

Redesigning the Northern state to combat global corruption

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Introduction

The usual focus for concerns about corruption is the state in the South. But Northern states have a considerable impact on corruption both globally and in Southern countries, though their role has often been ignored. There are a myriad ways in which Northern states affect governance and corruption in Southern countries. These include direct political intervention; pushing particular policies either through multilateral or bilateral institutions; and even leading or failing to lead by example.

Two of the most damaging ways that Northern institutions impact upon corruption in developing countries, however, in terms of sheer resource loss to those countries, are bribery by Northern companies, and money-laundering by Northern banks of the proceeds of bribery and theft of state assets. These forms of corruption involving Northern actors are also important because they involve direct complicity by Northern individuals or institutions in corruption in developing countries. In turn, they have often involved indirect complicity by Northern states, which have historically turned a blind eye to and adopted a course of inaction in relation to these activities – activities, it is worth noting, that would not be tolerated if they concerned their own public officials.

This complicity, direct and indirect by Northern banks, companies and states, has the potential for substantial symbolic and political impact on corruption in Southern

countries. Clearly, if Northern countries operate double-standards with regard to corruption and money-laundering of the proceeds of corruption and theft, it becomes much harder for them to urge Southern countries to clean up their act on corruption or to impose anti-corruption conditionalities in their aid programmes.¹ Many development professionals, such as the World Bank's Daniel Kaufmann and anti-corruption experts from donor agencies like Britain's Department for International Development (DFID), in recognition of this, now talk of the need for an "international compact" on corruption, where Northern countries accept their collective responsibility. The Commission for Africa certainly recognised that collective responsibility and the role of Northern governments in combating corruption.

The scale of bribery and money-laundering is notoriously difficult to measure. The World Bank estimates that a total of \$1 trillion is spent on bribes annually (including bribes paid by firms and by ordinary individuals). Some \$200 billion is spent on bribes in government procurement contracts alone, and 60% of OECD companies interviewed in a 2004 survey said that firms in their sector paid bribes in non-OECD countries, expecting to spend up to 1% of their annual revenue in bribes.²

Companies invariably include the cost of a bribe in the value of the contract. This means that Southern countries end up paying for inflated contracts and, in some instances, for projects of little or no value to the population at large. Where such projects are funded by loans, public debt in those countries is also increased, adding further to the costs of corruption.

In terms of money-laundering, some African officials have estimated that \$400 billion has been looted from African states and stashed in foreign bank accounts, around \$140 billion from Nigeria alone.³ Others estimate that between \$20-40 billion of

¹ A prime example is Iraq, where corruption in the Coalition Provisional Authority is now coming to light, involving a total lack of accountability on the part of the Authority and the accompanying loss of resources.

² Kaufmann, Daniel, "Corruption, Governance and Security: The challenges for the rich countries and the world", chapter 2, *Global Competitiveness Report*, World Bank, Washington, DC, September 2004.

³ UN General Assembly, "Global Study on the transfer of funds of illicit origin, especially funds derived from acts of corruption", 28 November 2002.

corrupt money from transition and developing countries flows into Western banks annually.⁴ It is worth noting that this is not a problem limited to poorer countries. China is thought to have lost around \$50 billion in assets stolen by public officials who have fled abroad with it, and is consequently one of the keenest new signatories to the recent UN Convention Against Corruption that is designed to enable greater and swifter repatriation of looted assets.

Northern state complicity with bribery

So how are Northern states complicit in bribery and money-laundering? Certain government ministries in the North are devoted in various ways to export promotion, and have direct involvement in export contract processes where they might well come across corrupt practices. Foreign ministry officials, for instance, provide advice about which intermediaries companies should use (the most common way through which bribes are paid). Defence export promotion staff in defence ministries likewise have detailed inside knowledge about contracts, and often, particularly on government-to-government defence deals, considerable involvement in setting them up. Various trade officials in trade ministries provide direct export promotion services to companies. And export credit agencies, which provide insurance to companies operating abroad, directly underwrite agency commissions in the contracts they insure. As a result, these agencies have known for many years what levels of commissions companies are paying.

