Turning a Blind Eye

Corruption and the UK Export Credits Guarantee Department

Dr Susan Hawley

June 2003

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Executive Summary

Corruption undermines democratic accountability, discourages good governance and worsens poverty. In poorer countries, corruption has a particularly devastating and immediate impact: it diverts public expenditure away from areas such as health and education to more immediately lucrative ones such as construction and defence.

The international community is increasingly demanding that poor countries eradicate corruption within their countries if they want to receive aid. Yet, despite a major international convention on combating bribery signed by 34 largely industrialised countries in 1997, large and mainly Western companies continue to bribe their way into government contracts around the world. Western governments are not doing enough to tackle this kind of corruption effectively.

Export Credit Agencies (ECAs) play an important role in exacerbating corruption. ECAs use taxpayers' money to support companies doing business abroad and are now the largest source of public finance for private sector projects worldwide As this study reveals, such taxpayers' money is often underwriting corruption by supporting projects that involve bribery, corruption and embezzlement. And it is the people of Southern countries – the people who can least afford it – who are ultimately picking up the tab in the form of increased debts and overpriced, poorly planned projects.

Focusing on Britain's Export Credits Guarantee Department (ECGD), this study is the first ever in-depth investigation of an ECA's record on corruption. Its assessment of nine specific ECGD-backed projects reveals an array of institutional practices within the Department that have allowed corruption to go unchecked. These include the ECGD's:

- Persistent failure to take account of corruption allegations when deciding whether to back projects;
- Reluctance to investigate corruption allegations and its woefully inadequate investigatory procedures;
- Unwillingness to pass on allegations to the appropriate external investigatory authorities;
- Disregard for international concerns about corruption in countries in which it supports projects;
- Inadequate vetting of UK companies with poor track records of corporate governance;
- Own lack of openness and accountability regarding projects that it backs.

This study examines recent reforms within the ECGD relating to corruption and finds that its new procedures, while an important step forward, fall short of international best practice, and of what is required to combat corruption more effectively. The study looks at one project backed by the ECGD since it brought in its new procedures, which reveals ongoing weaknesses in the ECGD's approach to corruption. It finds that:

- The ECGD needs to be doing more to foster compliance with the UK legislation that implements the OECD Convention on Combating Bribery and makes bribery abroad illegal;
- The ECGD has yet to meet all the requirements for Export Credit Agencies under the OECD Action Statement on Bribery and Officially Supported Export Credits: in particular, it has yet to make companies applying for support aware of the legal consequences of bribery and to take sufficient evidence of corruption as a reason for withholding support;
- Despite receiving seven allegations of corruption in as many years, the ECGD has only referred two allegations to the UK's investigatory authorities, one of them within the last few months, although it states that it makes referrals as a matter of routine procedure;
- The contract the ECGD signs with companies requires the ECGD to give five days' notice before entering the premises of the company for inspection and audit and to hold in confidence any information that it obtains, thus rendering its investigatory procedures inadequate;
- The ECGD's new warranty procedure, whereby companies state that they have not

engaged in bribery, risks being unenforceable because of the ECGD's lack of investigatory powers;

- The ECGD continues to give backing to projects in countries that have severe corruption problems, and in several instances has given backing even though the buyer institution in the host country has been recognised as among the most corrupt government department or state company in that country; and

- The ECGD still has some way to go in being open and transparent enough to be truly publicly accountable.

Action is required if the UK is to live up to its international commitments to combat bribery and corruption. The Corner House strongly recommends that:

- The ECGD stipulates that in order to be eligible for cover companies must be able to show that they have a properly enforced and comprehensive code of conduct bringing them into compliance with the UK legislation that implements the OECD Convention on Combating Bribery;

- The ECGD rewords its warranty to make companies aware of the legal consequences of bribery in international business transactions;

- The ECGD seriously rethinks its investigatory procedures, preferably through an independent review. In particular, it needs to rewrite the contract it signs with companies to give it greater powers of investigation and to make a formal commitment to refer all cases of alleged corruption to the Serious Fraud Office or appropriate police force;*

- The ECGD acts immediately to bring itself into line with international best practice by debarring from further ECGD cover or insurance any company found guilty of fraud or corruption for a period of at least three years;

- The ECGD introduces a requirement that the contracts it supports are awarded through transparent, fair and competitive tender processes, and that it publishes post-issue monitoring reports on projects with significant cost over-runs;

- The ECGD introduces a requirement that buyer institutions in countries where it supports projects meet certain benchmarks on institutional integrity, including their ability to account for resources, their commitment to transparency, public disclosure and public participation, and their commitment to transparent public procurement processes;

- The ECGD extends its due diligence to ensure that advice from donor agencies and civil society is sought regarding the appropriateness of projects before it gives cover;

- The ECGD introduces a system of staff incentives that rewards underwriters for providing cover to projects that meet enhanced due diligence standards for combating corruption, and penalise those who consistently fail to meet these standards;

- The ECGD enhances its own transparency and accountability by making it a condition of cover (rather than an option which companies can reject) that the ECGD publishes full details about projects it supports; includes in its annual report a list of all projects covered under its insurance business and Overseas Investment Insurance scheme; and includes in its annual report a detailed breakdown of the corruption allegations it has received, investigated and passed to the Serious Fraud Office.

* As this report was going to press, the ECGD stated that it has now "signed a memorandum of understanding with relevant agencies obliging us to report any allegation of bribery and corruption to the National Criminal Investigation Service (NCIS)." *See* this report, Appendices, "ECGD Response to Turning A Blind Eye", p.78.

Introduction

"Politicians and public officials from the world's leading industrial countries are ignoring the rot in their own backyards and the criminal bribe-paying activities of multinational firms headquartered in their countries."

Peter Eigen
Chairman of Transparency International
May 2002[1]

Corruption – broadly defined as "the abuse of public or private office for personal gain"[2] – takes many different forms, from the routine cases of bribery or petty abuse that are said to "grease the wheels" to the amassing of spectacular personal wealth through embezzlement or other dishonest means. The international community is adamant that corruption must be stopped. Yet there is a deep hypocrisy in its approach to doing so. At the heart of this hypocrisy are the taxpayer-funded export credit agencies of industrialised countries.

The international community is demanding that the governments of poorer countries eradicate corruption within their countries if they want to be considered eligible to receive Western aid.[3] Yet, despite a major international convention on combating bribery signed by 34 countries in 1997 and in effect from February 1999, large, mainly Western, companies continue to bribe their way into getting governments contracts in poorer countries.

Many of these companies are supported in various ways by export credit agencies. These are government departments, found in most Western countries, which use taxpayers' money to insure domestic companies doing business abroad against risks such as the company not being paid or the whole project collapsing. The price of Western companies' bribery is, however, ultimately paid for by not by Western governments but by the people of the Southern countries in which the companies operate. They pay for it in the form of increased debts incurred for overpriced and poorly planned projects that often provide little benefit to people or country.

The UK's export credit agency, the Export Credits Guarantee Department, is not an exception to this rule. It has a long history of institutional failure in addressing corruption. Since 2000, it has announced various measures to address bribery and corruption. Yet these measures are inadequate and it remains to be seen whether they will make a substantial difference.

Section One of this report outlines the ongoing problem of bribery and corruption in international business, the role of export credit agencies in perpetuating this corruption, and its cost to poorer countries. Section Two looks more specifically at the history of the UK's Export Credits Guarantee Department (ECGD) in backing projects or companies that have involved corruption. It details nine specific case studies, and analyses what this history reveals about the institutional culture operating within the ECGD. Section Three examines the ECGD's new anti-corruption measures and shows that they fall short of what is required to combat corruption in the projects that the ECGD backs. It makes a series of detailed policy recommendations as to how the ECGD could and should sharpen up its act in tackling corruption.

1. Transparency International, Press Release, "Bribe Payers Index 2002", 14/5/02
2. Asian Development Bank, *Anti-Corruption Policy: Description and Answers to Frequently Asked Questions*, Manila, Philippines, 1999, p.5.
3. The US has introduced a "Millennium Challenge Account", for instance, which will give aid only to countries that prove that they are fighting corruption and introducing market-friendly policies (*The East African*, 2/12/02, "Corruption: East Africa to be denied new US aid"). The UK government has also announced a new source of funding for development, the International Finance Facility, which will be accompanied by "tough conditionality – [insisting] on corruption-free regimes that pursue stable, equitable and sustainable economic growth" (Gordon Brown, "An assault on poverty is vital too", *The Guardian*, 13/2/03, p.22).

Section One
Bribery – Business As Usual

Between 1994 and 2001, the US government received reports of 400 international contracts worth $200 billion signed between governments and businesses worldwide that purportedly involved bribery.[4] Between May 2001 and April 2002 alone, the US government learned of 60 contracts worth a total of $35 billion that had been affected by bribery.[5] Some 70% of the allegations that the US government received in 2000-2001 involved companies from countries that had signed up to the OECD's 1997 anti-bribery Convention.[6] World Bank research shows that one-third (35%) of foreign companies operating in the countries of the former Soviet Union pay kickbacks, of which US and European companies are among the worst offenders. The Bank concludes that its research does "not support the notion that transnational bribery laws . . . have led to higher standards of probity in overseas public procurement".[7]

Although the OECD anti-bribery Convention has now existed for six years and been operational for four, it seems to have had little impact on company behaviour. The annual Bribe-Payers Index for the year 2002 collated by Transparency International (TI), an international NGO working against corruption, shows that only 35% of the 835 business experts they interviewed had compliance programmes in their companies, while 42% of those interviewed had not even heard about the Convention.[8] TI found that only one in five (19%) senior managers of foreign firms based in emerging market countries,[9] where the available evidence suggests that bribery is most likely to take place, were aware of the Convention.[10] A 2002 survey of business practice by EU firms, including UK ones, carried out by the UK investment company Friends Ivory and Sime (FIS), found that while 87% of companies responding to their survey[11] did have internal codes of conduct governing bribery and corruption, less than 25% had proper enforcement mechanisms within the company that would make such codes effective.[12] Some of the codes ruled out receiving bribes but not giving them, or allowed "local customs" to take precedence over the company's anti-corruption rules.

John Bray, an anti-corruption expert at Control Risks Group (a UK-based business risk consultancy specialising in providing companies and governments with political and commercial risk analysis and business intelligence) notes that "experience shows that [anti-corruption] codes will have little impact unless they are actively supported by top management."[13] But even this, he says, is not enough. As long as promotion within companies depends on winning business rather than observing company "rules", staff will remain under considerable pressure to bring in business to the company and to win contracts – at whatever cost.

On paper, the OECD anti-bribery Convention would seem to set out sufficient rules to combat Western companies engaging in corruption by paying bribes. The Convention requires each signatory country to enact national legislation making it a criminal offence to bribe a foreign public official.[14] So why has it had so little impact? Several answers suggest themselves. One reason is that, with the exception of the United States,

4. *The Economist*, "The Short Arm of the Law", 28/2/02. As the only government that had legislation actively prohibiting bribery of foreign public officials until the OECD anti-bribery Convention, the US government has monitored bribery in international contracts on a regular basis for many years, not least to assess how much business it loses as a result of its legislation. It produces an annual report, *Battling International Bribery*, which monitors other countries' compliance with the OECD Convention and includes a classified annex listing foreign companies about which the US government has received credible information that they have engaged in bribery.
5. Control Risks Group, *Facing Up To Corruption – Survey Results 2002*, p.5.
6. US Government, "Third Annual Report to Congress: Implementation of the OECD Anti-bribery Convention", 29/6/01, www.usinfo.state.gov/topical/econ/group8/summit01/wwwh01062905.html.
   The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions was signed by all 30 OECD countries as well as four non-OECD countries (Argentina, Brazil, Bulgaria and Chile) in 1997 and came into effect in February 1999 after six of the major OECD countries ratified it. The Convention now has 35 signatory countries (Slovenia signed in late 2001), of which 34 have ratified it.
   The Organisation for Cooperation and Development (OECD) comprises 30 of the world's richest countries, including EU countries, the US, Japan, Australia, New Zealand, Mexico, the Czech Republic, Hungary, Poland and Korea. Based in Paris, with an annual budget of $200 million, the OECD calls itself a "club of like-minded countries" that believe in market economics and pluralistic democracy. It provides a forum for discussion on economic and social policy issues for governments, as well as producing research, policy papers, and international treaties and agreements. *See* http://www.oecd.org/about/general.
7. Joel Hellman, Geraint Jones and Daniel Kaufmann, "Are Foreign Investors and Multinationals Engaging in Corrupt Practices in Transition Economies?" *Transition*, May-June-July 2000, pp.5-6.
8. Transparency International, Press Release, "Bribe Payers Index 2002", 14/5/02
9. The top emerging market countries are Brazil, China, India, Indonesia, Mexico, Poland, South Africa, South Korea, Taiwan and Turkey.
10. *Financial Times*, 17/10/02, Letter to the Editor from Dr Peter Eigen, Transparency International Chairman, "Anti-bribery convention needs support".
11. 33% did not respond at all.
12. Friends Ivory and Sime, "Governance of Bribery and Corruption: A survey of current practice", February 2002, http://www.friendsis.com/uploadFiles/Area%20of%20Engagement%20-%20Bribery%20%20Corruption%20%20Report%20Feb%2002.pdf.

no company in any OECD country has been prosecuted for or convicted of bribery since the Convention came into effect. As John Githongo of Transparency International Kenya puts it: "Until people are brought before the courts, the OECD Convention will not make a difference to the developing world".[15]

Bribery is notoriously difficult and potentially expensive to prove.[16] It often depends on a dissatisfied party to the bribe turning whistleblower for any information to come out in the first place. Or it requires extensive forensic auditing and investigations in various places, including offshore tax havens, to come up with sufficient evidence for a prosecution. Companies meanwhile almost always hide behind the defence that the bribe was either a legitimate commission or that they had no knowledge of the bribe in cases in which the bribe was made through an agent or subsidiary. Western governments are often reluctant for investigations into bribery to go ahead for fear of upsetting trade or diplomatic relations with the country in which a foreign official is alleged to have taken a bribe. And law enforcement agencies still tend to have the attitude that bribe-giving companies are simply the victims of greedy foreigners who demand bribes – or that bribery is just the way of doing business abroad.[17]

The complexity of corruption cases means that, if Western governments are serious about tackling bribery carried out by their companies, they have to devote sufficient resources to their law enforcement agencies and make it a priority for these agencies to pursue allegations of bribery. Recent initiatives to combat money-laundering, such as strengthened national legislation, in order to counter terrorism should theoretically provide governments and law enforcement agencies with far greater access to information about bribes and other corrupt payments, although it is not clear that such information is leading to any more investigations into or convictions for bribery.

Even in the US, which has had legislation since 1977 criminalising the payment of bribes to foreign government officials and political parties by US businesses and individuals and requiring companies to keep accurate and detailed accounts reflecting all transactions,[18] the pursuit in the courts of companies paying bribes outside the US has been limited. Since the Foreign Corrupt Practices Act (FCPA) came into force, there have been 32 criminal prosecutions and 14 civil enforcement actions with 21 convictions – an average of one conviction a year.[19] Lack of funds for proper enforcement, high standards for initiating prosecutions, the self-regulation approach of the US Securities and Exchange Commission, and fluctuating political will have all been cited as reasons for why the FCPA has not been as effective in bringing American companies to book as it might have been.[20] This may explain why World Bank research shows that 42% of US companies pay kickbacks to gain government contracts in former Soviet Union countries.[21] Transparency International found that US companies were perceived as *more* likely to bribe than French, Spanish, German or British companies – only Italian companies beat them in the bribery stakes involving US and EU firms. A recent survey by Control Risks Group showed that 67% of those they questioned believed that US companies used middlemen, such as agents, joint venture partners or foreign subsidiaries, to get around the FCPA.[22]

Ironically, the US stance on corruption may be exacerbating the need

13. John Bray, "Beyond compliance: corruption as a business risk", paper presented to conference on *Fighting Corruption in Developing Countries and Emerging Countries: the role of the private sector*, Washington DC, February 1999.
14. The term "foreign official" is meant to include anyone holding a "legislative, administrative or judicial post in a foreign country" as well as anyone in public sector companies and international organisations. Bribery is prohibited not just in procuring orders but also in regulatory proceedings (including those involving environmental permits), tax and customs matters, and judicial proceedings. The Convention also requires governments to:
    – ensure proper punishment for bribery of a foreign official (including prison sentences and fines);
    – tighten accounting and auditing requirements by prohibiting "the establishment of off-the-book accounts, the making of off-the-books or inadequately-identified transactions, the recording of non-existent expenditures, the entry of liabilities with incorrect identification of their object, as well as the use of false documents by companies . . . for the purpose of bribing foreign public officials or of hiding such bribery" (OECD Convention, article 8.1)
    – provide for international legal cooperation, including extradition of guilty parties;
    – take steps to end tax deductibility for illicit payments.
15. Transparency International, Press Release, "Bribe Payers Index 2002", 14/5/02
16. Bribery has also become more sophisticated. Companies now are as likely to pay for the medical or educational expenses of a relative, or lend the company credit card to the foreign public official as to make a direct payment.
17. Interviews that The Corner House conducted with various senior law enforcement officials in the UK in the autumn of 2002 regarding enforcement of the UK law on bribery confirmed that such cases are not high priority because of the expense involved in launching an investigation and the fear that the chances of prosecution are low.
18. The US Foreign Corrupt Practices Act specifically excludes facilitation payments, and does not directly prohibit bribery committed by US-owned foreign subsidiaries.
19. Response of the United States, Questions Concerning Phase 2 [of OECD Convention on Bribery – monitoring], www.usdoj.gov/criminal/fraud/fcpa/phaseII.htm.
20. Ran Goel, "Anti-Corruption Measures at Export Development Canada", Independent Study Course, 22/4/02, p.2. In 1988 amendments to the FCPA made under the Reagan administration weakened its force by raising the threshold for prosecution and redefining facilitation payments in a looser way. The fact that no other country had similar legislation has also effectively undermined political will by successive administrations to enforce the FCPA with much rigour.
21. Joel Hellman, Geraint Jones and Daniel Kaufmann, "Are Foreign Investors and Multinationals Engaging in Corrupt Practices in Transition Economies?" *Transition*, May-June-July 2000, pp.5-6.
22. *Financial Times*, 15/10/02, "Laws fail to halt international business bribery".

perceived by companies based elsewhere in the world to bribe. While research shows that US companies do still bribe, evidence suggests that these companies are able to rely on the US government exerting heavy political pressure to win contracts for them. In some instances, the US has threatened to sever diplomatic links with a country and even development aid if it does not award a contract to a US company.[23] There is some suggestion that some European and Asian companies feel that the only way they can compete against this political pressure is to resort to bribery.[24]

Another reason why the OECD anti-bribery Convention is ineffective is that the OECD's monitoring of its implementation by signatory countries is slow.[25] The OECD was meant to have reviewed the effectiveness of the legislation that each country had introduced to implement the Convention by the year 2005. Since November 2001, it has reviewed four countries, and is only able to review three to four countries a year. At this rate, it will be 2010 at the earliest before all the signatories to the Convention have been assessed.

The main reason, however, that the OECD Convention and anti-corruption legislation in general has had little effect is, in the words of *The Economist*, that "there are holes in the anti-bribery laws that are big enough for a half-blind elephant to blunder through."[26] The biggest of those holes is that companies are not held responsible for the actions of their subsidiaries or of agents acting on their behalf.[27] As a Control Risks Group survey found in 1997, 56% of European companies and 70% of US companies said they "occasionally" used middlemen such as agents, joint venture partners or subsidiaries to make corrupt payments; while 44% of European firms and 22% of US ones admitted to doing so regularly.[28] Even the OECD recognises that its Convention's omission of subsidiaries is a major weakness in the agreement.[29]

Until the loopholes are tightened and there is real political will to monitor and pursue domestic companies who engage in bribery, it looks as if bribery is here to stay.

