>138</sup>

In that sense, corporations should be encouraged to adopt the recommendations promoted in the Guidelines. Chapters III and

132. OECD GUIDELINES, *supra* note 123, at 19; ANTI-CORRUPTION INSTRUMENTS, *supra* note 124, at 14.

133. See OECD GUIDELINES, *supra* note 123, at 15 (stating that the Guidelines provide "voluntary principles and standards for responsible business conduct consistent with applicable laws").

134. *Id.* at 20. See also William B.T. Mock, *Corporate Transparency and Human Rights*, 8 TULSA J. COMP. & INT'L L. 15, 17 (2000) (defining transparency as a "measure of the degree to which information about significant procedures, plans, and actions is made available to interested parties").

135. OECD GUIDELINES, *supra* note 123, at 20; *Anti-Corruption Instruments*, *supra* note 124, at 13.

136. OECD GUIDELINES, *supra* note 123, at 20.

137. *Id.* The Guidelines also encourage corporate transparency with regard to corporate affiliates, as well as to material information "on: a) The financial and operating results of the company. b) Company objectives. c) Major share ownership and voting right. d) Members of the board and key executives, and their remuneration. e) Material foreseeable risk factors. f) Material issues regarding employees and other stakeholders. g) Governance structures and policies." *Id.*

138. Eliott, *supra* note 15, at 187; Heimann, *supra* note 60, at 152-59.

VI both set up a solid foundation for a corporate code of conduct that can be modeled according to the business culture of the specific country where the business is located. The recommendations do not specify dollar amounts or specific acts that constitute "corruption" across the board, rather they leave a wide margin for the corporation to create a code according to its own business and national standards. Other commentators have presented similar understandings of corporate needs.

## 2. *Dunfee & Hess and the "C2 Principles"*

One corporate code approach recommended by Dunfee and Hess is the Combating Corruption Principles ("C2 Principles"), which focuses on disclosure and transparent practices in corporate action without trying to "define" the different types of corrupt behavior.<sup>139</sup> According to the C2 Principles, a corporation must pledge to observe the following requirements:

1. To disclose publicly and make widely known its endorsement of the C2 Principles.
2. To establish a clearly articulated written policy against the payment of bribes and "kickbacks" by the firm's employees.
3. To implement the policy with due care and take appropriate disciplinary action against any employee discovered to have made payments in violation of the policy.
4. To provide training for employees to carry out the policy [and] to assist employees to act in compliance with the firm's policy.
5. To record all transactions fully and fairly, in accordance with clearly stated record keeping procedures and accounting controls, and conduct internal audits to assure no improper payments are made.
6. To report annually on the firm's bribery and corruption policy along with a description of the firm's experience in implementing and enforcing the policy.
7. To have the annual report in principle audited either by an independent financial auditor or by an independent social auditor, or both.
8. To require all agents of the firm to affirm that they have neither made nor will make any improper payments in any business venture or contract to which the firm is a party.
9. To require all suppliers of the firm to affirm that they have neither made nor will make any improper payments in any business

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139. Dunfee & Hess, *supra* note 103, at 482.

venture or contract to which the firm is a party.

10. To establish a monitoring and auditing system to detect any improper payments made by the firm's employees and agents.

11. To report publicly any solicitations for payments (or report privately to a monitoring organization or a social auditor).

12. To establish a system to allow any employee or agent of the firm to report any improper payment without fear of retribution for their disclosures.<sup>140</sup>

Similar to the OECD Guidelines, the C2 Principles "[b]y virtue of their lack of specificity . . . leave breathing room for decision-makers to exercise responsible ethical judgment."<sup>141</sup> The common denominator supporting the Guidelines and the C2 Principles is their emphasis on disclosure and transparency. Both are based on the understanding that corruption exists in secret and opaque transactions and that public exposure of these transactions will act as a strong deterrent. Both approaches also recognize that simply creating a detailed list of "corrupt" practices will be futile.

### *C. The Importance of Social [Re]action and Public Awareness*

The third essential element of a "portfolio approach" against corruption and international bribery is the active awareness and participation of the public. A public stance against corruption can have a serious impact on corporations just as the public stance on issues such as the environment and labor conditions has led to results.<sup>142</sup> The importance of public awareness has been emphasized by international organizations on various occasions. In a recent report on the application of the OECD Convention, the OECD expert group noted that "the area of awareness raising [sic] is one in which NGOs and civil society generally can make an important contribution."<sup>143</sup> Public awareness and participation is particularly important in the economies in transition where anti-corruption laws may be formally enacted, but the enforcement of

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140. *The Big Questions*, *supra* note 118, at 458-59.

141. *Id.* at 460.

142. See generally UNITED NATIONS CONFERENCE ON TRADE & DEV., DISCLOSURE OF THE IMPACT OF CORPORATIONS ON SOCIETY: CURRENT TRENDS AND ISSUES (2003), available at <http://r0.unctad.org/isar/Reports/20thsession/ISAR20/isar20english.pdf>. See also Mock, *supra* note 134.