Until recently (less than a decade ago and in many countries less than five years ago), bribery of foreign officials was not treated as a crime in any Northern countries apart from the US and bribes were tax deductible. Bribes were regarded, and still are regarded by some, as “normal business practice” abroad, and are to this day most commonly hidden in “commission payments” made to intermediaries and agents. The view that bribery was normal business practice pervaded the thinking of Northern government officials who were involved in promoting their countries’ exports, and

⁴ Raymond Baker, Evidence given to Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, US Senate, November 1999, http://hsgac.senate.gov/111099_baker.htm.

saw bribery as an unpleasant but inevitable way for their countries' companies to win contracts in export markets where there was fierce competition.

Examples of complicity by Northern government officials are common. Perhaps one of the most telling is from a 1976 UK government document recently uncovered in the Public Records Office. Because exchange controls still applied during the 1970s, the government at that time knew about payments made by companies into banks of foreign officials abroad and was directly authorising those payments. The tone of the paper is set by a quote from George Bernard Shaw's play, *Pygmalion*, in which Colonel Pickering asks Mr Doolittle: "Have you no morals, man?" to which Mr Doolittle replies: "Can't afford them, Governor." After an extensive discussion of international developments to combat bribery, the document states that the UK government cannot take any unilateral action on this issue, despite its direct knowledge and authorisation of bribes, because "we cannot afford to lose overseas business – and much business it at stake – by adopting holier policies (as opposed to attitudes) than those of other industrial nations".⁵ This approach continued through the 1980s and into the 1990s.

The UK is by no means unique. In 1998, *Le Monde* reported that the French export credit agency, COFACE, had underwritten £2 billion worth of bribes on defence contracts in the previous three years. More recently, a *Wall Street Journal* investigation into Suharto-Era deals reported that American trade officials were briefing US businessmen during the mid- to late-1990s on how they could avoid violating the US Foreign Corrupt Practices Act while doing business in Indonesia, primarily by using intermediaries.⁶ And even relatively clean Sweden was engulfed by a small scandal in 2004 when it was found that a book prepared by the Swedish Ministry of Foreign Affairs for the private sector on how to do business in foreign countries, particularly Vietnam, stated that in Vietnam "when you are doing business

⁵ Memorandum by the Department of Trade, "Special Commissions and Allied Payments", April 1976. See Nicholas Gilby, "The UK Government and Arms Trade Corruption: A Short History", Campaign Against the Arms Trade, Goodwin Paper, Number 4, June 2005.

⁶ "Washington's Tilt to Business Stirs a Backlash in Indonesia", *Wall Street Journal*, 2/12/04.

with government authorities or government owned companies, you sometimes have to pay to complete a deal”.⁷

Broadly speaking, complicity has ranged from direct knowledge and authorisation (which has become increasingly rare), to a more common approach of “ask no questions, tell no lies”. The example of export credit agencies is instructive. The UK’s Export Credit Guarantee Department (ECGD), for instance, has given support to projects in numerous cases where there have been corruption allegations. These include the Lesotho Highlands Water Project. Several multinational companies have since been convicted in Lesotho for paying bribes to win contracts on this project. More recently and despite improved anti-corruption procedures, the ECGD gave support for a Nigerian Liquefied Natural Gas project, built by a consortium involving Halliburton, which is now under investigation in three different countries (the US, France and Nigeria) for alleged bribes. Until 2003, however, the UK’s ECGD asked few questions of companies that would have enabled it to assess whether bribery was occurring on projects to be supported. It did not, for instance, ask companies who their agent was or many details about the agency commission they were about to insure. Having strengthened its procedures in 2004 to require such information, a huge industry backlash led to ECGD backtracking in December 2004 and allowing companies *not* to provide that information. In other G8 countries, export credit agencies still ask no questions about agents or agency commission at all. And no export credit agencies have proper and robust debarment procedures on a par with those of the World Bank.

In other cases, complicity has involved pressurising Southern countries to drop corruption investigations involving Northern companies and to honour contracts won in dubious circumstances. The best known example is Enron’s Dabhol project in India, where there is a large amount of circumstantial evidence that bribery occurred, but where the US government pressurised the Indian government to honour its guarantees on the project.