Export Credit Agencies

Export Credit Agencies (ECAs) are for the most part governmental or semi-governmental agencies that use taxpayers' money to help their country's companies win investment and export business overseas. [30] They are the largest source of public finance for private sector projects in the world. ECAs typically provide export finance in the form of guarantees and insurance (although some also provide direct loans). The main purpose of their support is to protect companies against the main commercial and political risks of not being paid while operating abroad.[31]

There can be little doubt that ECAs are now large and powerful players in international business. They now underwrite 10% of global exports from large industrial countries, whose exports account for three-quarters of total world exports.[32] Between 1982 and 2001, ECAs supported $7,334 billion worth of exports, primarily to developing countries, and $139 billion of foreign direct investment.[33] In 2000, export credit agencies were providing a total of $500 billion in guarantees and insurance to companies operating in developing countries, and issued $58.8 billion worth of new export credits that year alone.[34] This compares to a

23. In 1995, the US government threatened to cut off aid to Mozambique if its government did not award a contract to Enron for constructing a natural gas pipeline (Mark Clifford & Pete Engardio, "Enron hasn't made many friends in the Third World", *Business Week*, 12/2/01). In Uganda in 1999, the US Secretary for Trade, Denis William, warned, meanwhile, that US-Ugandan relations would be damaged if legislation that would enable a US company to build a dam in the country was not enacted (S. Nganda, "Who reaps from new power law", *The Monitor*, 29/9/00).
24. *Newsweek*, "The End of Swag", 1/7/02
25. The OECD Convention is accompanied by two stages of monitoring that are carried out by "peer" review. Phase 1 monitoring assesses whether the legislation passed in each country to implement the Convention was adequate. By the end of 2002, all 31 countries that had introduced legislation had been reviewed, three countries (Brazil, Chile and Turkey) had yet to put such legislation in place, and Slovenia was yet to be reviewed. The UK's initial stance that its existing corruption legislation was sufficient to implement the Convention was heavily criticised in this review process, leading to the hasty inclusion of clauses prohibiting bribery of foreign public officials in the 2001 Anti-Terrorism, Crime and Security Act, which came into effect on 14 February 2002. Phase 2 of monitoring, which began in November 2001, assesses enforcement of the implementing legislation. So far, five countries have been reviewed under Phase 2 (Finland, US, Iceland, Germany and Bulgaria) while Canada, France and Norway are due to be reviewed during 2003. The UK will be reviewed in 2004.
26. *The Economist*, "The Short Arm of the Law", 28/2/02
27. In the UK, companies can be found guilty under the law of conspiracy of "conspiring to make corrupt payments". Juries are able to infer a shared corrupt intention between an agent or subsidiary and the company. But it is exceptionally hard for the prosecution to provide hard evidence of such a shared intention. (*See* Herbert Smith lawyers, "Bribery and Corruption: Oiling the Wheels: Addressing Bribery Overseas in UK and US Legislation", *Power Economics*, 30/4/02). Under the US Foreign Corrupt Practices Act, meanwhile, a US business can be prosecuted for bribery carried out by a third party on its behalf only if it can be proved that the company might reasonably have known that the third party was going to make a corrupt payment. As already noted, that knowledge is exceptionally hard to prove if the company denies it vigorously enough.
28. John Bray, "Beyond Compliance: Corruption as a Business Risk", paper presented to conference on *Fighting Corruption in Developing Countries and Emerging Countries: the role of the private sector*, Washington, February 1999.
29. OECD Directorate for Financial, Fiscal and Enterprise Affairs, *Questionnaires on bribery acts in relation to foreign political parties, party officers and candidates, and on the role of foreign subsidiaries*, 20 September 2001.

total of $60 billion given out globally in overseas development assistance that year and the $41 billion provided as loans by multilateral development banks (such as the World Bank or Asian Development Bank) in 2000.[35] Moreover, ECAs play a crucial role in the privatisation of developing countries' public enterprises: they provide Western companies with investment insurance when they bid to buy or run them. ECA investment insurance has rocketed from $9 billion in 1990 to $58 billion at the end of 2000 largely because of this privatisation.[36]

There are now 76 export credit agencies in total from 62 countries – 51 of which are members of the Berne Union, the international trade association for export and investment insurance business.[37] The largest and most influential ECAs are:

- the Export Import Bank (Ex-Im) of the US, which provides $12-15 billion of loans, guarantees and insurance a year, and the Overseas Private Investment Corporation (OPIC), which provides $1-2 billion a year in loans, guarantees and insurance;
- the Export Development Corporation (EDC) of Canada, which gives short-term and medium- to long-term export and investment support worth $30 billion a year;
- the Japan Bank for International Cooperation (JBIC – formerly JEXIM, Japanese Export Import Bank), which provides $20-25 billion per year, and Nippon Export Investment Insurance (NEXI), which gives $8 billion in medium- and long-term support and $86 billion in short-term insurance per year;
- the Export Credits Guarantee Department (ECGD) of the UK, which issues $5-6 billion of guarantees a year for medium- to long-term business (its short-term business was privatised in 1991);
- Compagnie Française d'Assurance pour le Commerce Exterieur (COFACE) of France which issues $5-6 billion of support for medium- and long-term business and $40-2 billion for short-term business a year;
- Hermes of Germany, which provides $8-10 billion in guarantees for medium- and long-term business and $5-9 billion in guarantees for short-term business a year, and KfW (Kreditanstalt für Wiederaufbau), which provides export insurance, loans for exports and tied aid to the tune of $10-11 billion a year;[38]
- Istituto per i Servizi Assicurativi per il Commercio Estero, formerly Sezione Speciale per l'Assicurazione del Credito all'Esportazione (SACE),[39] of Italy, which gives $5.5 billion of support for medium- to long-term business each year and $200 million for short-term business.[40]

While the terms of loans supported by ECAs to developing countries are similar to commercial terms, ECAs generally provide cover for larger sums, longer periods and for higher risk countries than the private sector is willing to do. Like the private sector, they charge companies a premium. But premium charges have generally been low, and income from premiums has only ever covered a portion of the losses made by ECAs.[41] Indeed, historically, ECAs have operated at a loss, paying out far more in claims than what they have received in the form of premium charges and recoveries on claims. Between 1982 and 1997, export credit agencies lost taxpayers from their respective countries a total of $64.5 billion.[42]

30. For a full analysis of export credit agencies, *see* Nicholas Hildyard, *Snouts in the Trough: Export Credit Agencies, Corporate Welfare and Policy Incoherence*, Corner House Briefing No 14, June 1999. www.thecornerhouse.org.uk/briefing/14ecas.html.
31. These risks include war, nationalisation/expropriation, moratorium on external debt, break off in trade relations, foreign exchange shortages, the risk that the project will not be completed or is not commercially viable, insolvency of the buying institution, a refusal by the buying institution to pay, or importing government interference with the project.
32. Horst Kohler, "Reforming the International Financial System", in *The Berne Union 2001 Yearbook*, February 2001.
33. Vivian Brown, "Looking to the future", *Berne Union Yearbook 2003*, p.5.
34. World Bank, *Global Development Finance 2002*, Chapter 4; OECD, "Officially supported export credits – levels of new flows and stocks", data for 1999 and 2000.
35. Figures from OECD DAC Statistics and US Treasury note on Multilateral Development Banks, www.ustreas.gov/omdb/tab9.pdf. The World Bank, for instance, makes $20-25 billion of new loan commitments a year.
36. World Bank, *Global Development Finance 2002*, Chapter 4; OECD, "Officially supported export credits – levels of new flows and stocks", data for 1999 and 2000.
37. The Berne Union, established in 1934, is also known as the International Union of Credit and Investment Insurers. Newly-established ECAs that have not yet qualified for Berne Union membership – of which there are currently 25 – belong to a premembership training group called the Prague Club, all of whose members are presently Middle Eastern, Eastern European or Third World countries.
38. Germany also uses the company PwC Deutsche Revision, affiliated to PricewaterhouseCoopers, to administer the federal government's Overseas Investment Insurance Guarantee Scheme jointly with Hermes. PwC Deutsche Revision has an annual turnover of $5 billion.
39. Despite the change of name in 1999, Italy's ECA is still known by the acronym, SACE. Italy also has another organisation, SIMEST (Societa Italiana per le Impresse All'Estero), which is a joint stock company controlled by the Ministry of Foreign Trade to help raise funds to support exports and foreign investment.
40. Information and figures taken from *Ex-Im Bank News* September 2002, Vol 2, Issue 10, "G-7 Export Credit Agencies Vary in Mission in Structure: an overview of Ex-Im Bank's Counterparts: A Special Report", and ECA websites. The figures are drawn mainly from business in 2000.
41. Between 1982 and 1997, for instance, ECAs that were members of the Berne Union received a total of $40.2 billion in premiums, but paid out $153.6 billion in claims. They clawed back $70.9 billion through recoveries (*see* S. Estrin, S. Powell, P. Bagci, S. Thornton, P. Goate, "The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD: a report for the Export Credits Guarantee Department", National Economic Research Associates, April 2000, Appendix D). In 2000 and 2001, ECAs received around $2 billion in premium income and paid out around $3 billion in claims

(OECD, "2001 cashflow report from the Export Credit Group Members", www.oecd.org/pdf/M00038000/M00038847.pdf).

42. Malcolm Stephens, "The Changing Role of Export Credit Agencies", IMF, 1999, Introduction; S. Estrin, S. Powell, P. Bagci, S. Thornton, P. Goate, "The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD: a report for the Export Credits Guarantee Department", National Economic Research Associates, April 2000, p.14, footnote 18.
43. The OECD Export Credit Arrangement is an informal agreement among OECD members with export credit agencies that provides a framework for medium- to long-term officially-supported export credits. The Arrangement is intended to avoid an export credit race in which export credit agencies seek to provide the best possible terms for their domestic companies. It does this by setting minimum interest rates to be charged and maximum repayment periods, and by harmonising country classification. The Arrangement is policed through peer pressure and self-regulation. It has, however, subsequently been adopted in law via the EU and is therefore legally binding for EU countries.
44. OECD, "2001 cashflow report from the ECG Members", p.3, www.oecd.org/pdf/M00038000/M00038847.pdf. Figures in OECD report are in Special Drawing Rights.
45. The low level of premium (compared to commercial levels) that ECAs charge under the "break-even" requirement, however, still represents an ongoing form of subsidy, since ECAs are not required to make a rate of return comparable to that required by the private sector. Moreover, the fact that defence equipment and agricultural goods are exempt from the OECD Export Credit Arrangement means that the subsidy element of ECA support to these sectors is much starker. Meanwhile, many ECAs operate a "national interest account", which allows them to back projects with no regard to breaking even or even to normal underwriting criteria (within the ECGD, this is called Account 3).
46. There has been some change in the last few years, however, in response to heavy criticism from NGOs and because ECAs lagged far behind development banks such as the World Bank in their social and environmental guidelines. In July 2001, for instance, the OECD's Export Credit Group announced a set of principles for discouraging the use of official export credits for "unproductive" expenditure to Highly Indebted Poor Countries (HIPC) – defined as expenditure that does not contribute to social and economic development, poverty reduction or debt sustainability (although the definition and principles explicitly still allow expenditure on national security). OECD Export Credit Group members are now required to inform the group of all export credit transactions with HIPC countries that are monitored on an annual basis. In December 2001, meanwhile, the OECD's Export Credit Group announced a set of proposals for common approaches to officially supported export credits and the environment to be implemented by ECAs in early 2002. These include proposals that projects should be screened for environmental impact and classified according to potential impact; that projects should be benchmarked against international standards such as those of the World Bank;

The 1994 Subsidies and Countervailing Measures (SCM) Agreement of the World Trade Organisation, however, required ECAs to break even in the long-term in order to eliminate any subsidy that their support might provide. Amendments to the 1978 OECD Export Credit Arrangement,[43] meanwhile, which came into force in April 1999, established minimum premium rate benchmarks below which ECAs cannot charge (except for military equipment and agricultural products that are exempted from the agreement). The effect is that, since 1995, ECAs have been slowly moving into the black and achieved a net operating surplus of $2.8 billion in 2001.[44]

Thus while ECAs *use* taxpayers' money, they are less likely today to *lose* it.[45] It is rather the people of the South, from whose governments the recoveries on claims are made – recoveries that account for almost double what ECAs receive in premiums, representing therefore a large slice of ECA income – who pay the price for ECA involvement in dubious or economically-unviable projects. Export credit guarantees are almost without exception underwritten by sovereign guarantees issued by the importing country. In the case of a default, and once the affected exporter or investor has been paid by the ECA, the ECA will always seek to recover from the importing country the claims it has paid out, either directly or by adding it to their official debt stock (*see below*, "Export Credit Agencies, Debt and Corruption", p.19).

The sole purpose of ECAs is to support their domestic companies in the export market. They have had a poor history of taking into account the potential environmental or social impacts of projects they support.[46] Because their approach has been to support domestic business at any cost in the fierce world of export competition – the mantra is "if we don't, they will" – export credit agencies have furthermore closed their eyes to large-scale bribery and corruption on the part of the companies they support in their race against other companies to win contracts. In so doing, they have, in effect, been underwriting the bribery carried out by their domestic companies with impunity. Indeed, Transparency International has suggested that export credit agency behaviour is "close to complicity with a criminal offence".[47]

Underwriting Bribery

"It is safe to assume that many contracts financed, insured or guaranteed by ECAs in the past have been tainted by corruption."

Michael Wiehen
Transparency International[48]

Export credit agency complicity with corruption takes various forms, both direct and indirect. It is most direct when commissions are involved. The payment of commissions to a local agent or fixer to help win a contract has long been a legal part of business practice. But commissions have also long been used as a means of hiding bribes. A legitimate commission might be 2-3% of the total cost of a project, paid to a local bank account of a respected local businessman with no personal ties to decision-makers on the project. A dubious commission containing a bribe, however, might be in the region of 10-20%, paid into an offshore account or secret trust, or paid to a minister or official (whether public or private) directly involved in decision-making on the contract to be awarded.[49]

When ECAs underwrite a company's contracts, it has been common practice for them to include the cost of commissions the company has paid to win the contract in the overall sum underwritten against the risk of the company not being paid or the project being cancelled. Indeed, only four ECAs that are party to the OECD Export Credit Group do not underwrite commissions as part of the export contract (Turkey, Greece, Hungary and Poland), while only six out of the 28 countries monitored by the OECD Group set any kind of limit on the amount of agents' commissions they would cover.[50] As a former Director-General for Development at the EU, Dieter Frisch, puts it, the practice of underwriting commissions "constitutes an indirect encouragement to bribe".[51]

ECAs have also been complicit with corruption when they pay out insurance claims to companies whose contracts have been cancelled by Southern governments because of allegations that the company has paid bribes. In July 1998, for instance, Canada's export credit agency, the Export Development Corporation, reimbursed a Canadian power generation company, BC Hydro, after the Pakistani government cancelled BC Hydro's contract for the Raiwand power plant project, alleging that bribes had been paid to officials of the previous government.[52]

In May 2001, one of the US's export credit agencies, the Overseas Private Investment Corporation (OPIC), compensated MidAmerican Energy Holdings Co after the Indonesian state electricity company, PLN, reneged on buying power from one of the company's power plants and suspended a second plant being built by the company after a new government came to power. OPIC went on to force the new Indonesian government to pay it $260 million for this compensation. MidAmerican's contracts for the plants had been signed in the early 1990s during the notoriously corrupt regime of President Suharto without competitive tender. Indonesian officials in the new government said that the way in which the contracts were won smacked of corruption, and that the power the Indonesian government had contracted to buy from MidAmerican was over-priced.[53] MidAmerican took the Indonesian government to an international arbitration court and won. The corruption allegations have never been fully investigated.

In India in March 2002, meanwhile, another US export credit agency, the Export-Import Bank, called in guarantees from Indian banks after it paid out $298.2 million to the Dabhol Power Company in the Indian state of Maharashtra, set up by the US energy giant, Enron.[54] Dabhol had long been subject to allegations of corruption and governance failure (*see* Section Two, Case Study 8, p.48).

ECAs have even pressured Southern governments to drop corruption investigations into companies that ECAs have backed. In Pakistan in 1998, for instance, aid donors such as the World Bank and various Western countries including Britain put pressure on the government to abandon investigations into the Hubco power plant, built in Pakistan in 1997, owned by a consortium that included British energy company National Power, and backed by the ECAs of France, Italy and Japan. Pakistan's Accountability Bureau had claimed that Hubco's project costs were marked up by $400 million, and there were suggestions that the companies involved had paid kickbacks to Benazir Bhutto's government of the time.[55] Hubco has always denied the charges, which have been dropped since the more pro-Western General Musharraf became President of Pakistan in late 1999.

and that there should be disclosure of information to relevant stakeholders. (The latest information, as of December 2002, on ECA action on these proposals is available at www.oecd.org/pdf/M00038000/M00038796.pdf.) The proposals have been criticised, however, as too weak, too reliant on host country legislation and for not being binding. The US delegation to the OECD Export Credit Group even voted against the proposals because it considered them to be too weak. *See* Sharon Coutts, *ABC Radio National Background Briefing*, "The Catastrophe Market: Export Credit Agencies" 16/2/03

47. Dieter Frisch, "Export Credit Insurance and the Fight Against International Corruption", Transparency International Working Paper, 26/2/99
48. Michael Wiehen, "TI Working Paper: OECD Working Party on Export Credits and Credit Guarantees", Informal Consultation in Paris, 16/11/00
49. There is considerable secrecy surrounding commission payments. Businesses rarely disclose such payments, or indeed company guidelines on commission payments, because they regard them as commercially confidential. Scandals over large commission payments in the Middle East, particularly for defence equipment, have led to most Middle Eastern countries introducing laws on disclosure of commission payments or, in the case of Bahrain, seeking to phase out commission payments altogether (www.ustr.gov/pdf/1999_gcc.pdf). "Basic Rules" on combating extortion and bribery, drawn up by the International Chamber of Commerce (ICC) in 1996 as a means of self-regulation by international business, state that companies should ensure that "any payment made to any agent represents no more than an appropriate remuneration for legitimate services rendered", and that all such payments are recorded by the company (http://iccwbo.org/home/statements_rules/rules/1999/briberydoc99.asp). An ICC manual on corruption and bribery, meanwhile, states that companies should beware of paying commissions in a third country, to a numbered bank account or to another person other than the agent, and of paying commissions either in advance of or immediately upon award of contract (Michael N Davies, "The Role of Agents and Sales Representatives", Chapter 4, *Fighting Bribery: a corporate practices manual"*, International Chamber of Commerce, no date).
50. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on Measures Taken to Combat Bribery in Officially Supported Export Credits – as of 30 April 2003", 21/5/03. www.oecd.org/pdf/M00040000/M00040397.pdf.
51. Dieter Frisch, "Export Credit Insurance and the Fight Against International Corruption", Transparency International Working Paper, 26/2/99
52. Naomi Klein, "A chance to practice what we preach", *The Toronto Star*, 28 January 1999, quoted in Nicholas Hildyard, *Snouts in the Trough*, Corner House Briefing 14, July 1999, www.thecornerhouse.org.uk/briefing/14ecas.html; *Canada Asia Commentary*, No. 14, July 2000, Asia Pacific Foundation of Canada, www.asiapacific.ca/analysis/pubs/pdfs/cac14/pdf. BC Hydro subsequently sold its share in Raiwand at a significant loss.

In July 1999, the ECAs of Japan, Germany, Switzerland and the US took another approach and put considerable pressure on the new post-Suharto government in Indonesia to honour contracts awarded to Western companies to supply power to Indonesia during Suharto's regime. The total cost of these contracts had been inflated by as much as 37% on average, the contracts had not been won through competitive tender, and there were strong suspicions that they were infused with corruption. The Indonesian people ended up paying for that possible corruption in the form of higher power tariffs.[56]

More indirect ways in which ECAs back corruption include turning a blind eye to the track-record of companies that have been involved in corruption scandals, failing to investigate corruption allegations made against a company, and failing to ensure that the countries awarding the contracts that ECAs underwrite have fair, public and competitive tendering systems and transparent public accounting systems. Many ECAs, for instance, do not require the contracts they back to have been won through competitive tender, despite the fact that competitive tendering can be one of the surest ways for buying or importing countries to ensure that they get value for money. Moreover, as Transparency International's Michael Wiehen puts it, "some of the destination countries with the highest levels of ECA coverage are also well known to have necessitated . . . significant bribery as part of any export deal".[57] By providing export credits to companies to operate in countries in which governments have little commitment to transparency or fair procurement, ECAs are effectively undermining local attempts in these countries to stamp out corruption or to hold their governments to account.

Finally, a lack of transparency and accountability within ECAs themselves has fostered an institutional culture within the agencies that tacitly accepts bribery and corruption as a necessary albeit ugly means for companies to achieve their goal of winning contracts abroad. Despite the fact that they are backed by taxpayers' money, for instance, most ECAs are highly secretive. Most still refuse to make public information about the contracts that they back unless the companies agree. Even Members of Parliament cannot obtain this information. Most governments that have ECAs have signed up to a declaration issued in 2001 by the Global Forum on Fighting Corruption, the biannual intergovernmental conference on corruption started in 1999,[58] that "corruption cannot prosper in the full light of openness. Transparency and impartial forms of public control . . . are of the utmost importance".[59] Yet these governments do not apply these to ECAs.