143. OECD DIRECTORATE FOR FIN., FISCAL & ENTER. AFFAIRS, BULGARIA: PHASE 2, REPORT ON THE APPLICATION OF THE CONVENTION ON COMBATING BRIBERY OF FOREIGN PUBLIC OFFICIALS IN INTERNATIONAL BUSINESS TRANSACTIONS AND THE 1997 RECOMMENDATION ON COMBATING BRIBERY IN INTERNATIONAL BUSINESS TRANSACTIONS AND THE 1997 RECOMMENDATION ON COMBATING BRIBERY IN INTERNATIONAL BUSINESS TRANSACTIONS (2003), available at <http://www.oecd.org/dataoecd/8/19/2790505.pdf>.

the laws or even knowledge that such laws exist may still be lagging behind.

A case in point is Bulgaria, which ratified the OECD Convention and subsequently amended its criminal code in order to comply with the Convention's requirements.<sup>144</sup> Bulgaria also ratified the Council of Europe's Civil Law and Criminal Conventions on Corruption and introduced the Law on Access to Public Information.<sup>145</sup> A recent OECD report on Bulgaria's progress noted, however, that there is more to be done in the area of public and government awareness.<sup>146</sup> One of the recommendations was that there should be additional efforts to raise the level of awareness among ordinary citizens and governmental agencies that bribing a foreign public official is a crime.<sup>147</sup>

The situation in Bulgaria is common for many of the transition economies in the former communist bloc.<sup>148</sup> However, despite the need for higher awareness, there have been success stories where "[m]ajor think tanks, academics, [and] media . . . are increasingly forming coalitions to pursue or support anti-corruption initiatives [that] advocate and lobby for structured and at times institutionalized strategies to combat corruption."<sup>149</sup> Such coalitions "undertake educational activities, assist in assessment and drafting of legislation, and participate in the monitoring of privatization and procurement procedures. Prominent examples of such coalitions (i.e., SPAI, CoE), are found in Albania (hundreds of NGOs formed the Albanian Coalition against Corruption), Bulgaria (Coalition 2000), [and] Poland ("Against Corruption" Programme)."<sup>150</sup> Public coalitions and NGOs can monitor both the government and the corporate actors in their dealings and pressure them for change and higher levels of transparency. Some authors even suggest that NGOs may not only supplement, but outright supplant governmental action in the fight against corruption.<sup>151</sup>

International organizations have also been increasingly active in promoting anti-corruption initiatives. The important role of the OECD was already sufficiently addressed. Other international

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144. *Id.* at 7.

145. *Id.*

146. *Id.* at 10.

147. *Id.* at 10-11. Some of the recommendations included introduction of codes of conduct and compliance in the business community, as well as "practical training . . . for those actively involved in enforcement, including the development of guidelines and typologies," as part of a "training in international economic crime." *Id.* at 11.

148. See generally UNDP, *supra* note 101.

149. *Id.* at 8-9.

150. *Id.* at 9.

151. *The Big Questions*, *supra* note 119, at 461-68.

organizations that have become leaders in the anti-corruption movement are the World Bank, the IMF, and Transparency International.<sup>152</sup> Both the World Bank and the IMF underwent a long evolution in their underlying economic policy before they were able to address corruption with full force.<sup>153</sup> Transparency International has been most active in its anti-corruption efforts and has been publishing a number of corruption indexes that are increasingly important for the business world and the anti-corruption community.<sup>154</sup>

## V. CONCLUSION

The rise of corruption awareness is already an undisputed fact. Higher awareness has led to increasing inquiries into various anti-corruption strategies as well as to identifying lesser known, yet still very disruptive, forms of corruption such as state capture. Current experience and commentary seems to suggest that extraterritorial legislation in the fight against corruption is often ineffective.<sup>155</sup> Relying solely on legislation may be particularly ineffective in the fight against state capture, as state capture represents the distorted relationship between entrenched power groups and the lawmaking process of a country.<sup>156</sup> Commentators have pointed out that a more comprehensive approach that involves governments, businesses, NGOs, and public coalitions will be much more successful in the fight against corruption and state capture. Among these, of specific importance are corporate codes of conduct, which do not only discourage bribery, but also promote transparent corporate policies in operations and auditing. Of similar importance are NGOs and public coalitions comprised of citizens from all ranks of society that monitor procurement contracts, privatization deals, and lawmaking.<sup>157</sup>

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152. For a detailed discussion of the World Bank's anti-corruption efforts see Shihata, *supra* note 14, at 474-83.

153. *Id.* See also Jonathan Finer, *World Bank Focused on Fighting Corruption; Graft and Bribery, Once Tolerated, Punished by Blacklisting*, WASH. POST, July 4, 2003, at E1.

154. *Id.*

155. *Foreign Investors & Corrupt Practices*, *supra* note 12, at 6. The authors point out that FDI originating in the United States (which has been governed by the FCPA since the 1970s) "does not appear to be characterized by higher standards of corporate [governance]." *Id.*

156. *Beyond the Grabbing Hand*, *supra* note 18, at 11.

157. *Foreign Investment and Corrupt Practices*, *supra* note 12, at 7.

The underlying policy behind these efforts is the need for greater transparency and increased competition, which will expose instances of corruption and discourage further corrupt practices. Such a comprehensive, “portfolio” approach will strike the proper balance between the need for decisive anti-corruption actions on one hand, and the need to recognize the complexities of corruption in a pluralistic business community on the other.