⁷ OECD Working Group on Bribery, “Sweden: Phase 2 Report on the Application of the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions and the 1997

In recent years, all OECD countries have signed up to various international instruments to combat corruption and passed national legislation outlawing bribes to foreign officials. However, complicity has not gone away; rather, it now takes the form of inaction in the face of allegations. It is telling that there have been very few prosecutions for bribery since the OECD Convention on Combating Bribery came into effect in 1999. Even in the US, prosecutions are few and fines for companies comparatively low. In the UK, there have been over 40 allegations over the past few years, not a single prosecution and only a handful of investigations. Until 2005, the laws in the UK were essentially not being enforced in any way, with lack of government resources and prioritisation sending the message to law enforcement agencies that this was not an issue to be taken very seriously.⁸

Northern state complicity with money-laundering

Complicity with regard to money-laundering has perhaps been more indirect than bribery and tended more towards inaction. Some money-laundering experts, such as Raymond Baker, argue that US and European governments have actively “facilitated” illegal capital flight from Southern countries. Baker claims that there have been open statements by US Treasury Department officials that it was US policy to attract flight capital out of other countries, and whether it was legal or not did not concern them.⁹ Certainly, it is true that Northern governments have not been seen proactively to discourage corrupt money coming into their countries. It is also the case that, despite new anti-money-laundering regimes in all Northern countries, very few banks are prosecuted for money-laundering.

Recommendation on Combating Bribery in International Business Transactions”, September 2005, page 11.

⁸ Susan Hawley, “Enforcing the Law on Overseas Corruption: towards a model for excellence”, The Corner House, June 2004. *See also* OECD Working Group on Bribery, “UK: 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”, March 2005.

⁹ Raymond Baker, Evidence given to Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, US Senate, November 1999, http://hsgac.senate.gov/111099_baker.htm.

A good example of inaction in the US was uncovered by the July 2004 US Senate Investigation into Riggs Bank and its holding of accounts by General Pinochet and officials from Equatorial Guinea. The investigation found that enforcement of US money-laundering legislation was “uneven and at times ineffective”.¹⁰ This was despite draconian anti-money-laundering legislation introduced after the September 11th attacks on New York’s World Trade Center. The Committee found that there had been ‘regulatory failure’ by the Office of the Controller of Currency (OCC). This included a senior OCC enforcement official advising against taking action against Riggs, and a month later taking up employment with Riggs Bank, creating a serious conflict of interest. A US General Accounting Office report also found that federal regulators allowed anti-money-laundering compliance problems to continue for years with correction.¹¹ Riggs Bank has now been indicted but up until the end of 2003, no US bank had ever been convicted of money-laundering, despite estimates that US banks launder around \$250 billion a year.¹²

In the UK, similarly, there has been little apparent government action to crack down on the proceeds of corruption coming into the UK banking system, and no banks have been prosecuted for money-laundering. Jack Blum, another international money-laundering expert, believes that a significant amount of Nigerian’s stolen wealth is in London.¹³ A Financial Services Authority investigation in 2001 found that \$1.3 billion of money had passed from Nigeria through London during the four-and-half years that the dictator Sani Abacha was in power, and that 15 banks involved had “significant control weaknesses” in their anti-money-laundering programmes.¹⁴ While the FSA imposed immediate remedial action programmes on seven of the banks, none of the banks were ever investigated or prosecuted by the law enforcement agencies. More recently, in October 2003, the head of Nigeria’s Economic and Financial Crimes Commission stated that he had substantial evidence that 20 of Nigeria’s serving governors owned luxury houses in London, despite the fact that it was illegal

¹⁰ US Senate Permanent Subcommittee on Investigations, “Money laundering and Foreign Corruption: Enforcement and Effectiveness of the Patriot Act”, 15 July 2004.

¹¹ Ibid, page 5.

¹² “Money Laundering: a wink and a nod”, *Houston Chronicle*, 25/12/03.