Seeds of Change? Corruption and the OECD's Working Party on Export Credits and Credit Guarantees Group (ECG)[60]

Export credit agencies' active negligence towards corruption has created a glaring policy incoherence in that their parent governments have signed up to international treaties such as the OECD Convention on Combating Bribery while strongly pushing a good governance agenda on developing countries. This policy incoherence has recently led to a flurry of activity at the OECD. In December 2000, the OECD's Working Party on Export Credits and Credit Guarantees Group (ECG) issued

53. Michael Schuman, *Wall Street Journal*, "Indonesia to pay reduced claim to US in long-disputed overseas insurance case", 11/5/01
54. K. Giriprakash, "Financial Institutions pay RS 70 crore to US Exim", *India Finance*, 19/3/02; PSIRU, "Export credit agency threaten to call in guarantees to Enron", PSIRU news item 4609, September 2001, www.psiru.org/news
55. Andrew Taylor and Mark Nicholson, "Hubco seeks World Bank Intervention", *Financial Times* special report, 14/10/98
56. Stephanie Fried and Titi Soentoro, "Export Credit Agency Finance in Indonesia: Ecological Destruction and Corruption", Environmental Defense and Bioforum, December 2000; Peter Bosshard, *Publicly Guaranteed Corruption – Switzerland*, www.eca-watch.org/bosshard7.html.
57. Michael Wiehen, "TI Working Paper: OECD Working Party on Export Credits and Credit Guarantees", Informal Consultation in Paris, 16/11/00. According to the IMF, some of the top main recipient countries for export credit in 1995 included Russia, China, Indonesia and Nigeria – all known for high corruption levels. *See* Paulo Drummond, *Recent Export Credit Market Developments*, IMF Working Paper, March 1997.
58. *See* http://usinfo.state.gov/topical/econ/integrity and www.adb.org/Documents/Events/2003/Anticorruption?Corruption_Integrity/default.asp. The Global Forum on Fighting Corruption brings together government ministers responsible for controlling corruption and experts from all over the world. It was initiated largely by the US government, and the first Forum was held in Washington. The Third Forum was held in May 2003 in Korea.
59. Final Declaration, Global Forum on Fighting Corruption and Safeguarding Integrity II, The Hague, 28/31 May 2001.
60. The Export Credit Group describes itself as a policy group of government representatives of OECD Member countries with official export credit agencies, and is a sub-group of the OECD trade group.

an Action Statement on Bribery and Officially Supported Export Credits.[61] The statement is a major step forward in recognising the role of ECAs in corruption. Members of the Group agree to:

- Inform applicants about the legal consequences of bribery in international business transactions;
- "Invite" applicants seeking export credit guarantees to declare that neither they nor anyone acting on their behalf has or will engage in bribery;
- Refuse to approve credit, cover or other support where there is "sufficient evidence" of bribery;
- Take appropriate action against a company whose bribery is "proved" after credit, cover or other support has been provided, such as denying indemnification, requiring a refund of sums provided and referring evidence of such bribery to national investigatory authorities.

From November 2002, the ECG agreed to publish its survey of member country procedures on combating bribery. The 2002 survey comprehensively covers what measures ECAs have put in place to fulfil their requirements under the Action Statement; what procedures ECAs have established to deal with suspected bribery, sufficient evidence of bribery and cases of proven bribery; and what their actual experience with bribery has been.[62] The survey shows that ECAs are beginning to take corruption procedures seriously but in a somewhat patchy and arbitrary manner.

Two years on from the Action Statement, out of 30 ECAs who responded to the survey from the 27 OECD member countries,[63] all but four now inform applicants of the legal consequences of bribery in international business transactions (the UK is one of the four that does not, along with New Zealand, Turkey and Australia). Only one ECA (Turkey) does not have a warranty procedure inviting companies to state that neither they nor anyone acting on their behalf has or will engage in bribery in the transaction to be supported.

But ten ECAs (including the UK) have still to make it a required institutional practice to withhold support for transactions if there is sufficient evidence of bribery, and five ECAs (again including the UK) have yet to make an institutional commitment to withhold such support where there has been a legal judgement of bribery.[64] As to appropriate action on proven bribery after an ECA has given cover, ten ECAs (including the UK) have yet to make it an institutional requirement to deny indemnification in cases where bribery has been proven in a legal case, while 17 have not yet committed themselves institutionally to seeking recourse from the company concerned in such cases. Meanwhile, 12 out of the 30 ECAs have yet to make it an institutional requirement to inform investigative authorities when they have sufficient evidence of bribery after they have given support.

The survey also covered actions taken by ECAs to combat bribery that are not specifically required under the Action Statement. These reveal a pattern of emerging "best practice" and that a few ECAs are ahead of the rest. For instance, eight ECAs have made it institutional practice to withhold support if there is a suspicion of bribery; five ECAs have committed themselves institutionally to report suspicions of bribery to national investigatory authorities before cover is given; and three ECAs

61. Action Statement on Bribery and Officially Supported Export Credits, OECD Working Party on Export Credits and Credit Guarantees, December 2000, www.oecd.org/EN/about/0,,EN-about-355-10-no-no-no-0,00.html. Prior to this and in response to the OECD Convention on Combating Bribery, the ECG had agreed since January 1998 to exchange information by surveying members' procedures to combat bribery in export credit transactions. This survey was updated following the ECG's Action Statement.
62. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on Measures Taken to Combat Bribery in Officially Supported Export Credits – As of 31 January 2003", 10/2/03, www.oecd.org/pdf/M00038000/M00038795.pdf. This survey is a working document, which is continually being updated. The latest version from April 2003 was published on 21 May 2003, www.oecd.org/pdf/M00040000/M00040397.pdf.
63. Portugal has yet to respond. The Slovak Republic, which failed to respond to the first survey, has now responded in the latest April 2003 update. Korea, Japan and Hungary all responded twice for their two respective ECAs.
64. Some countries, such as the UK, have indicated in the survey that this course of action is "available" to them legally but that they have chosen not to make it formal institutional practice. The UK's response to the survey about withholding support in cases where a legal judgement of bribery has been passed suggests that the ECGD's statements to The Corner House that "a previous conviction for corruption is a prima facie case for ECGD refusing further cover" leaves its underwriters room to give cover to companies with such convictions on a case by case basis. This means that the ECGD's policy is optional rather than required.

have committed themselves to not giving further official support if a company has been convicted of bribery after support has been given.[65]

Despite the fact that a good number of ECAs have put in place most of the requirements of the OECD Export Credit Group's Action Statement, and that a few have committed themselves to institutional best practice on bribery, in the two years since the Group adopted its Action Statement in December 2000, only four ECAs have taken any action on bribery.[66] Every other ECA claims to have had no suspicion, sufficient evidence or legal judgement concerning bribery.

But it lacks credibility and certainly contradicts US intelligence information on bribery that, in the past two years, the major exporting countries have come across just one or two suspicions of bribery in its their dealings with their major exporting companies. This suggests that the ECAs stance against corruption may be more rhetorical than practical at present and that there is an ongoing institutional failure and lack of political will to take action. It also suggests that Western governments are in fact deeply reluctant to take a stand on the actions and practices of their export credit agencies for fear of losing business for their country. This was summed up by the EU Trade Commissioner Pascal Lamy, who observed that "every time any of them move forward a millimeter, they stop to see if anyone else moved."[67]

If ECAs are really to clean up their act with regard to bribery and corruption, the OECD's ECG must introduce a clearer process of monitoring, and naming and shaming reluctant ECAs. It should establish a much clearer picture of just what best practice really is, since the Action Statement is relatively vague as to what it actually requires of ECAs. Following a meeting of the ECG in April 2003, Members have agreed that the Secretariat should produce a review of ECA best practice by November 2003, with a view to revising the Action Statement. Ideally, a revised Action Statement should require ECAs to:

- Demand full disclosure of agents' commissions and to refuse support where commissions are above a reasonable threshold of around 5%. (At the moment, only 6 out of the 30 ECAs surveyed by the ECG set any kind of limit on the amount of commission they allow to be included in the sum to be supported, and only one-third of these ECAs require details of the agent and the purpose of the commission);
- Require companies receiving support to have in place codes of conduct that prove their compliance with national legislation implementing the OECD Convention on Combating Bribery;
- Inform national investigative authorities and take appropriate action in cases of suspicion of bribery – such as withholding support for cover if it has not yet been authorised, or suspending cover if it has already been authorised until further investigation has been undertaken and requiring additional safeguards;
- Conduct due diligence procedures that take into account the track-record of companies when considering giving cover or support;
- Exclude from support or cover for a certain period of time companies that have been proven guilty of bribery, either by a court or by a national authority such as an anti-corruption agency or audit body.[68]

In addition, the OECD's ECG should commission an independent review as to whether ECAs should even include agents' commissions in

65. Curiously, the US does not say it will refuse further official support to a company if it has been convicted of bribery after support has been given, even though it is required under new legislation to do so (*see* Section Three, Debarring Companies, p.65ff).
66. Australia reported that it had taken an unspecified action in relation to suspicion of bribery; France withheld support for a specific transaction due to suspicion of bribery; the UK notified investigative authorities of a suspicion of bribery; and the US notified investigative authorities and sought recourse in a case of sufficient evidence of bribery.
67. High Level Panel of the Trans-Atlantic Environmental Dialogue, Brussels, May 2000, quoted in "Export Credit Agencies Explained", ECA-Watch, www.eca-watch.org. This view is clearly reflected in a statement by the Minister for Trade, Richard Caborn, to the UK Parliament during a November 2000 House of Commons debate: "I understand and share the concern of business that the ECGD's policy and process for handling sensitive cases should not get ahead of other ECAs" (*Hansard*, 2/11/00, House of Commons Debate, Column 267WH, Export Credits Guarantee Department).
68. In April 2003, Transparency International asked the OECD's Export Credit Group to issue a second Action Statement to strengthen ECA anti-corruption measures. Transparency suggested that such an Action Statement should:
a) strengthen the no-bribery warranty of ECAs by adding a clause that companies will do their best effort to comply with the OECD Guidelines on Multinational Enterprises (which include other issues besides corruption such as environment and labour standards); by adding a declaration that companies have not been barred from tender by the World Bank or any other aid agency, nor have they been found guilty by a court of engaging in corrupt activity; by requiring that companies have a code of conduct; and by requiring that the warranty be submitted at each draw-down of loans or cover;
b) require ECAs to list the amount of agents' commissions in the application and set a threshold (preferably 5%) beyond which increased due diligence would take place;
c) require ECAs to take appropriate action such as increased due diligence, suspension of administrative processing, or informing investigative authorities when there is suspicion of bribery and apply appropriate sanctions where there is sufficient evidence of bribery;
d) require ECAs to introduce adequate disclosure of applications under consideration and approved; and
e) extend the ECA corruption measures to investment insurance and guarantees.
See Michael Wiehen, "Implementation of the ECGD's Action Statement of December 2000 on Export Credit Support", Presentation to the OECD ECG, 23/4/03.

the amount to be supported. The OECD's ECG also needs to address its own alleged "lack of transparency and meaningful public consultation."[69] In particular, NGOs have accused it of failing to consult representatives of communities and groups from developing countries that have been affected by ECA-backed projects.[70] ECAs and the OECD's ECG will continue to be considered unaccountable and secretive until they prove themselves more open to consulting and listening to NGO concerns, particularly from Southern countries.

Corruption: Who Picks Up the Tab?

"Corruption is not a charitable game; 'winners' have every intention of recovering their bribery costs."

Donald Strombom
former chief of procurement for the World Bank

Corruption – broadly defined as the abuse of public or private office for personal gain[71] – has a major impact in all countries of the world. It undermines democratic accountability, diverts resources away from the public good and into private pockets, and "redistribut[es] wealth and power to the undeserving".[72] Corruption increases inequality and poverty. A 1998 IMF study shows that an increase of just 0.78% in corruption reduces the income growth of the poorest 20% of the people in a country by 7.8% a year.[73]

Indeed, it is the people of the South, particularly the poor, who have paid a heavy price for the "business at any cost" approach of ECAs and for the bribery that ECA-backed companies engage in. Companies paying a bribe aim to recover it by charging governments more for what they provide. Corruption can add an average of 20-30% to the cost of government procurement.[74] In some Asian countries, according to Asian Development Bank research, it doubles the cost of goods and services.[75] This means that every year governments waste millions of what little public money they do have, money that could be spent on education, health and poverty eradication. The World Bank estimates that the Philippines loses $47 million a year because of corruption – a total of $48 billion between 1977-1997.[76] A recent report from the African Union[77] suggests that Africa loses $148 billion a year to corruption.[78] And in Latin America, in countries such as Colombia and Brazil, corruption has been estimated to cost each person some $6,000 a year.[79]

Recent scandals in both the US and across Europe – from the bankruptcy and collapse of energy company Enron in the US to political financing scandals in Germany involving former chancellor Helmut Kohl to corruption allegations against President Jacques Chirac in France and President Silvio Berlusconi in Italy, to mention but a few – indicate that corruption is just as pervasive and institutionalised in the North as in the South. Corruption is perceived to be on the increase across the world because of policies such as privatisation and public-private partnerships that give multinational corporations ever-greater access to governments and that have led to "increased interface between public officials and private business".[80]

In poorer countries, however, corruption has a more devastating and immediate impact. It diverts public expenditure away from areas such as health and education in which bribery returns may be small,[81] to more

69. *Jakarta Declaration for Reform of Official Export Credit and Investment Insurance Agencies*, May 2000, signed by 342 NGOs from 45 countries, www.eca-watch.org/goals/jakartadec.html.
70. Following these criticisms, the ECG did, however, state in a letter to six NGOs that it would seek the views of recipient countries through "appropriate consultations in the course of its future work" (Letter from Birgitta Nygren, Chairman of the Working Party on Export Credits and Credit Guarantees to Environmental Defense, Berne Declaration, Bioforum, Les Amis de la Terre (France), The Corner House, and Pacific Environment and Resources Centre, 24/7/00).
71. Asian Development Bank, *Anti-Corruption Policy: Description and Answers to Frequently Asked Questions*, Manila, Philippines, 1999, p.5; Donald Strombom, "Corruption in Procurement", *USIA, Economic Perspectives*, November 1998.
72. Robert Klitgaard, "Subverting Corruption", *Finance and Development*, June 2000, Vol 37, No 2.
73. Sanjeev Gupta, Hamid Davoodi and Rosa Alonso-Terme, "Does Corruption Affect Income Inequality and Poverty?" IMF Working Paper, May 1998.
74. Donald Strombom, "Corruption in Procurement", *USIA Economic Persp*ectives, November 1998; Asian Development Bank, *Anti-Corruption Policy: Description and Answers to Frequently Asked Questions*, Manila, Philippines, 1999.
75. quoted in Susan Coté-Freeman, "False Economies", *Developments*, 4th quarter, 1999.
76. *BBC News*, Nicholas Nugent, "High cost of corruption in Philippines", 6/12/00, news.bbc.co.uk/1/hi/world/asia-pacific/1057716.stm.
77. The African Union, which comprises 53 African countries, was set up in 2001 to replace the Organisation of African Unity, and became operational in 2002. The Union is loosely modelled on the European Union and states that one of its main goals is to promote democratic principles and institutions, popular participation and good governance.
78. *Reuters*, 19/9/02, "African Union approves anti-corruption policy".
79. *Business News Americas*, 4/10/02, "Shedding light on shady dealings".
80. Samuel Brittan, "The Third Way is a temptation to corruption", *Financial Times*, 20/6/02
81. With increased privatisation of health and education services, however, the possibility that companies will pay bribes to win contracts in these sectors could well increase. The health and education sectors are by no means corruption free even when in state hands. But contracts tend to be smaller than in sectors such as construction, defence, and oil and gas; in these areas the size of the contracts means that the addition of a few million dollars to cover the cost of a bribe is less likely to attract attention.

lucrative sectors such as construction, defence, and oil and gas.[82] The poor end up paying directly for the consequences of contracts that have been signed in corrupt circumstances. They are most affected by "white elephant" projects such as power plants or dams that fail to meet their stated objectives,[83] which dislocate local communities and cause environmental damage. In the energy sector, they are affected by contracts awarded in dubious circumstances that have locked governments into paying excessively high rates for electricity, which are often passed on to the consumer in the form of higher tariffs.

Even more critically, the people of Southern countries often end up paying for corrupt and unproductive projects themselves. As noted above, when export credit agencies pay out compensation to companies when projects go wrong, they recover the amount directly from Southern governments or, failing that, add this amount on to a country's official debt.

Export Credit Agencies, Debt and Corruption

When ECAs give backing to a company or bank, they almost always require the importing country to offer a counter-guarantee. This means that in the event of a default, such as if a contracting party does not pay up or if the project proves unviable, the importing government must compensate the ECA concerned. If it does not do so, the amount is added to the importing country's official debt as a bilateral (government to government) debt.

Export credit debt is charged at commercial rates of interest, not the lower rates incurred by bilateral or multilateral loans.[84] Export credit debt is therefore particularly onerous for poorer countries. One-quarter of the $2.2 trillion debt owed by developing countries and one-half of all debt owed by developing countries to official creditors (such as Multilateral Development Banks, the International Monetary Fund (IMF) and other governments rather than to private creditors such as banks) is owed to ECAs.[85] Some 95% of the debt owed to the UK government by Southern countries is export credit debt. Between one-third and one-half of this debt is interest owed on original debts and penalties.[86]

This build-of up debt owed by Southern countries to ECAs has been exacerbated by the "moral hazard" that lies at the heart of the export credit process.[87] Companies know that they will be rescued by ECAs from "the consequences of their own decisions"[88] – they will be bailed out by the public purse with few questions asked if things go wrong with their business decisions. They may not, therefore, be as prudent in their investment decisions or as cautious in their risk assessments as they might otherwise be, particularly if they do not have to consider fully whether a project is commercially viable or not because of ECA insurance. The substantial debt owed to ECAs suggests that this has indeed been the case. Southern governments would have incurred far fewer debts had companies backed by ECAs made more financially viable investment decisions.[89] A decision made in July 2001 by all ECAs not to back "unproductive" expenditure – expenditure that does not contribute to social and economic development, poverty reduction or debt sustainability[90] – in poorer countries in future is a tacit acknowledgement of this.

82. Vito Tanzi and Hamid Davoodi, *Corruption, Public Investment and Growth*, IMF Working Paper, October 1997.
83. For examples, *see* Section Two, Case Study 1 on the Turkwell Dam in Kenya, p.28, Case Study 3 on the KAFCO Fertiliser Complex in Bangladesh, p.33, and Case Study 8 on the Dabhol Power Plant in India, p.48.
84. Multilateral debt is owed to institutions such as the World Bank and the International Monetary Fund (IMF) or to regional development banks like the African Development Bank or Asian Development Bank. Bilateral debt is government-to-government debt. Private debt is owed to commercial banks and other private creditors. Multilateral and bilateral debt usually incurs far lower interest rates than other types of debt.
85. Horst Kohler, "Reforming the International Financial System", in *The Berne Union 2001 Yearbook*, February 2001
86. Much of the debt now owed to the ECGD has been incurred because of a lack of hard currency with which to repay British companies, debt that the ECGD has described as incurred as a result of political, rather than commercial, risk. Often overseas companies or governments have been able to repay British companies in local currency by depositing money into a local bank, only to run into the obstacle that the bank is unable to convert the local currency into sterling or US dollars. Export credit agency activity can thus lead to a balance of payments crisis for the borrowing country and macroeconomic instability. *See* Karen Joyner, "Export Credit and Debt", unpublished report.
87. *See* Michiel Van Voorst, "Debt Creating Aspects of Export Credits", Eurodad, August 1998, www.eca-watch.org. *See also* James A. Harman, Chairman of US Export Import Bank (Ex-Im), "Post-Crisis World Economic Development: lessons learned and thoughts for reform", speech to World Economic Development Congress, 22/9/99
88. Malcolm Stephens, "Export Credit Agencies, Trade Finance and South East Asia", IMF Working Paper, December 1998, p.36.
89. Karen Joyner, "Export Credit and Debt", unpublished report.
90. For an explanation of "unproductive expenditure", *see* footnote 46.

The people of Southern countries are paying debts incurred for some projects that have been of little or no value to either the country or its people. Furthermore, if ECA backing for contracts includes the cost of bribes hidden in commission payments, when ECAs recover compensation from importing governments for amounts they have paid out or add this amount to official debt, ECAs are in effect requiring taxpayers of the importing country to pay for the bribes made by the exporting company. The debt that Southern countries owe to ECAs may well include hidden millions of dollars worth of bribes.

Poorer countries, meanwhile, have little choice when it comes to using the financing facilities of export credit agencies. Today, 80% of financing for projects and investment in poorer countries comes from ECAs because few companies will operate in those countries without ECA support.[91] This means that export credit agencies have a huge and disproportionate say on what kind of projects get backed in poor countries. In the last five years, not a single project over $20 million backed by Western banks in poor countries has not had some form of official public guarantee.[92] Yet, despite being so dependent upon export credit for foreign direct investment, poor countries receive little of it. Only 8% of overall ECA exposure is in poor countries: the vast majority of export credit goes to a few middle-income countries such as Brazil, China, Indonesia, Mexico, the Philippines and Turkey.

Public outcry over the fact that national debt is crippling many poorer countries has led to international efforts to tackle the problem. In 1999, the countries of the G7 (Canada, France, Germany, Italy, Japan, the UK and the USA) agreed to write off 90% or more of export credit debt owed by the poorest countries as part of international debt relief efforts. They subsequently agreed to write-off 100% of these debts. But countries were eligible for such write-offs only under the World Bank and IMF's Highly Indebted Poor Country (HIPC) Initiative, which imposed strict structural adjustment programmes[93] on poorer countries in exchange for helping them to reduce their debts to "sustainable" levels. Actual debt relief has been slow in coming forward: four years on, only 8 out of 42 countries have become eligible for debt cancellation.[94] Middle-income countries that did not qualify for relief have been left to struggle under their large debt burdens.

Most importantly, debt relief initiatives have not ensured that ECAs accept mutual responsibility for the bad business deals they have backed. As the UK Executive Director at the IMF and World Bank for the years 1994-1997, Huw Evans, put it: "loans that turn out badly mean poor decisions by both lenders and borrowers . . . [genuine debt cancellation] require[s] governments (and their export credit agencies) to admit past mistakes."[107] Recognition of such mistakes would involve the ECAs of richer countries conducting a thorough audit of their export credit debt portfolios to identify projects that failed because of corruption on the part of Western companies and because of their own negligence and immediately writing off any relevant amounts from the debt portfolios of all developing countries, not just the poorest ones.

91. World Bank, *Global Development Finance 2002*, Chapter 4.
92. ibid.
93. In 1999, the World Bank and IMF renamed structural adjustment programmes as Poverty Reduction and Growth Facility programmes. Under these programmes, countries must prove that they are implementing a poverty reduction strategy, as well as continuing structural reforms such as liberalisation and privatisation.
94. These countries are Benin, Bolivia, Burkina Faso, Mali, Mauritania, Mozambique, Tanzania and Uganda. While G7 countries committed themselves to 100% debt cancellation for the poorest countries, overall debts have not been 100% cancelled, but rather cancelled to a level that World Bank and IMF economists deem to be "sustainable" (150% of exports). In practice, this means that the World Bank and IMF will cancel only around 35% of the debts owed to them by these countries. Countries receive this debt cancellation when they reach what is called "completion point" (that is, when they have fully proven that they have implemented structural reform and a poverty reduction programme). When the HIPC Initiative was first introduced in 1996, however, 19 out of 38 countries were to have received substantial debt cancellation by the end of 2002. Now 24 countries of the 38 have now reached "decision point" at which stage they receive interim debt relief and a commitment from the World Bank and IMF for fuller debt cancellation if they stay on track.
   The HIPC Initiative has been heavily criticised for being too slow and too miserly. Critics state that World Bank and IMF estimates of "sustainable" debt levels are based on unrealistic forecasts that have not taken into account the impact of falling commodity prices and other global economic developments that are entirely beyond the control of the HIPC countries. (This criticism has been acknowledged by the Operations Evaluation Department of the World Bank.) *See* Jubilee Research Press Release, "Ethiopian Prime Minister says HIPC is failing", 5/3/03; World Bank Operations Evaluation Department, "OED Review of the HIPC Initiative", *OED Reach*, 24/2/03
107. Huw Evans, "Debt Relief for the Poorest Countries: why did it take so long?" *Development Policy Review*, September 1999.

Box 1

UK Export Credits Guarantee

At the 1999 G7 summit in Cologne, the UK government committed itself to writing off all the debt owed to it by HIPC countries. As has been noted, 95% of debt owed to the UK by these countries is owed to the UK's Export Credits Guarantee Department (ECGD). The total amount of debt owed by 32 of the 42 HIPC countries to ECGD was £1.9 billion ($3 billion)[95] at the time of the announcement in 1999.[96] As of April 2003, the ECGD had written off £910 million ($1.48 billion) and was committed to writing off a further £1.3 billion ($2 billion).[97]

The ECGD has so far written off 100% of the debts of only the 8 countries that have reached the World Bank and IMF's "completion" point.[98] It has written off a further £338 million ($553.3 million) from 12 countries out of the 18 that have reached the World Bank and IMF's "decision" point. Once countries reach "decision" point, they are no longer required to make any payments on their debt to the ECGD as long as they stay "on track" with World Bank and IMF Poverty Relief and Growth Facility programmes. These 12 countries still owe the ECGD £370 million ($605.7 million) – an amount that will be written off when they reach "completion" point.

Once countries qualify for the UK government's 100% debt forgiveness policy through their adherence to the HIPC process, the UK Treasury, via the UK's Department for International Development (DfID) makes up the difference to the ECGD, ensuring that, as the ECGD website puts it, "ECGD and its customers are therefore not disadvantaged".[99]

Eleven countries are in fact still being billed by the ECGD for debt service payments, because they have not reached "decision" point – including several African countries that are, or have been until recently, embroiled in civil wars, such as Cote D'Ivoire, Democratic Republic of Congo, Liberia, Somalia and Sudan.[100] In fact, the World Bank recognises that bringing such countries to "decision point" is going to be nearly impossible because of the conflicts that have torn them apart and left them unable to implement the economic programmes required by the World Bank and IMF.[101] These countries still owe £838 million ($1.3 billion) to the ECGD.

95. Except where stated otherwise, currency conversions in this report were calculated according to April/May 2003 exchange rates.
96. www.britainusa.com/economy/xp/asp/Sarticletype.1/Article_ID.520/qx/articles_s..., "Britain forgives all its Third World Debt," 21/12/99
97. Figures taken from the ECGD website, www.ecgd.gov.uk. The ECGD has issued various contradictory figures, however. A February 2003 letter from the ECGD Communications Director, John Ormerod, to The Corner House says that the ECGD has written off £700 million ($1 billion) of debts and that the ECGD is committed only to writing off a further £370 million ($589 million) (Letter, 27 February 2003).
98. For an explanation of "completion" and "decision" point, *see* footnote 94.
   The ECGD has in fact given 100% debt cancellation for 9 countries altogether, because Yemen has also qualified for the UK's 100% debt forgiveness policy. The total amount written off for these 9 countries is £406 million. Yemen is deemed to have a sustainable debt burden, since 67% of its debt owed to the Paris club was written off. Other countries deemed to have sustainable debt burdens are Angola, Kenya, and Vietnam. *See* www.worldbank.org/hipc/progress-to-date/HIPC_Grouping_Mar03.pdf.
99. ECGD, *Annual Report and Resource Accounts 2001-2002*, p 26; *see also* http://www.ecgd.gov.uk/graphic/debtdevdebtfor.asp?sid=6&hdr=Sustainable%20Development. According to the ECGD, "usually the ECGD will have written off 90% of amounts falling due and the balance is serviced through *DfID*." The ECGD itself is only able to write off debt considered by the Paris Club and the IMF as necessary to achieve debt sustainability (Communication from the ECGD, 21/5/03).
100. The full list is: Angola, Central African Republic, Cote d'Ivoire, Democratic Republic of Congo, Republic of Congo, Kenya, Liberia, Somalia, Sudan, Togo and Vietnam. The ECGD has written off £134 million ($219 million) so far to these countries.
101. The World Bank's Operations Evaluation Department (OED) Reviews the Successes and Challenges of the Heavily-Indebted Poor Countries Initiative, Fact Sheet, February 2003, www.worldbank.org/hipc/OEC_Review.pdf. One of the contradictions of the HIPC Initiative is that Uganda has been given debt relief as a reward for good economic performance, even though this performance is in large part due to its exploitation of resources in the Democratic Republic of Congo, a war-torn country that has yet to reach "decision" point (Neil Cooper and Michael Pugh, "Security-sector transformation in post-conflict societies", The Conflict, Security and Development Group Working Papers, February 2002, csdg.kcl.ac.uk/publications/assets/PDF%20files/Working%20 paper%number%205.pdf)

Department and Debt Relief

In December 2000, the UK government committed itself to holding payments from these pre-"decision" point countries in trust, which would then be returned to these countries when they reach decision point. In practice, the ECGD has not received any payments from the war-torn countries mentioned above since December 2000.[102] In recognition of their inability to pay, and as a contribution to a longer-term peace in these countries, it is crucial that the UK government should declare 100% cancellation immediately for such war-torn countries.

The ECGD continues to receive payments, however, from Kenya, whose debt is considered by the World Bank and IMF to be "sustainable",[103] despite the fact that some of those debts were incurred for projects surrounded by allegations of corruption or mismanagement (*see* Section Two, Case Study 1, p.28, and Case Study 2, pp.31). The Corner House recommends that the ECGD conduct an audit of its debt porfolio, to ensure that it does not contain debts incurred as a result of corruption by Western companies or by negligence on the ECGD's behalf. Debts from countries with formerly corrupt dictatorships, such as the Democratic Republic of Congo, Nigeria, Indonesia, Iraq and the Philippines would be a good place to start.

As part of international efforts to ensure that countries do not build up unsustainable debt burdens in the future, the ECGD now applies "productive expenditure" criteria to 63 countries – the 42 HIPC countries plus the 21 countries that are eligible for zero interest loans from the World Bank's International Development Association.[104] These criteria call for projects or exports to contribute to a country's social and economic development without pushing it into unsustainable debt. Even with these criteria in place, however, the ECGD has backed the Mozal Aluminium smelter in Mozambique[105] – a project that, despite successful local community projects initiated by the smelter company, has been characterised by tax holidays on all corporate profits and expatriate worker salaries, and the repatriation of all dividends.[106] Because of these incentives, the smelter contributes impressively to Mozambique's economic growth figures, but does not clearly generate resources for poverty reduction in Mozambique itself.

102. The last payments that the ECGD received from these countries were: Sudan (1984), Somalia (no payment ever made), Liberia (1994) Republic of Congo (1997), DR Congo (1990), Cote D'Ivoire (1999) – figures provided in email from ECGD spokesperson to The Corner House, 17/3/03
103. Information provided to The Corner House by the ECGD in April 2003 suggests that Kenya, along with Angola, may require some debt reduction in order for their debts to remain sustainable.
104. In fact, there are 81 countries altogether that are eligible for loans from the International Development Association (*see* http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/IDA/0,,contentMDK:20054572~pagePK:83988~piPK:84004~theSitePK:73154,00.html), and the ECGD should extend its productive expenditure criteria to all these countries.
105. The ECGD has provided Overseas Investment Insurance to a syndicate of UK banks, led by Deutsche Bank, for £40 million worth of UK investment into Mozambique. The Overseas Investment Insurance provides cover to the UK banks against political risks in South Africa that could lead to non-payment of the loan. *See* ECGD Press Release, 13/1/03, "ECGD provides political risk insurance for UK Banks in Multi-Million Pound Mozambique project",
106. World Bank, *Global Development Finance* 2002, Chapter 4, box 4.4.

Section Two

The UK's Export Credits Guarantee Department

A History and Culture of Institutional Failure Concerning Corruption

The UK's Export Credits Guarantee Department (ECGD), set up in 1919, was the first export credit agency in the world. Its original mandate was to support British exports, especially to Russia, because private banks refused to do so.[108] It is a free-standing government department, which is not answerable to the UK Parliament directly, but rather indirectly through the Secretary of State for the Department of Trade and Industry. Between 1995 and 2000, the ECGD underwrote £17 billion ($27 billion) worth of British exports – an average of £4-5 billion ($6.5-8 billion) a year.[109] This compares with the UK's Department for International Development's annual aid budget of around £3 billion ($4.7 billion). The ECGD now covers 3% of the UK's total exports (down from about 30% in the late 1960s).

The ECGD has always operated a break-even objective.[110] It is now required to break even every three years (rather than on an annual basis). In the ten years prior to 1990, the ECGD incurred total losses of £3 billion ($5 billion).[111] For business it has backed since 1991, however, the ECGD has achieved a surplus of £753.5 million ($1.1 billion) and, since 1993, has generated a net cash surplus.[112] In fact, the ECGD achieved an operating surplus of £204.3 million ($325 million) in 2000/01 and £132.1 million ($210 million) in 2001/02 and now makes a net contribution to the UK Treasury of £100-200 million ($160-320 million) a year.[113]

The ECGD claims that it charges premiums at a rate that is "sufficient to cover" risks and administration costs, and that it does not therefore draw on taxpayers' money. But between 1995 and 2001, premium income usually covered only between one-third and one-half of claims paid out.[114] In 2000-2001, for instance, the ECGD earned £109.5 million ($175 million) in premiums, but paid out £298 million ($475 million) worth of claims.[115] In 2001-02, the ECGD earned £76.8 million ($122 million) in premiums and paid out £250 million ($398 million) in claims.[116]

Meanwhile, the fact that the ECGD only has to break even rather than to show a positive return of 8%, as other public sector enterprises such as London Underground has led to estimates that the ECGD provides an implicit annual subsidy to the companies it supports of around £400 million ($640 million) per year.[117] It also means that the ECGD is able

108. Malcolm Stephens, "The Changing Role of Export Credit Agencies", IMF, 1999, Introduction.
109. In 2000/2001, that figure had increased to £5.6 billion ($9 billion), but for 2001/02 it dropped to £3.2 billion ($5 billion). Except where stated otherwise, currency conversions in this report were calculated according to April/May 2003 exchange rates.
110. The precise formula is that the ECGD is required "to maintain a ratio of its reserves to its estimate of Expected Loss on amounts at risk under its guarantees of at least 1.5" (*Hansard*, 22/1/02, Commons Written Answers, Column 734W, Ms Hewitt to Mr Stinchcombe MP).
111. S. Estrin, S. Powell, P. Bagci, S. Thornton, P. Goate, "The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD: a report for the Export Credits Guarantee Department", National Economic Research Associates, April 2000, Annex F, p.80.
112. ibid, Para 2.6, p.14.
113. ECGD *Annual Report and Resource Accounts, 2001/02*, p.51.
114. *Hansard*, 10/7/02, Commons Written Answers, Ms Hewitt to Harry Cohen MP.
115. *Hansard*, 28/1/02, Commons Written Answers, Column 74W, Ms Hewitt to Mr Stinchcombe MP.
116. *ECGD Annual Report and Resource Accounts*, 2001-2002, pp.53-54.
117. Samuel Brittan, "Trying to create jobs by subsidising exports is like keeping lossmaking coal mines open to employ miners", *Financial Times*, 21/6/00; S. Estrin, S. Powell, P. Bagci, S. Thornton, P. Goate, "The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD: a report for the Export Credits Guarantee Department", National Economic Research Associates, April 2000, p.79. Confusion as to whether the ECGD does or does not provide a subsidy is reflected in a House of Commons debate in November 2000 on the ECGD in which the Minister for Trade, Richard Caborn, acknowledged that "ECAs represent an artificial market . . . [that] is subsidised in various ways", and that there was a subsidy element to the fixed-rate export finance (FREF) scheme run by the ECGD.

to keep premium charges much lower than they would be in the private sector.[118] A January 2003 report, produced for the ECGD by National Economic Research Associates on the economic costs and benefits of the ECGD, concluded that ECGD support did constitute a subsidy. It argued that removing this subsidy would "have a negligible effect on UK capital goods exports" and that there was a "strong rationale for eliminating any subsidy in ECGD's current pricing regime".[119]

Thus while UK taxpayers may not be losing money through the activities of the ECGD, they are subsidising the activities of UK companies operating abroad. ECGD ought, therefore, to be accountable to them for how it uses their money and be able to demonstrate a clear sustainable development purpose.

Backing Industry Sectors Prone to Corruption

Although all industry sectors can apply for ECGD support to do business abroad, the department primarily provides support to six of them: military and defence; civil aerospace; power generation and transmission; water; energy and transport.[122] Several of these sectors have some of the worst records on corruption.[123]

Yet he went on to say that the ECGD was "not regarded as having a subsidy" (*Hansard*, 2/11/00, House of Commons Debate, "Export Credits Guarantee Department", Columns 288WH and 327WH).

118. If the ECGD were operating as if it were a private sector enterprise, it would have to make a return of 11% (Dr Pinar Bagci, Stephen Powell, James Grayburn, Vaktang Kvekvetsia, Anthony Venables, "Estimating the Economic Costs and Benefits of ECGD: A Report for the Export Credits Guarantee Department", NERA, January 2003, p.iii).
119. Dr Pinar Bagci, Stephen Powell, James Grayburn, Vaktang Kvekvetsia, Anthony Venables, "Estimating the Economic Costs and Benefits of ECGD: A Report for the Export Credits Guarantee Department", NERA, January 2003, pp.ii, viii.
122. Only 1-2% of ECGD support goes to education and medical projects.
123. Transparency International press release, 14/5/02, "Transparency International releases new Bribe Payers Index (BPI) 2002".

Box 2

ECGD Products and Services

Unlike some ECAs, the ECGD does not provide direct loans. Nor does its financial support go directly to the exporter. Rather, the ECGD supports loans made by UK banks to a particular "buyer", usually the importing government or government department, specifically to enable the importing government or business to pay for goods and services from a particular UK company. These loans are often made through third parties such as banks in the importing country.

The bulk of ECGD business is in the form of **Buyer Credits**, which operate in exactly this way. The UK exporting company is paid by the UK bank upon delivery of the goods or services to the country concerned. The ECGD guarantees the UK bank both full repayment of the loan made and a reasonable rate of return. The other major business activity of the ECGD is **Supplier Credit Insurance**, particularly through **Export Insurance Policies** (EXIP) that give insurance cover to suppliers against the risk of not being paid under their contract.[120]

Other products offered by the ECGD are:

- **Supplier Credits** – which allow a UK exporter to pass on payment risks to the UK bank involved, and to get paid quickly and in full as soon as goods are delivered or services performed, rather than having to wait until the overseas buyer can raise the funds.
- **Lines of Credit** – which allow UK exporters to set up a finance package with buyer institutions to finance a series of contracts for either goods or services. A line of credit is put in place before the contract is signed and is therefore quick, as well as being available for contracts that are worth as little as £20,000 ($32,000).
- **Overseas Investment Insurance –** which is primarily political risk insurance on equity or loan investments made by a UK company in an overseas business, or on a bank loan made to an overseas company. These political risks include expropriation, war, restrictions on remittances and, in some cases, breach of undertaking. The ECGD states that one of the many advantages of this scheme is that, if a political event were to interfere with a business in which a UK company had an investment, the fact that the UK government is involved means that "we would hope to resolve the matter before the investor needs to make a claim" – that is, diplomatic pressure would be brought to bear to ensure the smooth running of the company.
- **Project Finance –** which covers large projects for which revenues from the project are relied upon for repayment, and for which the assets and contracts involved are used as security. The involvement of the ECGD often enables UK banks and businesses to find further financing from other sources. Project finance projects take several years to complete and are expensive.[121]

120. These risks covered by this insurance include the risk of the purchaser going bankrupt, or failing to pay, and also political risks such as civil disturbances or actions by overseas governments affecting performance of the contract, or political, economic or administrative occurring abroad that prevent payment.
121. Information taken from the ECGD website, www.ecgd.gov.uk.