¹³ Jack Blum, “Nigeria must go after looters”, *Nigeria Village Square*, July 2005, http://nigeriavillagesquare1.com/articles/laolu_akande/2005/07/nigeria-must-go-after...

¹⁴ Financial Services Authority, Press Release, “FSA publishes results of money laundering investigation”, 8/3/01,

for Nigerians to own property abroad.¹⁵ Two Nigerian governors were arrested, charged and allowed on bail over the past year by UK police. One of them was found with £1 million in cash in his house and £10 million worth of property in London. Both have managed to skip bail and return to Nigeria (one dressed as a woman) where they enjoy immunity. It is not clear what has happened, if anything, in relation to the other 18 governors. The Kenyan authorities were also believed to be seeking to recover \$1 billion of assets stolen from the public purse in Kenya, some of which was believed to be in the UK, including in the form of shares in two London hotels.¹⁶

The UK anti-money-laundering regime relies heavily on stringent duties placed on banks, lawyers and estate agents to report any suspicious activities to the police. However, a recent Home Office-sponsored study of the suspicious activity reporting system in the UK found that the police had insufficient resources to use the information provided by the system, and were under-utilising the reports.¹⁷ So far, there have been 150 such reports on foreign public officials transferring money or assets to the UK, but it is not clear how many investigations have resulted, and few have been reported in the press. Government priorities are focused much more heavily on drugs and terrorism, while confiscating the proceeds of corruption from poorer countries is not a high priority for law enforcement agencies. Meanwhile, it is likely that some resistance from both government officials and law enforcement agencies to tackle the issue more rigorously in the UK may derive from the fact that some of the money is likely to come from key UK foreign allies such as Middle Eastern royal families, or from Russian oligarchs whose wealth, some argue, the UK is keen to attract rather than turn away.¹⁸

Conclusion: how do Northern states need to be redesigned?

My argument is that the Northern state needs to be redesigned in order to combat corruption and to end complicity of Northern governments in corruption.

¹⁵ “20 serving govs own houses in London, says Crime Commission boss”, *Daily Trust* (Nigeria), 7/10/03

¹⁶ “Found: Sh75bn stashed abroad by Kanu looters”, *Daily Nation* (Kenya), 17/12/03.

¹⁷ Matthew Fleming, “UK Law Enforcement Agency Use and Management of Suspicious Activity Reports: Towards Determining the Value of the Regime”, 29/9/05.

Some of the redesign of Northern states is already underway. The fairly robust peer review process led by the OECD Working Group on Bribery has put pressure on Northern states to change some of their laws and practices in order to implement the OECD Convention on Combating Bribery. That process has started to identify various ongoing and common weaknesses. Loopholes abound. For instance, the fact that neither the Convention nor national laws in Northern states cover bribes paid through subsidiaries is a major weakness. Many Northern states, meanwhile, do not have proper corporate liability statutes. This makes it very difficult to sanction companies for committing bribery directly. Most Northern states do not have debarment or blacklisting policies despite the fact that debarment from public procurement is potentially one of the most potent deterrents against bribery and is used in various Southern countries. Those states that do have such policies, like the US, do not apply them in a rigorous or consistent way. And finally, many Northern states, including the UK, simply have not prioritised or resourced enforcement of anti-bribery laws.

Some of the difficulties in redesigning the Northern state mirror those of redesigning the Southern state to combat corruption: lack of political will or real political buy-in; too much lip service as opposed to action; and even perceived or actual political interference in investigations. The fact that several Northern states have been blocking recent attempts at the OECD to introduce higher multilateral standards on combating bribery for export credit agencies shows that these difficulties are real and persistent.

Of course, if Northern states stopped their multinationals tomorrow from paying bribes and their banks from laundering the proceeds of corruption, corruption in Southern states would not disappear. The reality is that corruption is not going to disappear overnight and probably never at all. But if the global community wants to put an end to some of its worst ravages, Northern states have to honour the international compact, and look seriously at designing out their own complicity in corruption.

¹⁸ On Russian oligarchs, *see* Tristram Hunt, “The Mayor of London is backing a campaign to entice Moscow’s oligarchs to bring their ill-gotten gains to his city”, *The Guardian*, 25/10/05.