124. ECGD, *Annual Report and Resource Accounts 2000/01*, p.40.
Nearly 55% of the ECGD's defence portfolio goes to the Middle East and 38% to Asia. The bulk of military cover is for aircraft (58.2%), vehicles (23%), radar and radios (12%) and ancillary equipment (6%). *See* Nicholas Hildyard, *Snouts in the Trough*, Corner House Briefing 14, July 1999, p.14, www.thecornerhouse.org.uk/briefing/14ecas.html.
125. Catherine Courtney, "Corruption in the Official Arms Trade", Transparency International, Policy Research Paper 001, April 2002, p.3; *The Economist*, "Odd Industry Out", 18/7/02
126. Michael Bartlett, "The case against

Almost one-third (30%) of ECGD backing goes each year to defence projects – almost half between the years 1998 and 2001.[124] The defence industry has consistently been one of the worst corruption offenders, second only to construction and public works in Transparency International's Bribe-Payers Index. According to the US Department of Commerce, half of all bribes paid between 1994 and 1999 involved defence contracts, despite the fact that arms constitute only 1% of world trade.[125] Research by the UK's Religious Society of Friends shows that the defence part of ECGD's business is heavily subsidised by the civil business it backs.[126]

Of the civil (rather than military) projects that the ECGD supports, the highest percentage (25% in 2000/01 and 41% in 1999/2000) is in the

Box 3
The ECGD and Arms Export Subsidies

OECD agreements about the minimum level at which ECAs can set their premium rates do not apply to defence equipment (*see* Section One, p.12). The ECGD states that while it therefore does not have to apply minimum benchmarks on arms exports, it does in fact do so.[127] However, from figures provided by the ECGD to Parliament, it appears that premiums earned by the ECGD from exports in the defence sector account for a much lower percentage of claims paid out than the overall figure.[128]

Whereas overall aggregate figures show that premiums cover one-third to one-half of claims paid out by the ECGD, for the defence sector, the percentage of claims covered by premium payments drops to between one-fifth and one-quarter. In 2000-01, for instance, premiums earned in defence projects amounted to £38 million ($60 million) while claims paid out came to nearly five times this amount at £181 million ($288 million).[129] In 1999-2000, premiums earned on defence projects amounted to £27 million ($43 million), while claims paid out amounted to £152 million ($242 million). Recoveries for the defence sector, meanwhile, have been very low. According to figures provided to the UK Parliament by the Department of Trade and Industry, from 1990-2001 premiums earned on defence business amounted to £251 million ($410 million), claims paid out amounted to £970 million ($1.58 billion) but only £122 million ($199.7 million) was recovered.[130] These figures mean that the ECGD was left with a £597 million ($977 million) shortfall for its defence business over this ten year period.

These figures also suggest that, at the very least, as chief economists from the Ministry of Defence and academics put it in a report for the University of York Centre for Defence Economics: "It is still not possible to conclude that the objective of covering the cost of claims through premiums so as to break even over the long run is being achieved".[131] By failing to break even, and therefore to cover its losses, the ECGD is in effect providing a subsidy to the defence sector.[132] As Michael Bartlett from the Religious Society of Friends states: "it is precisely by the losses that [the ECGD] makes in this sector of insurance that it is providing subsidies".[133] The ECGD has in fact made a loss on the defence sector in every one of the last 12 years. Since 1990, the amount of premium earned combined with claims recovered has never even approached the amount paid out in claims.

The subsidy that the ECGD provides the UK arms industry has also been calculated in other ways. According to research by Saferworld and the Oxford Research Group comparing the premiums that would be charged by private lending organisations for defence equipment to the same countries to which the ECGD backs arms exports with ECGD premium rates, the ECGD provides an annual subsidy of £227 million ($362 million) to the defence sector.[134]

NGOs and Members of Parliament have been making a strong moral argument for some years now that that the ECGD should not back defence exports at all. At present, the defence sector is entirely dependent upon the support offered by the ECGD. Government officials and supporters of the arms industry always assert that if the UK government were not to provide this kind of support, many thousands of jobs would be lost and the British economy would suffer. But analysis by the University of York Centre for Defence Economics in November 2001 suggests that, while a halving of defence exports would lead to the loss of 49,000 jobs in the defence industry, another 67,000 new jobs would be created in the civil economy over the following five years. It also states that "the economic costs of reducing defence exports are relatively small and largely one-off".[135]

The Corner House believes that it is not inherently wrong for the ECGD to provide subsidies, provided they are in the public interest. Subsidies could, for instance, be an appropriate tool to kick-start a domestic renewable energy export market – a market that could benefit power generation sector – a sector ranked sixth in Transparency International's list of corrupt industries. The oil and gas industry, meanwhile, another key, related area for the ECGD and the focus of its new "Good Projects in Difficult Markets"[140] initiative,[141] is the third most corrupt industry in Transparency International's Index.

It is hardly surprising, therefore, that the ECGD has been implicated in some of the worst scandals involving British business operating abroad. In the mid-1980s, it backed the Al Yamamah deal with the government of Saudi Arabia, a deal that included the sale of Hawk and Tornado jets. British defence companies are alleged to have either agreed to pay or actually paid commissions ranging anywhere from 5% to 25% of the contract price to middlemen and officials in connection with the deal.

ECGD underwriting of arms sales", paper given at "Beyond Business Principles" Seminar on Export Credit Reform, House of Commons, 23/5/02, www.thecornerhouse.org.uk/documents/subsidy/html.

140. The "Good Projects in Difficult Markets" scheme is for projects in countries for which the ECGD would not usually accept projects because of the risks of non-payment by the importing government in case of default. The scheme is primarily designed for projects in Africa, the Caspian Area and the Middle East and for those in the oil and gas, petrochemical, mining, telecommunications, and airport and port construction sectors. Projects under this scheme must be financially

developing countries importing crucial technology and could help the UK to meet its commitments under the Marrakech accords[136] to ensure that export credit agencies support the transfer of climate-friendly technologies.[137] But the ECGD should not contravene its own commitments to ensure that its activities mesh with other UK government objectives on sustainable development, human rights[138] and good governance by subsidising an industry that contributes nothing to these goals – an industry, moreover, that is generally uncompetitive, profoundly secretive and riddled with corruption.[139]

At the very least, the ECGD should broaden its current prohibition on selling arms to the 63 poorest developing countries to *all* developing countries. It should also bring the defence sector into line with all the other sectors it supports by ensuring that ECGD business in this sector breaks even, and by ensuring that its premium rates are commensurate with the specific risks involved in backing the defence sector.

127. Communication from the ECGD, 21/5/03.
128. The ECGD not only applies different financial criteria to the defence export sector: it also applies different impact screening criteria. Defence exports are not subject to the ECGD's impact assessment that all other sectors go through. The ECGD argues that this is because defence exports are already subject to scrutiny through the government's export licence process, overseen by the Department for Trade and Industry, which screens for human rights concerns and for whether the defence equipment might be used for internal repression, external aggression or might be a risk to regional security.
129. *Hansard*, 4/2/02, Commons Written Answers, Column 645W, Ms Hewitt to Mr Stinchcombe MP.
130. *Hansard*, 21/6/02, Commons Written Answers, Column 589W, Ms Hewitt to Mr Cousins MP.
131. Malcolm Chalmers, Neil Davies, Keith Hartley and Chris Wilkinson, "The Economic Costs and Benefits of UK Defence Exports", University of York Centre for Defence Economics, November 2001, www.york.ac.uk/depts/econ/rc/defence_exports_nov01.pdf.
132. The January 2003 National Economic Research Associates (NERA) report for the ECGD suggests that, far from there being a subsidy to the defence sector, the ECGD has in fact been slightly overcharging in its premiums in this sector (Dr Pinar Bagci, Stephen Powell, James Grayburn, Vaktang Kvekvetsia, Anthony Venables, "Estimating the Economic Costs and Benefits of ECGD: A Report for the Export Credits Guarantee Department", NERA, January 2003, pp.ii, viii). But this contradicts evidence given in Parliamentary Answers by the government, as noted in the main text of this report.
133. Michael Bartlett, "The case against ECGD underwriting of arms sales", paper given at "Beyond Business Principles" Seminar on Export Credit Reform, House of Commons, 23/5/02, www.thecornerhouse.org.uk/documents/subsidy/html.
134. Paul Ingram and Ian Davis, *The Subsidy Trap*, Saferworld and Oxford Research Group, July 2001, www.saferworld.co.uk/pubsubsidy.pdf.
135. Malcolm Chalmers, Neil Davies, Keith Hartley and Chris Wilkinson, "The Economic Costs and Benefits of UK Defence Exports", University of York Centre for Defence Economics, November 2001, www.york.ac.uk/depts/econ/rc/defence_exports_nov01.pdf, para 86, p.33.
136. The Marrakech accords were adopted in November 2001 at the 7th Conference of the Parties to the 1992 UN Framework Convention on Climate Change. They are a set of legally binding rules that implement the Kyoto Protocol – the global climate change treaty that committed industrialised nations to legally binding reductions in emissions of greenhouse gases.
137. Kate Hampton, "Recommendations from Friends of the Earth to the ECGD regarding Sustainable Energy and Climate Change", paper prepared for Seminar on Export Credit Reform, House of Commons, 23/5/02, www.thecornerhouse.org.uk/document/climate.html. A good example of ECGD backing for projects that could further sustainable development is ECGD support for a small UK company, John Gordon Ltd, to export low-emission burners that use coffee bean husks as fuel to a Costa Rican coffee co-operative. *See* www.ecgd.gov.uk/graphic/news/shownewsarticle.asp?newsid=100.
138. Countries with poor human rights records that, as of 2001, still owe the ECGD for defence equipment include Algeria, Indonesia, Kenya, Nigeria, Saudi Arabia and Turkey (*Hansard*, 2/12/01, Commons Written Answers, Column 145W, Ms Hewitt to Dr Cable MP).
139. Catherine Courtney, "Corruption in the Official Arms Trade", Transparency International, Policy Research Paper 001, April 2002.

Throughout the 1990s, there were persistent rumours of corruption.[142] A 1992 report by the UK's National Audit Office investigating the deal has yet to be published despite repeated requests from Parliament.

In 1991, the ECGD was involved (through the UK government's now defunct Aid and Trade Provision[143]) in supporting the involvement of a consortium led by UK company Balfour Beatty to build the Pergau dam in Malaysia. The construction of the dam, which was funded by the then Overseas Development Administration (ODA) of the UK government, was linked to an arms deal with Malaysia worth £1 billion ($1.6 billion). Officials at the ODA described the dam as "uneconomic", a "very bad buy" and a burden on Malaysian consumers, who would end up paying £100 million ($160 million) more for electricity than other cheaper power generation alternatives could have supplied.[144] The contract was not won through competitive tender. During the process of investigating the spiralling price of the contract, ODA officials urged Balfour Beatty to lower its fees for agency services for the project, which it regarded as excessive.[145] ODA officials were effectively over-ridden by the UK's Foreign Office, which pushed for UK government support for the dam to go ahead. The UK NGO, the World Development Movement, successfully challenged the use of British aid money for this project in the UK courts in November 1994.[146] The case effectively set a precedent to make it illegal to use British aid money for uneconomic projects.[147]

These high-profile cases are not just one-offs. As the case studies below illustrate, an institutional culture has existed within the ECGD of almost completely disregarding corruption as a serious risk factor that could undermine the viability of projects backed and could increase the costs both for UK taxpayers and for the citizens of countries in which the projects take place.

ECGD and British Business Culture

The institutional failure within the ECGD to recognise or tackle corruption has developed out of a long-standing and intimate relationship between the ECGD and the British business community.

Huw Evans, a former UK Executive Director at the IMF and World Bank and one-time deputy secretary at the UK Treasury, said that the ECGD was far too vulnerable to the intensive lobbying of UK government ministers carried out by large corporations.[148] In addition, the ECGD's Advisory Council was until recently made up solely of members of the business and banking community, some of whose companies benefited from export credits. This closeness between the ECGD and the business community may be why the ECGD has reflected the commonly accepted notion in the business community that bribery is a normal, albeit unsavoury, way of winning contracts abroad.

This notion is indicated in a recent comment made by Gary Campkin of the Confederation of British Industry (CBI) – the UK employers' organisation – that: "The CBI and British business is totally against bribery, corruption and extortion. But these sort of issues are often about the way you do business."[149] A report in the *Daily Telegraph* national newspaper into British anti-corruption legislation passed in 2002 to implement the OECD anti-bribery convention noted that "few businessmen, understandably, will talk openly about bribery and corruption abroad.

viable, generate hard currency, use escrow accounts (special bank accounts in which money is held to pay for taxes, premium on insurance and other ongoing costs on time), and have majority private sector ownership. So far, UK company involvement in the Blue Stream Pipeline between Russia and Turkey (*see* Section Three, Case Study A, p.59), in a £1.24 billion ($1.98 billion) Liquid Natural Gas Plant on Bonny Island in Nigeria, and in the construction of the Kotoka airport in Ghana has been funded under this scheme.

141. *Project Finance*, 1/11/01, p.44, "Image and Reality: ECA Review".
142. Campaign Against the Arms Trade, "Memorandum submitted to the International Development Committee hearing on corruption", March 2001 (http://www.caat.org.uk/information/issues/corruption-submission-0900.php); Paul Ingram and Ian Davis, *The Subsidy Trap: British Government Financial Support for Arms Exports and the Defence Industry,* Saferworld and the Oxford Research Group, July 2001, www.saferworld.co.uk/pubsubsidy.pdf.
143. The Aid and Trade Provision – a tied aid scheme that started in 1977 and was run jointly by the Department of Trade and Industry and the Overseas Development Administration – was specifically aimed at supporting overseas aid projects with developmental value that were of particular commercial importance to the UK. It was abolished by the New Labour Government in 1997.
144. National Audit Office, "Pergau Hydro-Electric Project", October 1993, para 20, p.5.
145. ibid, para 19, p.5l. The price first quoted by an Australian company for building the dam was £140-150 million ($223-240 million). The Balfour Beatty/Cementation International joint venture originally quoted for £200-300 million ($320-480 million) in 1988. By 1989, they had revised the contract proposal, first to £316 million ($503 million) and then, a couple of months later, to £397 million ($632 million). By 1991, the contract price had become £417 million ($664 million).
146. *R v Secretary of State for Foreign Affairs ex parte World Development Movement* [1995] 1 All ER 611, at 617e-620h.
147. Information taken from Pratap Chaterjee, "British aid for Malaysian Dam", *World Rivers Review*, 11 November 1993; and FIVAS (Association of International Water and Forest Studies), "Court Cases in Dam Projects", Norway, 1999, http://www.solidaritetshuset.org/fivas/rettsskr/nyrettsindex.htm; National Audit Office, "Pergau Hydro-Electric Project", October 1993.
148. Samuel Brittan, "The hidden cost of promoting arms sales", *Financial Times*, 6/1/00
149. *The Daily Telegraph*, 11/2/02 "No Baksheesh please, we're British".

Off the record however they admit that enormous amounts go on."[150] *The Economist* has reported that many in the business community "believe that in large parts of the world a company that does not pay bribes does not do business."[151]

According to Transparency International's annual Bribe Payers Index, British companies resort to bribery more than Dutch, Belgian or Swedish ones, but not as much as US, French or German companies. World Bank research indicates that 14% of British companies operating in former Soviet Union countries pay kickbacks to obtain government contracts.[152] Until recently, the majority of firms blacklisted by the World Bank under its fraud and corruption guidelines, and thus not eligible for World Bank contracts, were British.[153]

British companies appear familiar with the traditional bribery practice of making payments into offshore bank accounts, but may also use more subtle and less traceable means such as buying villas or homes for influential decision-makers, paying for children of public officials to attend private schools or universities in Britain, paying for lavish holidays, or lending the company credit card to the relevant official. They are also, according to a former chief executive officer of UK energy company Premier Oil and Gas, Roland Shaw, "very good at finding other ways of doing it [bribery] – perhaps investing in a college so that the politician can stand up and say they bought the equipment, but look at the benefit we got for the country."[154]

ECGD Backing in Countries With Corruption Problems

Another major reason why the ECGD has ignored corruption is that some of the best opportunities for British exports are in countries with the most serious corruption problems. Between 1996 and 2001, China, Indonesia, the Philippines, Saudi Arabia, Turkey and Russia – all countries noted for high levels of corruption in business transactions and public procurement[155] – regularly featured in the top 10 countries for ECGD support (*see* Appendix 1, p.75).[156]

Indonesia has been in the top five countries for ECGD guarantees over the last two years. An Indonesian state audit report in September 2002 revealed that 4.2 billion rupiahs (£280,000/$550,000) of foreign funding intended as export credit facilities for the Indonesian defence ministry, armed forces and national police were missing because of corruption.[157] The worst offender, according to the report, was the Indonesian air force, whose finances showed irregularities worth $82.5 million. The Indonesian air force is now conducting a review of its procurement procedures in the 1990s amid allegations that the price it paid for Hawk jets sold by British Aerospace (now BAE Systems) in the early 1990s with ECGD backing was inflated to encompass a large commission to then President Suharto's daughter, Siti Hardiyanti "Tutut" Rukmana, who acted as British Aerospace's agent for the contract.[158]

There is considerable pressure on the ECGD to provide cover in those markets that British business considers to be its best opportunities, irrespective of local conditions or corruption problems. Such pressure is illustrated by the intense industry lobbying of the ECGD to extend cover

150. ibid.
151. *The Economist*, "The Short Arm of the Law", 28/2/02. There is a distinction to be made between "facilitation payments" and bribes. The former are generally small payments made to bureaucrats or lower officials to speed up access to visas, documents, telephone lines and so on, or to avoid unwelcome vaccinations of employees requested by customs officials, or unnecessary fines by policemen. In evidence to the UK Parliament's International Development Committee in March 2001, two UK companies, BP and Unilever, admitted making such payments. Technically, facilitation payments are illegal under the UK's 2001 Anti-Terrorism, Crime and Security Act, but the UK government has stated that it will not prosecute such payments (Foreign and Commonwealth Office and Trade Partners UK leaflet, "UK Bribery and Corruption Law", January 2003). Evidence shows, however, that companies that make such payments are in fact *more* likely to spend more time, not less, engaged in bureaucracy and to have further demands for more bribes made of them. With regards to large bribes, companies usually present themselves as victims of venal local politicians. In fact, the reverse is often the case as companies trip over themselves to give bribes in order to win a contract and even turn up in countries with suitcases full of cash. For analysis of the institutional racism at the heart of the presumption to bribe by Western businesses, *see* Nicholas Hildyard, "The Lesotho Highlands Water Project – What went wrong? (Or rather: What went right? For whom?), presentation to Chatham House Conference "Corruption in Southern Africa – Sources and Solutions", London, 10 July 2000, www.thecornerhouse.org.uk/document/lesochat.html.
152. The Transparency International and World Bank research are at odds with each other on Austria and Belgium. According to TI, these countries are among the least likely to bribe, while the World Bank maintains that they are the most likely after Greece to bribe when their companies do business in transition countries. This discrepancy shows how provisional such ratings are since they depend upon the perceptions of those interviewed.
153. In 1998, the World Bank set up a sanctions committee to investigate cases of corruption by companies involved in bidding for or carrying out a World Bank-backed contract. The Sanctions Committee meets regularly to review investigations and to debar firms found guilty. It also publishes a comprehensive list of debarred firms, "The World Bank Listing of Ineligible Firms". In December 2002, there were 78 companies on this list, 36 of them British. *See* http://www.worldbank/org/html/opr/procure/debarr.html.
154. *The Daily Telegraph*, 11/2/02 "No Baksheesh please, we're British".
155. In Transparency International's Corruption Perceptions Index for 2002, Russia, China, Indonesia and the Philippines all come in the bottom 45 countries out of 102 countries surveyed. The Index ranks countries from 1 (the least corrupt) to 102 (the most corrupt) according to surveys that assess the perception of the degree of corruption in each country by business people, academics and risk analysts. The top country, which is perceived to be the least corrupt,

for oil-rich Angola. Several oil and construction interests, including BP Amoco plc, the Export Group for Constructional Industries and the Engineering Employers Federation, have asked the UK government to extend ECGD cover to Angola. The country has been off cover for 15 years because of political and economic instability, owes the ECGD £131 million ($208.5 million) and is considered to be one of the most corrupt countries in the world. It is beaten to bottom place only by Nigeria and Bangladesh in Transparency International's 2002 Corruption Perceptions Index that surveys 102 countries.[159] In November 2001, the ECGD stated that it was considering including Angola under its new "Good Projects in Difficult Markets" scheme.[160] This statement suggests that, as Huw Evans told the UK Parliament's Trade and Industry Select Committee in 2000 when it was looking into the future of the ECGD, final decisions about whether the ECGD should support projects "often owe more to political weight than to fine calculations of risk assessment."[161]

The following nine case studies examine projects that the ECGD backed, mainly in the 1990s, with insufficient regard to corruption issues, and illustrate the ECGD's inadequate procedures. The Department has since introduced anti-corruption measures, which are examined in Section Three (p.57ff). While the case studies may therefore be considered "historical", most of them are still very much current or "live" in that the extent of corruption involved is only now coming to light and still requires action on the part of ECGD. Action is also required in those cases in which the countries involved are paying the price for the historical failure of the ECGD to follow adequate due diligence procedures[162] on corruption.

Case Study 1
The Turkwell Gorge Hydro-Electric Power Station, Kenya, 1986

"The whitest of white elephants"

"A stinking scandal"

"A fiasco of the first magnitude"

"The bastard issue of indifference and greed"

"The richest dirty deal in Kenya's history"

Various descriptions of the Turkwell Dam[163]

In August 1986, the ECGD issued a guarantee of £17.5 million ($28 million) to a British consulting company, Watermeyer Lesse Piesold and Uhlmann (WLPU),[164] subsequently renamed Knight Piesold (and now called Scott Wilson Piesold), to act as second consultant and assistant employer on the Turkwell Gorge Hydro-Electric Dam in Kenya.[165] Despite evidence to the contrary, the ECGD denied supporting Turkwell both in the UK Parliament and to The Corner House directly until 2001 when it finally admitted publicly that it had backed the project.[166] Turkwell has become a by-word in Kenya for corruption and mismanagement.

The Turkwell Gorge project was conceived in the 1960s. From the beginning, concerns were expressed that it would be problematic. The dam was to be built on a major earthquake fault, even though other more

has consistently been either Finland or Denmark. A country must have at least three surveys to draw on before it can be included in the list. Saudi Arabia is not named in this Index because of the lack of surveys, but is known to have a corruption problem. Commissions on military contracts in the country run from anywhere between 5% to 40%. One Saudi Royal, Prince Sultan, is alleged to have amassed a personal $10 billion fortune largely from taking commissions for arms sales.

156. *Annual Report and Resource Accounts 2000/01*, ECGD.
157. *BBC News* 18 September 2002, "Indonesia 'loses' $711 m".
158. *The Jakarta Post*, 15 July 2002 "Soeharto clan's past abuses emerge".
159. *See* BP Amoco Plc, Memorandum to International Development Committee's report "The Export Credits Guarantee Department – Developmental Issues", 30/11/99; Trade and Industry Select Committee, Third Report, "The Future of the Export Credits Guarantee Department", 11/1/00; Engineering Employers Federation, "Budget Representation to HM Treasury for 2001". For Corruption Perceptions Index, *see* Transparency International's Press Release, 13/9/02. In 2000, government ministers were said to be holding discussions about whether to extend export credit cover to Angola.
160. *Project Finance*, 1/11/02, "Image and reality: ECA Review".
161. Trade and Industry Select Committee report, "The Future of the Export Credits Guarantee Department", 11/1/2000
162. Due diligence means investigating the history, performance and value of a company before investing in it or extending financial support to it.
163. Drawn from newspapers except the last two quotes that are from Blaine Harden, *Africa: Dispatches from a Fragile Continent*, Fontana, 1992, p.187.
164. WLPU was also a consulting engineer on the Pergau Dam, *see* p.26.
165. A. Darnaudet and M. Fauconnier, "Retrospective Evaluation of the Turkwell Project in Kenya", Report for French Ministry of Economy and Finance – Treasury Department, March 1992, p.2.
166. According to the ECGD, the project was called simply "Hydro-electric dam, Kenya" in its files and not "Turkwell Gorge hydro-electric dam, Kenya", accounting for the confusion as to whether it had backed the project or not.

suitable and cheaper sites had been identified. Initial feasibility studies[167] raised questions about the reliability of the seasonal flow of the Turkwell river, possible siltage problems and potential detrimental environmental impacts downstream, particularly to forests that sustained local people.[168] The Kenyan government repeatedly postponed carrying out a study funded by the Norwegian government's aid department, Norad, into the effects of the dam on the Turkana people living in the area.[169]

The European Economic Community (EEC) was in the process of commissioning a study to look further into these issues when, in January 1986, the Kenyan government awarded the contract to build the dam to the French company, Spie Batignolles, without any international competitive bidding procedure.[170] The contract signed was for $250 million (£157 million), some $102 million (£64 million) more than an original estimate, and $60 million (£37 million) more than was judged economically feasible by the French consulting firm, Sogreah.[171] Furthermore, the terms of financing the dam as laid out in the contract were extremely disadvantageous to the Kenyan government: financing was mainly in the form of non-concessional (that is, full market rate) loans denominated in rapidly appreciating Swiss francs, leaving Kenya with the prospect of an ever-increasing debt burden. At the time, there was an informal agreement among European countries that they would pay for major projects in Africa with low-cost loans, and there were more than enough donor funds available at the time to fund Turkwell on a concessional basis.[172]

In a March 1986 internal memo leaked to the *Financial Times*, the European Commission delegate to Kenya, Achim Kratz, stated that the dam was "extremely disadvantageous for Kenya", but suggested that Kenyan government officials (particularly President Daniel Arap Moi and energy minister Nicholas Biwott) "nevertheless accepted it because of high personal advantages".[173] Allegations of bribery have been consistently raised in the Kenyan media.[174] The World Bank, rival Scandinavian and British companies, and the British government itself raised further criticisms of the deal at the time.[175]

The Turkwell Gorge Dam eventually cost $450 million (£285 million) to build, three times the initial estimate[176] and nearly twice the contract price. Soon after it was completed in October 1993, the critics' predictions started to come true. The dam was meant to produce 160 MW of electricity, but produced only 85 MW because of low water levels.[177] By 1998, the river Turkwell's flow had fallen by 13%,[178] and by 2000, the dam was producing 80 MW, with its reservoir nearly 50 metres below its full supply level.[179]

Because of the corruption surrounding Turkwell, a 1991 Consultative Group meeting of donors to Kenya, including the World Bank and IMF, imposed a full aid embargo on Kenya. International donor aid to Kenya's energy sector was frozen until late 1996. The British government, however, did not participate in this aid embargo,[180] and it was not until 1998 that the ECGD responded to corruption concerns by reducing its liabilities on other projects in Kenya.

The Turkwell Gorge Dam has continued to be dogged by ongoing allegations of corruption and financial mismanagement. These have included

167. Various consultants including Norwegian company NORCONSULT, French company Sogreah and British firm Preece Cadew and Rider carried out studies into the feasibility of the project between 1960 and 1984. *The Standard*, 6/10/93, "Turkwell Gorge Supplement"
168. Note presentée au Comité d'aide au développement, Section VI, "The practice of French assistance: Turkwell Dam project", based on study of French aid to Africa by Mrs Kleemeier, March 1991; *Sunday Nation*, 5/9/93, "How white is the Turkwell elephant?"; and A. Darnaudet and M. Fauconnier, "Retrospective Evaluation of the Turkwell Project in Kenya", March 1992, p.2.
169. Blaine Harden, *Africa: Dispatches from a Fragile Continent*, Fontana, 1992, p.187.
170. *Sunday Nation*, 5/9/93, "How white is the Turkwell elephant?", p.10.
171. Note presentée au Comité d'aide au développement, Section VI. "The practice of French assistance: Turkwell Dam project", based on study of French aid to Africa by Mrs Kleemeier, March 1991, p.36.
172. *See* Blaine Harden, *Africa: Dispatches from a Fragile Continent*, Fontana, 1992, pp.187, 210.
173. Achim Kratz, *Delegation of the Commission of the European Communities in the Republic of Kenya. Confidential memo re Turkwell Gorge Project*, 5th February 1986, quoted in *Financial Times*, 27/11/91, "Mr Biwott the Businessman: A look at the former Kenyan minister's road to riches".
174. Journalist Blaine Harden estimates roughly that the kickback would probably have been about $27 million (£17 million), based on the going rate, according to local Kenyan sources, for kickbacks on similar projects that was never less than 10%. *See* Blaine Harden, *Africa: Dispatches from a Fragile Continent*, Fontana, 1992, p.210.
175. *Sunday Nation*, 5/9/93, "How white is the Turkwell elephant?", p.10; *Daily Nation*, 29/9/93, "Turkwell: 'Sour Grapes' charge".
176. *Daily Nation*, 31/10/95, "Another big dam for Kerio Valley".
177. *Daily Nation*, Wednesday Magazine section, 1/12/93, "Turkwell: Darkness amidst light . . . "
178. *Daily Nation*, 21/5/01 "At this rate, we shall import water by 2010".
179. *East African*, 18/5/00, "Power crisis deepens".
180. In December 1991, the then Secretary for Overseas Development Administration (ODA, the predecessor department to the current Department for International Development), Lynda Chalker, told Parliament that the UK government was considering "further aid on top of the very substantial aid which continues to be well used in Kenya" (*Hansard*, 18/12/91, House of Commons Debate, Column 267)

illegal contracts, failure to account for expenditure, and overpayment of contractors by the parastatal company responsible for the dam, the Kerio Valley Development Authority (KVDA). [181] Most recently, in 2001, the Kenyan Parliament's Public Investment Committee questioned President Moi's son, Jonathan, regarding pressure exerted on the KVDA to award one contract to a particular Kenyan consulting company, Meacom Consultants Ltd, in 1996-7.[182] No final audit of the original Turkwell deal has ever been completed.[183]

One-third of the Turkana people were dependent, particularly in times of drought, upon a riverine forest irrigated by the river Turkwell. Before the dam was built, serious concerns were raised that the dam would destroy the Turkana people's ability to keep livestock, thus forcing them to depend upon food aid. A Norad study feared that the dam would "have a devastating effect on the economy, as well as the ecology, of central Turkana District".[184]

Some 800 people were displaced by the Turkwell dam, compensation for whom was slow and inadequate.[185] "Community projects" to lessen the impact of the project were poorly designed. A hospital and school were built too far from where people lived. As soon as the dam had been completed, the drugs in the hospital ran out. Untreated water from the dam was blamed for an outbreak of typhoid at the local hospital.[186] During construction, school attendance dropped sharply as children took unskilled jobs on the site; prostitution became rampant; and 12 people died and 50 were injured as a result of working on the dam.[187]

Longer-term damage to the environment and local people is only just coming to light. In early 2001, the United Nations Environmental Programme started a five-year study on the rehabilitation of rangelands in African arid zones. It stated that the main threat to indigenous species of plants – the main food sources for humans and livestock – was "the effect of the dam on the Turkwell River which has changed flood patterns and threatened fauna habitats."[188]

Kenya, a drought-prone country, has been crippled by energy shortages since it became dependent on hydro-electric power. Two-thirds of its power comes from hydro-electric stations, which in 2000 were producing only one-quarter of their average production capacity.[189] Kenya's most serious drought between 1998 and 2000 brought the country to its knees. Domestic electricity consumers were rationed to 12 hours of electricity a day, 6 days a week. Kenyan businesses were severely affected as power surges wrecked machinery, orders could not be met and staff had to be laid off.[190] Heated exchanges in the Kenyan parliament took place during 2000 over whether Turkwell was a "white elephant" and over the corruption allegations that had always dogged the project. Commentators have suggested that Kenya's dependence on hydro-electric power stems from the lucrative opportunity for some Kenyans to collect bribes paid by Western companies to secure big construction programmes.

The ECGD has paid out claims of £2 million ($3 million) on the Turkwell Gorge Dam, of which it has recovered from Kenya £1.2 million ($2 million). As of mid-2002, the ECGD still had a £0.36 million ($0.57 million) liability in respect of Turkwell.[191] Given that Kenya is a Highly Indebted Poor Country and given that in December 2002, a new government with a strong commitment to tackling corruption was elected, The

181. Allegations documented in the Fourth, Sixth and Eighth Reports of the Republic of Kenya's Public Investment Committee of the Accounts of State Corporations (1993, 1995 and 1999 respectively).
182. *Daily Nation*, 26/6/01, "Parliamentary Investment Committee preparing its 10th audit report"
183. Transparency International, Submission to International Development Committee Inquiry into Corruption, October 2000.
184. Quoted in Blaine Harden, *Africa: Dispatches from a Fragile Continent*, Fontana, 1992, p.211.
185. *Daily Nation*, 1/12/93, "Turkwell: Darkness amidst light . . . "
186. ibid.
187. ibid.
188. UNEP/GEF Project Document "Management of Indigenous Vegetation for the Rehabilitation of Degraded Rangelands in the Arid zone of Africa", Feb/March 2001.
189. *Daily Nation*, 21/5/00, "Severe Rationing to Take Place"
190. *Daily Nation*, 14/9/99, "Economy the top casualty of power deficit"
191. Email from ECGD Spokesperson to The Corner House, 10/6/02

Corner House believes that the ECGD should review its role in funding the Turkwell Dam, with a view to cancelling unconditionally the outstanding debt. The Corner House believes that the ECGD must accept responsibility for this debt because of its negligence with regard to corruption.

The Turkwell Gorge Hydro-Electric Power Station, Kenya

Date of ECGD guarantee:	August 1986
Date of corruption allegation:	March 1986
Source of corruption allegation:	EU delegate to Kenya, local newspapers
Failures in ECGD response:	a) Gave guarantee despite well-known allegations of corruption from credible sources. b) Gave guarantee despite the fact that European countries had agreed to fund such projects in Africa with low-cost loans, which export credit financing is not. c) Failed to insist on proper audit of project being carried out by Kenyan government. d) Denied backing the project despite questions in parliament and from The Corner House until 2001.
Cost to Kenyan taxpayer of ECGD guarantee:	£1.2 million ($2 million)
Cost to Kenyan taxpayer of corruption:	Incalculable sums of money lost through environmental damage, the effects of the aid embargo, and dependence on unsuitable hydro-electric schemes.

Case Study 2
Ewaso Ngiro Hydropower Scheme, Kenya, 1990

In June 1990, the ECGD backed 85% of Knight Piesold's involvement in another hydro-electric project in Kenya, the Ewaso Ngiro Hydropower Scheme, with an export credit of £37 million ($59 million). Knight Piesold conducted feasibility studies and environmental impact assessments for the scheme that proposed to build three dams for $350 million (£220 million) in total by the year 2007.

In 1992, a World Bank study team criticised the £38.1 million ($60 million) contract awarded by the Kenyan government to Knight Piesold[192] as being "five times what such services would normally cost." Its report, which was obtained by the *Financial Times,* also stated that Knight Piesold had been paid £15.3 million ($24.3 million) up front although the dam would not come on-stream for another 10 years. The report noted that "the exorbitant cost of this contract together with the high level of upfront payments . . . even before the feasibility study was completed, raises fundamental questions about procurement practices and financial mismanagement". A 1999 Scoping Study carried out by Knight Piesold indicated that the company published 14 reports between 1991 and 1993, suggesting that the average cost of each report was more than £2.7 million ($4.2 million).[193]

192. The contract was not won through competitive tender.
193. Knight Piesold, *Ewaso Ngiro (South) Hydroelectric Project, Scope of Work, Pre-Feasibility Study and Environmental Assessment (Scoping) of Irrigating Rangeland in Olkiramatian and Shompole Group Ranches,* 1999, pp.24-25.

At the time, Knight Piesold said its fee "was entirely in line with the norm for work of this nature". They argued that its fees were not just for the feasibility study but also for adjudicating tenders, supervising construction, and conducting post-construction monitoring and site investigations.[194] According to a Kenyan newspaper report, Knight Piesold claimed that the upfront payment was necessary "because of the lack of traditional concessionary funding certain departures from the ordinary were inevitable if the funds were to be availed and the projects brought on stream on time."[195] A World Bank team of auditors that subsequently investigated the cost of the feasibility study cleared the company of any wrong-doing.[196]

ECGD supported this project despite the furore over the Turkwell Gorge Dam and the imminent aid embargo on Kenya (*see* p.29)[197] and despite the murder five months earlier of the Kenyan foreign minister, Robert Ouko, who had been looking into allegations of corruption against senior government ministers. The chief suspect for Ouko's murder was alleged to be Nicholas Biwott, the energy minister responsible for commissioning both Turkwell and Ewaso Ngiro. Biwott has strenuously denied the allegations and has never been charged. There is no evidence that the ECGD investigated the "financial mismanagement" questions raised by the World Bank at the time or conducted a full audit of the project.

Knight Piesold's partners in the Ewaso Ngiro Hydropower Scheme were the Kenya Power Company (KPC) and the Ewaso Ngiro South Development Authority. Both bodies have since been criticised by the Kenyan Auditor-General for Corporations for failing to keep adequate accounts and to prepare proper budgets.[198]

In March 2000, the Kenya Power and Lighting Company (the successor to the Kenya Power Company) downgraded the project's priority in its annual Least Cost Expansion Plan. But the project has not been abandoned. Drilling to establish geological and geotechnical conditions for underground structures for the dam was completed during 2000. According to the World Bank in Nairobi, the scheme "may reappear in the future, there is no guarantee that it won't."[199] Knight Piesold was involved in 1998 in studies to reduce the impacts of the dam through an irrigation scheme.

Among the concerns raised by the Maasai Environmental Resource Coalition (MERC) about the hydroelectric scheme are that the local Maasai population will lose land and that compensation will not adequately address or reflect the current communal ownership of land. MERC has also criticised the project for not holding meaningful consultations with local Maasai communities and for failing to disclose information about the project to these communities.

The project would divert water away from the Masarua Swamp, a key water resource in Tanzania's famous Serengeti National Park, and would increase water flow into Lake Natron, also in Tanzania. The increase of water into Lake Natron might flood the principal breeding and nesting grounds of the lesser flamingo. Tanzania has twice vetoed the hydroelectric scheme on the grounds that it would drive wild animals into Kenya, thereby destroying Tanzania's tourist industry.[200]

194. *Kenya Times*, "World Bank and the Ewaso Ngiro scandal", 28/1/92
195. ibid.
196. *The Daily Nation*, "Energy projects stalled by donor conditions", 30/4/00
197. In this same year, 1990, the ECGD also backed the sale of British Aerospace Hawk jets to Kenya despite considerable concern among the international community at humans rights abuses and corruption in the country. *See Hansard*, 16/10/90, Commons Written Answers, Column 771, Mr Lilley to Mr David Davis MP; support from the ECGD for the sale of the jets was "subject to Ministerial Direction" according to Hansard, 23/10/00, Commons Written Answers, Column 73 W, Mr Andrew Smith to Mr Matthew Taylor MP.
198. Republic of Kenya, National Assembly, 1999, *Eighth Report of the Public Investments Committee on the Accounts of State Corporations,* p.239.
199. Interview with Shelley Braithwaite for The Corner House, 31/10/00. Knight Piesold has reported that the project has almost been completed through to the tender document stage, was top of the Kenya Power and Lighting Company's list of hydropower projects, and "could proceed if there were more water around". Despite Kenya's constant drought problems, Knight Piesold insists that this is a viable project. (Interview by The Corner House with Knight Piesold representative, 21/8/02)
200. *Daily Nation*, "Environmentalists discuss power project", 25/3/99

There are already reports from the upriver Boran pastoralist people of intense conflict over access to the Ewaso Ngiro river, particularly when large-scale export-oriented farms siphon off water for irrigation. They also report that the Ewaso Ngiro River has dried up since 1984 except in the rainy season.[201]

The ECGD has paid out claims of £8.12 million ($13 million) with regard to Ewaso Ngiro. It has recovered £5.74 million ($9 million) of this from the Kenyan government, and still has a residual liability of £2.38 million ($3.8 million).[202] Again, given the changed circumstances in Kenya and the ECGD's stated commitment to tackling corruption, The Corner House believes that the ECGD should review this debt.

201. Daoud Tari Abkulla, "Water as basic need: The case of Ewaso Ngiro in Northern Kenya" *in* Daniell Morley, (ed), *Perspectives on freshwater issues and recommendations of NGOs*, Report for World Social Development Forum, 12/5/02
202. Email from ECGD Spokesperson to The Corner House, 10/6/02

Ewaso Ngiro Hydropower Scheme, Kenya

Date of ECGD guarantee: June 1990

Date of corruption allegation: 1992

Source of corruption allegation: World Bank

Failures of ECGD response:
a) Gave guarantee despite international concerns over corruption in Kenya, particularly in the energy sector.
b) Failed to investigate allegations of financial mismanagement.

Cost to Kenyan taxpayer of ECGD guarantee: £5.74 million ($9 million)

Cost to Kenyan taxpayer of corruption: Unknown

Case Study 3
KAFCO Fertiliser Plant, Bangladesh, 1991[203]

"A complete sell-out of national interests"

"The most corrupt deal in Bangladesh's history"

Various Bangladeshi ministers[204]

In March 1991, the ECGD gave investment insurance worth £20 million ($32 million) to Citibank UK for its involvement in the Karnaphuli Fertiliser Company (KAFCO) Fertiliser Complex in Chittagong, Bangladesh. KAFCO is the largest private foreign investment project in Bangladesh and the single largest industrial project in the country. The Complex produces high-grade ammonia and granular urea out of Bangladesh's natural gas for export to the international market.

The $500 million (£315 million) contract for KAFCO, signed in 1990 between the Karnaphuli Fertiliser Company and Japanese companies Chiyoda and Marubeni, together with the Italian Petro-Chemical Manufacturers Association, was hailed by *Trade Finance* Magazine as the "Deal of the Year" in 1990. It was later described in early 1992 by a government minister investigating allegations of corruption as "the most corrupt deal in Bangladesh's history".[205]

The government of Bangladesh holds the largest share in KAFCO, at 43.4%, through the state-owned Bangladesh Chemical Industries

203. The details of this case study have been compiled by the author with the help of Manucher Towhidi, former Managing Director of KAFCO, and Toufique Khalidi, a former BBC World Service journalist, previously with the *Daily Star* in Bangladesh.
204. *The Daily Star* (Bangladesh), 5/2/99, "KAFCO: How the Flagship Turned Sour".
205. *The Daily Star* (Bangladesh), 5/2/99, "KAFCO: How the Flagship Turned Sour".

Corporation. The government is also a guarantor for the whole project. The largest foreign investors in KAFCO are the Japanese companies, Chiyoda (an engineering company) and Marubeni (a trading company specialising in textiles, metals, chemicals and fertiliser). Together with the Japanese government's Overseas Economic Cooperation Fund – which prior to 1999 disbursed Japan's Overseas Development Assistance (ODA)[206] – these two companies set up the Kafco Japan Investment Co Ltd, which holds a 31.3% share in the Complex. Other shareholders include: the Danish company, Haldor Topsoe (14.95%); Denmark's Industrialisation Fund for the Underdeveloped (4.35%); the UK government's Commonwealth Development Corporation (4.35% share);[207] and Stamicarbon BV of Holland (1.56%). Chiyoda, Marubeni and the Italian Petro-Chemical Manufacturers Association (IPMA) acted as contractors on the project. Marubeni and the US trading company, Transammonia AG, secured off-take agreements[208] allowing them a virtually risk-free monopoly to sell all the ammonia and urea produced by KAFCO and to charge KAFCO a 2-5% commission on each sale without requiring the companies themselves to get any minimum price for the products.

The contracts between KAFCO and the foreign contractors were all signed between April and October 1990 in the last months of the military dictatorship of General Hussain Mohammad Ershad. The Gas Supply and Gas Price and Payment Agreements between KAFCO and the Bangladesh government were signed on 1 December 1990 in the midst of a popular revolt that led to the collapse of Ershad's dictatorship on 6 December 1990. These agreements have been most controversial in Bangladesh, because they entailed the government of Bangladesh supplying KAFCO with cut-price gas. There was no competitive tender for the contracts despite stringent requirements in Bangladesh for competitive tender in public procurement.[209]

According to a Bangladeshi journalist reporting on the case at the time, it was common knowledge in Bangladesh that KAFCO involved extensive bribery of government ministers and officials. Mosharraf Hossain,[210] the Permanent Secretary at the Ministry of Industries who negotiated the deal and who was given an unprecedented power of attorney to act on behalf of General Ershad, allegedly continues to receive personal financial support from one of KAFCO's largest foreign investors, Japanese company Marubeni. According to one person familiar with the KAFCO deal, "the misshapen nature of KAFCO's contractual structure could not have come about without serious high-level corruption". General Ershad was subsequently tried and jailed on various charges including corruption. But there has never been an official investigation of corruption in relation to KAFCO, and no one has ever been prosecuted.

The terms of the various KAFCO deals were so unfavourable to Bangladesh that when Khaleda Zia's new government took over from Ershad in 1991, a cabinet committee investigated the project and concluded that it was not in Bangladesh's interests and that the whole arrangement should be revised. But strong pressure from Japan, whose export credit agency, the Export Import Bank of Japan, had underwritten the deal, ensured that only a few revisions were made. This pressure also led the government of Bangladesh itself to issue guarantees on the project in 1992 against $250 million (£157 million) of loans and guarantees to KAFCO from various export credit agencies.

206. The Japanese Overseas Economic Cooperation Fund provides official development assistance in the form of loans and private sector finance. Since October 1999, it has been incorporated into the Export-Import Bank of Japan (JEXIM) to form the Japanese Bank for International Cooperation (JBIC).
207. The Commonwealth Development Corporation also extended £12.8 million ($20 million) worth of loans to KAFCO. The Commonwealth Development Corporation, now CDC Group plc, is 100% owned by the UK government's Department for International Development. It has £1 billion ($1.6 billion) of taxpayers' money invested in more than 50 countries, and provides equity and risk capital for private sector businesses in emerging markets. Its goal is to invest in businesses that contribute positively to national development. In late 1999, it became a public limited company, and proposals have now been made to turn CDC Group plc into a Public Private Partnership.
208. Off-take agreements are long-term agreements to purchase a set minimum amount of a particular product at an agreed price.
209. Although this was strictly speaking a private procurement contract for which tender was not legally required, the government of Bangladesh had such a large share in the project that competitive bidding should have been applied.
210. Mosharraf Hossain is currently State Minister for Energy and Mineral Resources in the government of Khaleda Zia, despite the fact that Zia helped to lead the movement that toppled Ershad.

The contracts for KAFCO have been described in a white paper produced for the government of Bangladesh in 2001 on the project as "manifestly disadvantageous" to the company itself. Even though the Bangladeshi government was the project's major shareholder, it did not "benefit in any significant way from its investment in KAFCO".[211] The fact that almost all KAFCO's foreign shareholders also acted as suppliers, contractors or lenders to the project gave rise "to conflict of interests among shareholders which may have deterred them [from taking] optimal decisions favouring the interest of KAFCO".[212]

From the beginning, the government of Bangladesh granted KAFCO extraordinary concessions that were far more in the interests of the foreign investors than of the country. KAFCO was to receive gas on a preferential basis and at a cheaper rate than any other consumer in the country – at half the price of gas supplied to other fertiliser companies in the public sector. This annual subsidy to KAFCO of cheap gas provided by the Government of Bangladesh has been estimated at $18.5 million (£11.6 million) a year. Bangladesh's total subsidy to KAFCO up to January 2003 is estimated to be in the region of $120 million (£75 million). KAFCO was given an income tax holiday for the first nine years of its production, followed by an annual rebate of 50% on income tax.[213] KAFCO's foreign equity holders and lenders did not have to pay any taxes, import or export duties, charges or fees.[214]

The government of Bangladesh is not only one of the major suppliers to KAFCO but also its major shareholder. It is one of KAFCO's major purchasers as well – but it has to buy fertiliser from KAFCO in foreign exchange and at international prices. KAFCO itself is required to pay 2% commission to US company Transammonia and Japanese company Marubeni for these sales to the government of Bangladesh, even though the sales require no work on the companies' part and even though it was understood at the outset that the Bangladeshi government would be a major purchaser of the plant's products.

The KAFCO fertiliser plant has proved a costly drain on the government of Bangladesh's resources, and not just because of its gas subsidy. The plant, according to the contract, was considerably over-priced. It cost between $130-150 million (£82-95 million) more to build than a similar plant in Bangladesh at Jamuna.[215] Cost overruns of more than 26% meant that the project finally cost $632.7 million (£397.6 million) instead of the original contract price of $500 million (£315 million).[216]

Equipment bought from Romania and Italy was so substandard that the plant did not function properly when it finally opened in December 1994, five years after the signing of the contract. Within four months of opening, the plant had suffered numerous shutdowns. It failed a performance test carried out in May 1995, and the plant did not achieve Plant Acceptance[217] until October 2000, after one contractor (and investor), Japanese company Chiyoda, had paid out $30 million (£19 million) in compensation. Production losses caused by shutdowns due to substandard equipment have been estimated at $78 million (£49 million),[218] but according to internal projections by KAFCO's management, the total losses to KAFCO are likely to be in excess of $110 million (£69 million).

It is only in the last two financial years, 2000-2001 and 2001-2002, that KAFCO has shown an operating profit of roughly $5 million (£3 million)

211. White Paper on Karnaphuli Fertilizer Company Ltd, prepared for Ministry of Industries, Government of Bangladesh, by Dr Debapriya Bhattacharya, 16/9/01, p.27.
212. ibid, p.27.
213. *The Daily Star* (Bangladesh), 5/2/99, "KAFCO: How the Flagship Turned Sour".
214. A White Paper on Karnaphuli Fertilizer Company Ltd, Prepared for Ministry of Industries, Government of Bangladesh, Dr Debapriya Bhattacharya, 16/9/01
215. ibid, p.24.
216. ibid, p.42.
217. Plant Acceptance is acceptance by the company commissioning a project at the end of construction that the plant has been satisfactorily completed according to the terms of the contract.
218. ibid, p.25.

a year. But if the gas subsidies provided by the government of Bangladesh were removed, KAFCO would still be operating at a loss.

The white paper on KAFCO prepared for Bangladesh's Ministry of Industries in November 2001 was deeply critical of the project's viability. It found that the plant's mid-term financial viability was in doubt and that the company's net assets had declined by 38.5% over six years.[219] It also noted that it is unlikely that the government of Bangladesh will receive "any dividend income [from KAFCO] for the foreseeable future".[220]

Bangladesh is one of the poorest countries in South Asia and the world. In 1999, according to the Asian Development Bank, 45% of its population lived below the poverty line, while in 2000, World Bank statistics show that 47% of its children under the age of five were malnourished.[221] It can least afford substandard projects from which, at best, it draws no benefit and, at worst, which it is forced to subsidise with its limited public funds. According to the former managing director of KAFCO, Manucher Towhidi, "simply put, [KAFCO] is the story of a poor nation raped by a group of multinationals in the name of industrialisation, while three so-called enlightened and helpful governments (Japan, UK and Denmark) stood by and allowed it to happen and to continue to this day".[222] Estimates of the net drain on Bangladesh's resources of the KAFCO project are in the region of $350 million (£220 million).

The ECGD has played a significant role as a guarantor for Citibank UK's substantial loans to KAFCO. Neither the ECGD, nor its fellow UK government department, the Commonwealth Development Corporation, which is a KAFCO shareholder and lender, seem to have undertaken any serious analysis of the project's cost before giving financial support. The ECGD's involvement shows considerable disregard for the interests of Bangladesh and for the impact that corruption can have on the design and implementation of a project. A former KAFCO insider told The Corner House, "I think they [the ECGD] were half asleep when they went into this project. I think they were transfixed by the wonder of how the plant looked on paper and didn't stop to take a look at the details".

The ECGD is still insuring the KAFCO Fertiliser Complex.[223]

219. *The Daily Star* (Bangladesh), 7/11/02
220. Dr Debapriya Bhattacharya, A White Paper on Karnaphuli Fertiliser Company Ltd, Prepared for Ministry of Industries, Government of Bangladesh, 16/9/01, p.46.
221. World Bank Bangladesh Data profile, Asian Development Bank country data
222. Personal communication with Manucher Towhidi, former Managing Director of KAFCO, 13/1/03
223. ECGD Press Release, 9/3/01, "ECGD Cements support for Rolls-Royce Investment in Bangladesh".

KAFCO Fertiliser Plant, Bangladesh

Date of ECGD guarantee: 1991

Date of corruption allegation: 1991

Source of corruption allegation: Government ministers in new Bangladeshi government

Failures of ECGD response:

a) Almost total failure of any due diligence procedures.

b) Total lack of regard for corruption and its effect on project design.

c) Total lack of regard for the potential negative impact on Bangladesh of the project.

d) Failure to ensure that safeguards were built into the contract to ensure that the project would function adequately.

Cost to Bangladeshi taxpayer of ECGD guarantee: None so far

Cost to Bangladeshi taxpayer of corruption: Around $350 million (£220 million)

Case Study 4
Lesotho Highlands Water Project, Lesotho, 1993-7

Between 1990 and 1997, the ECGD supported the involvement of four British companies to build the Lesotho Highlands Water Project and its associated Muela and Katse dams.[224] The four companies were Kier International, Sterling International, Balfour Beatty and Kvaerner Boving Ltd. The ECGD's total support amounted to £215 million ($342 million).[225]

Three of the companies backed by the ECGD, Balfour Beatty, Kier International and Sterling International, are members of business consortia formed for the Project that have been implicated in bribery connected with the scheme. (Another UK company, Sir Alexander Gibb [now known as Gibb Ltd], which received EU grants, was on the original list of companies to be prosecuted in the Lesotho courts for bribery.) Masupha Sole, the chief executive of the Lesotho Highlands Development Authority, the state body responsible overall for the project, was convicted in May 2002 in a Lesotho court for receiving bribes and sentenced to 18 years in prison in June 2002.[226]

The Lesotho Highlands Water Project, the biggest water scheme of its kind in the world, has always been controversial. The £5.5 billion ($8.7 billion) project, which is due to be completed in 2020, was designed to divert water from the mountains of Lesotho through a series of dams and tunnels to South Africa's industrial province of Gauteng. When the project started in 1986, its financing from sources outside the country, in particular, the World Bank, the European Investment Bank, the European Development Fund, the African Development Bank, various export credit agencies and private banks, was channelled through a UK bank account in London to get around international sanctions against the apartheid government of South Africa.

Critics always questioned whether the project would bring any benefits to the people of Lesotho. For a country in which only 9% of the land can be cultivated, the loss of 925 hectares of arable land and 3,000 hectares of grazing land had considerable social and environmental impacts.[227] Some 27,000 people have lost their farms or access to grazing pastures as a result of the first two dams (Katse and Muela) built so far (five or six are envisaged in all). About 2,000 people have been resettled. Many of these people believe that they have not received fair compensation, and mass demonstrations against the project have taken place. At one demonstration in 1996, prompted by the sacking of 2,300 workers for striking, five people were killed and 30 injured. Resettlement has broken up communities and increased social problems, while the project has lowered water quality in Lesotho and destroyed natural habitats.[228]

Suspicions of bribery first surfaced in 1994. Leaked correspondence between the World Bank and the Lesotho government shows that the Lesotho government wanted to suspend Masupha Sole and another Lesotho Highlands Development Authority official for about four months while a management audit was completed. Irregularities in the Authority's accounts had prompted the internal investigation. The World Bank vigorously opposed the suspension of Sole and the other official, even threatening legal action should the Lesotho government go ahead with this course of action.[229] This correspondence was copied to the UK government's overseas aid department, the Overseas Development Administration (now the

224. ECGD *Annual Reports and Trading Accounts* for 1993/4, 1994/5, 1995/6 and 1996/7.
225. Email from ECGD Spokesperson to The Corner House, 5/11/02. Figures drawn from parliamentary questions in Hansard, however, suggest a total level of support of £540.2 million ($860 million). The ECGD has implied that, because of the complexity of the project, figures given in different parliamentary answers may have been duplicated.
226. In May 2003, Sole's appeal against conviction was dismissed, and his conviction on 13 counts of bribery confirmed by Lesotho's Court of Appeal. His sentence was reduced to 15 years to allow for some sentences to run concurrently rather than consecutively.
227. David Letsie and Patrick Bond, "Social, Ecological and Economic Characteristics of Bulk Water Infrastructure: debating the financial and service delivery implications of the Lesotho Highlands Water Project", www.econjustice.net/wbb/lesotho3.htm.
228. PSIRU News Item 4730, "Lesotho Highland Water Project sparks mass demonstrations", 19/11/01. For more information on the Lesotho Highlands Water Project *see* www.irn.org/programs/lesotho/index.shtml, and The Corner House, "Dams Incorporated: The Record of Twelve European Dam Building Companies", February 2000, www.thecornerhouse.org.uk/documents/damsinc.html.
229. Letter from Praful C Patel, Country Operations manager, Southern Africa Department, World Bank, to Mr B Pekeche, Government of Lesotho, 2 December, 1994, marked "LESOTHO: Highlands Water Project (Ln. 3393-LSO).

Department for International Development, D*f*ID), and to the British High Commission in Lesotho. The ECGD was also informed of the decision to suspend Sole and one other official at the time although it claims that "there was no suggestion of illegal acts on the part of these individuals".[230] The fact that they were suspended pending an audit, however, suggests that, at the very least, irregularities were suspected.

The Lesotho government did not make its first moves towards initiating a criminal prosecution until 1999, when Swiss bank accounts belonging to Sole were discovered. Three years later, on 20 May 2002, Lesotho's Judge Cullinan found Masupha Sole, the former chief executive of the Lesotho Highlands Development Authority, guilty of receiving nearly £3 million ($5 million) worth of bribes over the course of a decade from companies involved in constructing the project.[231]

The Judge found that one of the consortiums involved, the Lesotho Highlands Project Consortium (LHPC), in which British company Balfour Beatty had a 16% share,[232] had made payments totalling £33,904.96 ($50,870.59)[233] to Masupha Sole. These payments, according to the charges laid before the court, were made via the Swiss bank account of a Panamanian company, Universal Development Corporation, controlled by an agent, Max Cohen, who then transferred them into Sole's bank account with UBS Zurich in Switzerland.[234] The Judge found Masupha Sole guilty of Count 4, a bribery charge, which stated that "LHPC and/ or one or more or all of its constituent members corruptly offered payment(s) to the Accused in return for the Accused exercising his influence/powers in his official capacity for the benefit of LHPC." The Judge also found Sole guilty of Count 3, another bribery charge, which stated that the lead contractor in LHPC, French construction company Spie Batignolles, paid Sole (through the same agent, according to the charges) £6,027.02 ($11,263.00).[235] Spie Batignolles now faces prosecution for bribery by the Lesotho authorities.

The charges laid before the court show that a subsequent joint venture involving four companies from the Lesotho Highlands Project Consortium and called the Muela Hydropower Project Contractors (MHPC) won two contracts in 1994 in contentious circumstances. In one instance, the MHPC was allowed to revise its bid downwards after a rival company had tendered at a lower price, leading the African Development Bank to withdraw its funding in protest. In another instance, the MHPC sought to increase the contract price after tender, leading to disputes with the contract negotiating committee and to the European Commission, which was sponsoring the contract, refusing to fund the irregular increase.[236]

A spokesperson for Balfour Beatty told the UK's *Guardian* newspaper in July 2002 that all the Consortium members had made payments to the agent involved.[237] All the companies deny, however, any knowledge of these payments being used to bribe Sole or others.

Judge Cullinan found that another consortium, the Highlands Water Venture, which includes British companies Kier International and Stirling International and which was headed by the Italian construction and engineering company, Impregilo, had paid $375,000 (£261,506) to Sole between October 1991 and September 1992. On another count, the Judge found that Gibb had paid £20,000 ($32,000) to Sole.[238] On 17 September 2002, meanwhile, the first company to be tried for bribery, Canadian

230. *Hansard*, 2/12/02, Commons Written Answers, PQ 2002/94, Ms Hewitt to John Austin MP.
231. Judgement of Justice BP Cullinan, 20th May 2002, *Rex vs Masupha Ephraim Sole*.
232. Other companies in the Consortium were French companies Spie Batignolles and Campenon Bernard, German company Ed Zublin AG and the South African company, LTA Construction.
233. Currency conversion has been made in real terms, that is, for the date on which the payments were made. The judgement states that Sole received French Francs 58,654.90, £15,200.00 and $17,180.49 between November 1992 and March 1994.
234. Count 4, Judgement of Justice BP Cullinan, 20th May 2002, *Rex vs Masupha Ephraim Sole*, p.223.
235. Currency conversion has been made in real terms, that is, for the date on which the payments were made.
236. Judgement of Justice BP Cullinan, 20th May 2002, *Rex vs Masupha Ephraim Sole*, pp.77-78.
237. David Pallister, "Blacklisting Scandal threat to UK firm in dam cash scandal", *The Guardian* 6/7/02
238. Highlands Water Venture, Count 1, Judgement of Justice BP Cullinan, 20th May 2002, *Rex vs Masupha Ephraim Sole*, p.222; Gibb, Count 14, ibid, p.120.

construction firm Acres, was convicted by the Lesotho High Court of paying bribes to Sole and was fined £1.5 million ($2.2 million) in October 2002, a sentence against which it is appealing.

The ECGD says that it is monitoring developments in the Lesotho court cases and that it has "sought and received assurances from [the companies involved] that they had no involvement in any unlawful conduct and [that it has] been provided with no information to suggest that they were involved in corruption."[239] This does not suggest that the ECGD has instigated a thorough investigation of the corruption charges. Moreover, the ECGD seems to have made no effort to contact the prosecuting authorities in Lesotho to find out details of the charges. Since the government of Lesotho, one of the poorest countries in the world, is running out of funds to conduct prosecutions against all the companies implicated, the involvement of the British companies in bribery and corruption in this project may well go uninvestigated. Funds that the government of Lesotho was led to expect would come from the World Bank and European Commission to help fund the trials have not been forthcoming.

The ECGD has been unclear and reticent about its backing of the Lesotho Highlands Water Project. In February 2000, a minister from the Department of Trade and Industry (DTI), which is responsible for the ECGD, reported to Parliament that the ECGD could find no trace of an application for credit guarantees for the Muela dam, which is part of the project.[240] Just a year later, however, in February 2001, another DTI minister reported to Parliament that the ECGD had issued four guarantees dating from 1993 through to 1997 for the Muela dam.[241] It is also clear that the ECGD was negligent with regards to irregularities both in the Lesotho Highlands Development Authority (LHDA) and in the tender processes on the Muela dam. The ECGD was alerted to irregularities at the LHDA in 1994 and should have been aware of concerns raised by the African Development Bank and the European Commission also in 1994 about tender processes on the Muela dam. But the ECGD continued to back British companies on the project after this date.

The ECGD's residual liability on the Lesotho Highlands Water Project is £36 million ($57 million).[242]

239. *Hansard*, 2/12/02, Commons Written Answers, PQ no: 2002/94, Ms Hewitt to John Austin MP.
240. *Hansard*, 22/2/00, Commons Written Answers, Column 958W, Dr Howells to Menzies Campbell MP.
241. *Hansard*, 26/2/01, Commons Written Answers, Column 405W, Mr Caborn to Dr Tonge MP.
242. Email from ECGD Spokesperson to The Corner House, 10/1/03

Lesotho Highlands Water Project, Lesotho

Date of ECGD guarantee: Various between 1990 and 1997

Date of corruption allegation: Autumn 1994

Source of corruption allegation: Government of Lesotho

Failures of ECGD response:

a) Continued to give guarantees after first corruption suspicions arose.
b) Failed to implement adequate due diligence procedures towards the consortia in which the British companies it backed were involved. Fellow consortia members, including Spie Batignoles and Impregilo, had very poor corruption records.
c) Failed to institute proper investigation, stating only that it has asked the companies themselves for information.
d) Failed to pass on corruption allegations to the Serious Fraud Office.
e) Denied in Parliament giving backing to the Muela dam.

Cost to Lesotho taxpayer of ECGD guarantee: None so far

Cost to Lesotho taxpayer of corruption: Unknown, but includes considerably higher costs of construction, owing to contracts going to companies that may have paid bribes, despite lower bids from rival companies.

Case Study 5
Coco Palm Apartments and La Palm Beach Hotel, Ghana, 1994[243]

"A pyramid of fraud . . . that has now festered into a full blow scandal"

Ghanaian Chronicle[244]

In August 1994, the ECGD underwrote two loans made by the Bank of Scotland worth £22.3 million ($35.5 million) for a UK company, International Generics Ltd, to build two hotel and luxury apartment complexes, Coco Palm and La Palm Beach, in Accra, Ghana. International Generics Ltd is owned by the Tamman family, who are based in the UK and have close links to the wife of the former President of Ghana, Jerry Rawlings. The previous owner of International Generics and father of the current owner, Danny Tamman, was godfather to Mrs Rawlings.[245] Mrs Rawlings is reported to have an equity stake in the hotels.[246]

International Generics Ltd is wholly owned by Rexol Group NV (also owned by Tamman), which is based in the offshore tax haven of the Netherlands Antilles, via Panama. A former UK Trade Minister, Anthony Nelson, is a former director of International Generics while the former European Commissioner and former UK Chancellor of the Exchequer during Margaret Thatcher's premiership, Sir Leon Brittain, was an adviser to the company during the 1980s.[247] In 1994, the year that the ECGD gave its support for the hotels, the House of Lords ruled in a case concerning the company's tax liability that it owed the UK Inland Revenue corporation tax of over £1 million ($1.6 million).[248]

The hotel and luxury apartments were meant to be built within two years, but it was not until seven years later that they were completed, by which time both projects were crippled with large debts and surrounded by allegations of serious financial mismanagement. There were suggestions that the original loans from the Bank of Scotland had disappeared and that money from Ghana's state Social Security Pension Fund (SSNIT) had been used to take on the debts when the Fund bought a 70% share in the project.[249]

The Ghana Commercial Bank (GCB) had provided a further $36 million worth of loans, backed by a sovereign guarantee from the Ghanaian Ministry of Finance.[250] As of the end of 2001, these loans had not even begun to be repaid, and the GCB had initiated proceedings to recover them. Tamman had apparently made at least £8.5 million ($13.6 million) from the sale of 44 of the 46 Coco Palm chalets between 1998-2000, but had not used the money to pay back the loans.[251]

The role of the Ghanaian Ministry of Finance appears to be crucial to the whole financial arrangement. According to the ECGD, it provided export credit cover for this project "following a request from the Ghanaian Ministry of Finance".[252] Former Finance Ministry officials are heavily involved in the project or have benefited from it. The La Palm Beach project is part of the larger Golden Beach Hotels company, whose Board Chairman is a former Deputy Minister of Finance, Mr Paa Kwesi Amissah-Arthur.[253] According to Ghanaian newspaper reports, the Director of the Private Sector and Financial Institutions Division of the Ministry of Finance, Dr George Yankey, played a key role in persuading

243. Thanks to the Mark Thomas Product and Vera Productions for information regarding this case study.
244. *Ghanaian Chronicle*, "How and Why Henry Dei, Sam Came To Near Blows Over Hotel", 21/8/00
245. *Ghanaian Chronicle*, "La Palm Hotel Robbery Discovered to be Cover up", 14/8/00
246. Vera Productions, Mark Thomas Product – Ghana, Submission to the International Development Select Committee Inquiry Into Corruption, 30/1/01
247. ibid.
248. International Generics Ltd, Notes to the Financial Statements for the year ended 31st December 1994, p.25.
249. *Ghanaian Chronicle*, "How and Why Henry Dei, Sam Came To Near Blows Over Hotel", 21/8/00
250. *Ghana Review International*, "Coco Palm Ltd in big trouble", 13/9/01
251. *Ghanaian Chronicle*, "La Palm Hotel Robbery Discovered to be cover up", 14/8/00
252. *Hansard*, 7/2/01, Commons Written Answers, Column 561 W, Mr Byers to Dr Cable MP.
253. *Ghanaian Chronicle*, "Fitting the Jigsaw at SSNIT", 5/10/00

a former Minister of Finance, Kwame Peprah, to provide the guarantees for the project. Dr Yankey is now said to own one of the Coco Beach apartments.[254]

The ECGD recognises that there were serious corruption issues with this project. In 2001, it reported to Parliament that it had "carried out extensive inquiries into this project, the results of which were passed to the DTI [Department of Trade and Industry] Companies Investigation Branch and the Serious Fraud Office (SFO).[255] The DTI and SFO informed ECGD that they did not consider these cases suitable for investigation owing to the difficulty in finding a criminal offence that had occurred within UK jurisdiction which they could investigate and prosecute."[256] This is the only known case in which the ECGD has passed on information concerning corruption allegations to external investigatory authorities. It has promised to cooperate fully with any investigation undertaken by the Ghanaian authorities.

This action comes too late for the Ghanaian people, however. Ghana is another of the world's poorest countries. By late 2002, the ECGD had paid a total of £18.4 million ($29.4 million) on the two projects of which it had recovered £10 million ($16 million) from the government of Ghana.[257] The ECGD has subsequently written off £31.1 million ($49.8 million) of Ghana's debt owed to it.

254. *Ghana Review International*, "Coco Palm Ltd in big trouble", 13/9/01
255. The Serious Fraud Office is an independent UK government department responsible for investigating and prosecuting complex or serious fraud cases of over £1 million ($1.6 million), usually with an international dimension or of public concern.
256. *Hansard*, 7/2/01, Commons Written Answers, Column 561W, Mr Byers to Dr Cable MP.
257. Email from ECGD Spokesperson to The Corner House, 7/10/02

Coco Palm Apartments and La Palm Beach Hotel, Ghana

Date of ECGD guarantee: August 1994

Date of corruption allegation: 2000

Source of corruption allegation: *Ghanaian Chronicle* newspaper

Failures of ECGD response:

a) Inadequate due diligence regarding the company involved and the circumstances in Ghana leading to the project

b) No apparent action against the company concerned and claims paid to the company despite corruption allegations

Cost to Ghanaian taxpayer of ECGD guarantee: £10 million

Cost to Ghanaian taxpayer of corruption: Unknown, but could include losses to the Social Security Pension Fund, and to the government of Ghana through the guarantee of the loan from Ghana Commercial Bank

Case Study 6
Godavari Power Plant, Andhra Pradesh, India, 1995

In March 1995, the ECGD announced that it was backing a loan of £50 million ($80 million) from ANZ Grindlays Bank to Spectrum Power Generation Limited (SPGL) to run a 208MW gas-fired combined-cycle power plant at Godavari in India's state of Andhra Pradesh. The loan was to support the involvement of Parsons Power Generation Systems Ltd (now Heaton Power Ltd[258]) and Rolls Royce Industrial Power (India) Ltd – both subsidiaries of the UK engineering company Rolls Royce plc – in constructing and operating the £110 million ($176 million) plant.

258. According to UK Companies House documents, Heaton Power Ltd did not trade during 2002, is an agent for Rolls-Royce Power Engineering plc, and is ultimately owned by Rolls-Royce plc. Two of Heaton Power's current directors are also directors of Rolls-Royce Industrial Power (India).

The US engineering firm, Westinghouse, acted as a joint venture partner to both companies on the different contracts that each won.

The Godavari Power Plant has been plagued by allegations of corruption and financial mismanagement. Rolls Royce Industrial Power and Heaton Power Ltd are currently facing a court case in the UK brought by minority shareholders in SPGL to try to force them to repay commission payments made to the SPGL's Managing Director in the course of trying to win contracts from the company. An initial court case in December 2001 focused on whether the UK courts had jurisdiction to hear the case. The judge, Mr Justice Lawrence Collins, found that while the UK courts did have jurisdiction, the most appropriate jurisdiction for the case was India.[259] An appeal to hear the case in the UK is due to take place in the autumn of 2003.

The proposal for a power plant at Godavari was initially put forward as a project of the Andhra Pradesh state, but it was turned over to the private sector in 1992 as part of India's liberalisation programme. Together with a state company, National Thermal Power Corporation Ltd (NTPC), Spectrum Technologies USA (STUSA) was chosen to develop the project. Shortly after, Jaya Foods Limited, a small Indian vermicelli company, joined the project and the three companies signed a Promoter's Agreement in 1993. All three companies set up a new company, Spectrum Power Generation Limited (SPGL), to commission and run the plant. STUSA and Jaya Foods Limited were allocated 90% of the shareholding in this new company and NTPC the remaining 10%.

Problems began early on. Kishan Rao of Jaya Foods Limited appears to have taken advantage of the fact that he incorporated SPGL in his name and that he was its managing director to ease out the other promoters, STUSA and NTPC. He apparently refused to issue shares to STUSA and its investors, and revoked the Promoter's Agreement to the surprise of NTPC and STUSA. This effectively denied STUSA and NTPC any rights in the company or a say in how the company was run. In effect, from mid-1995, Spectrum Power Generation Limited was run by a food company that had no previous experience of the power sector.

NTPC and STUSA brought several legal cases against Kishan Rao in the Indian courts. Information disclosed during these lengthy legal battles revealed that Kishan Rao used his position to ensure that SPGL awarded numerous bogus contracts to his family and friends. Between October 1993 and March 1994, SPGL gave out about Rs (rupees) 30 crore (£4 million/$6.4 million) worth of contracts for land and site development to newly floated companies that were held in the names of his relatives and associates. These contracts were for work identical to that covered in the contracts awarded to Rolls Royce Industrial Power and Parsons Power Generation Systems, but no work was ever carried out by these new companies.[260] Kishan Rao seems to have transferred the funds SPGL gave to these companies on to yet other companies that he also owned and then brought the funds back into SPGL as equity of affiliates of Jaya Foods.[261]

In 2001, it emerged from these legal battles that on 1 November 1993, Rolls Royce Industrial Power (India) Ltd and Parsons Power Generation Systems Ltd entered into Agency Agreements with Towanda Services Ltd, a company based in the offshore tax haven of the British Virgin Islands. According to these agreements, Rolls Royce Industrial Power

259. www.lawreports.co.uk/chanjanb0.1.htm
260. Audits of Spectrum Power Generation Ltd carried out on behalf of the lead financial institution, Industrial Development Bank of India (IDBI), by Billimoria and Company and the federal Income Tax Department both found the companies and the contracts to be bogus.
A crore is a unit in a traditional numbering system still widely used in India. One crore equals 10 million.
261. *Powerline* (India), October 2001, Volume 6, No 1, "Five years and still fighting: accusations abound in the Spectrum saga", p.15.

agreed to pay £1.5 million ($2.4 million) and Parsons Power $19.3 million (£13 million) to Towanda Services if Towanda helped the two companies win, respectively, the Operation and Maintenance (O&M) contract and the Engineering, Procurement and Construction (EPC) contract from Spectrum Power Generation Limited.[262] The Agency Agreements appear to have been signed by Mr A.D. Perkins who was Managing Director of Rolls Royce Power Engineering in Newcastle at the time until he left the company in July 1996.

Towanda Services, however, was owned and controlled by Kishan Rao of Jaya Food Industries, who was also Managing Director of SPGL.[263] The company was incorporated only in October 1993, just one month before the Agency Agreements were signed, and had no experience, history or expertise in acting as an agent.[264] This means that the two Rolls Royce subsidiaries entered into an agreement to pay commissions to a company owned by the managing director of the company from which it wished to secure contracts – a fact that Rolls Royce Industrial Power and Parsons Power either knew or wilfully ignored. Kishan Rao has subsequently been subject to an investigation under the 1973 Indian Foreign Exchange Regulatory Act, which prohibits Indian nationals from holding a foreign bank account or from getting money in foreign exchange without government permission. Towanda Services, meanwhile, was struck off the Registry of Companies in the British Virgin Islands in May 1999 for non-payment of its licence fee.[265]

On 4 November 1993, just three days after the Agency Agreement was signed, Kishan Rao announced to the board of SPGL that Parsons Power would be given the Engineering, Procurement and Construction Contract, rather than ABB, Siemens, General Electric or BHEL of India, which had also tendered for the contract.[266] Parsons Power was given the letter of award for the project on board the British Royal Family's cruise ship, the Royal Yacht Britannia, just a few weeks later during "Bombay week" in November 1993.[267] In announcing ECGD support for Parsons' involvement in the Godavari Power Plant in 1995, the UK Minister for Trade at the time, Richard Needham, announced, "Parsons have worked very hard to secure this high profile and valuable contract".[268]

Although awarded in 1993, it was not until the end of 1994 and early 1995 that the £54.3 million ($86.9 million) Engineering, Procurement and Construction contract and the £2.8 million ($4.5 million) Operation and Maintenance contract with Parsons Power and Rolls Royce Industrial Power, respectively, were actually signed. Construction began in May 1995.

But problems with the construction meant that the plant did not become operational until nine months after its due date. Under the contract, SPGL could have required Parsons Power to pay it damages arising from this delay worth about Rs 29,960 lakh (£45 million/$72 million).[269] Mohan Rao, director of STUSA, in his affidavit before a Delhi court in July 1998, claimed that Kishan Rao and the Rolls Royce subsidiary were attempting to sign an agreement withdrawing all claims against each other, thus relieving Rolls Royce from any liability for cost overruns.[270] According to a February 2000 audit report commissioned by AP Transco, Andhra Pradesh's state electricity board, Rolls Royce Industrial Power and SPGL did enter into such an agreement, the legal status of which the audit report suggested needed to be verified.[271] Rolls Royce Industrial Power made counter-claims against SPGL of £16.5 million ($26.4 million)

262. Agency Agreements between Rolls Royce Industrial Power (India) limited and Parsons Turbine Generators Ltd, with Towanda Services, November 1993.
263. Affidavit of Mr Kishan Rao against Mr Mohan Rao, City Civil Court of Hyderabad, 24/5/99.
264. UK High Court, "Particulars of Claim", Konameni versus Rolls Royce Industrial Power (India) Ltd, point 18, 13/7/2000
265. *The Asian Age*, 11/2/03, "Rolls-Royce powers Andhra bribe".
266. UK High Court, "Particulars of Claim", Konameni versus Rolls Royce Industrial Power (India) Ltd, point 18, 13/7.2000
267. ECGD Press Release, 3/3/95, "ECGD Support for Indian Power Project".
268. ibid.
269. ICRA Advisory Services, "Examination of Completed Capital Cost", presentation to AP Transco. Based on report by M Anandam & Co on behalf of ICRA Advisory Services, "A report on examination of completed Capital Cost and Other issues of Spectrum Power Generation Ltd", February 2000.
   A lakh is a unit in a traditional numbering system still widely used in India. One lakh equals 100,000; 100 lakh equal 1 crore. *See* footnote 260.
270. Affidavit of Mr Mohan Rao, July 1998, in the High Court of Delhi.
271. ICRA Advisory Services, "Examination of Completed Capital Cost", presentation to AP Transco. Based on report by M Anandam & Co on behalf of ICRA Advisory Services, "A report on examination of completed Capital Cost and Other issues of Spectrum Power Generation Ltd", February 2000.

– very close to the amount that it had originally paid in commissions to Kishan Rao's Towanda Services.

In March 1996, Rolls Royce Industrial Power invested in Spectrum Power Generation Limited (SPGL) directly through its Mauritius-based arm, RR Godavari Power Ltd (RRGP), for a 48% stake in the company. According to Mohan Rao's July 1998 affidavit, Rolls Royce Industrial Power did not nominate a director to the Board of SPGL, despite being the single largest shareholder, nor did it attend shareholder meetings, nor did it apparently receive any dividends from the project.[272] The issue of contractors becoming shareholders has raised concerns on other projects, such as the KAFCO Fertiliser Complex in Bangladesh (*see* Case Study 3, pp.33ff), due to potential conflicts of interest.

The Godavari power plant was finally completed and commenced operation in April 1998. But it generated cost over-runs of Rs 192 crore (£28.9 million/$46.3 million).[273] Nearly half of this cost over-run, some £14 million ($22.4 million), was on the Parsons Power contract alone.[274] Cost over-runs mean that the plant cost more than Rs 1,000 crore (£150 million/$240 million), one-third more than the costs of £113 million ($181 million) approved in the contracts and more than double what the original 1992 state-run project would have cost, Rs 400 crore (£60 million/ $96 million).[275] It is likely that ordinary consumers of electricity in Andhra Pradesh will be the ones who end up paying for this cost increase.

Just a year after the Godavari power plant started up, the Comptroller and Auditor General of India stated in March 1999 that he wanted the Power Purchase Agreement (PPA) to be renegotiated because the price charged for the electricity was too high. In his report on the plant, he stated that the terms of the agreement violated government guidelines and were contrary to the principles of financial propriety.[276] The PPA has yet to be renegotiated, however.

A report commissioned by the state electricity board of Andhra Pradesh, AP Transco, on Spectrum Power Generation Ltd and carried out by Indian chartered accountants M Anandam and Co in February 2000 noted that there were serious discrepancies in the company's system of accounting and that "internal controls regarding approval of expenditure was absent".[277] This report revealed that audits carried out between 1994 and 1998 consistently raised the concern that the company had no internal audit system, that contracts were awarded without obtaining comparative quotations, and that there was no proper system regarding personal expenses.[278] These omissions make it even more extraordinary that Rolls Royce bought a 48% share in the company – given that even a cursory look at the audit reports would have indicated that SPGL was seriously financially mismanaged – and that the ECGD backed the project.

By May 2002, SPGL was continually defaulting on its interest and loan payments. Despite the fact that the Andhra Pradesh electricity board, AP Transco, that was buying power from the plant was paying its bills on time, SPGL had not paid dividends to its shareholders, or debts to its creditors.[279] The plant owed the Gas Authority India Limited (GAIL), the state-owned gas supplier to the plant, some Rs 45 crore (£6.3 million/$10 million), and GAIL was threatening disconnection.[280] There was a serious risk that the Godavari plant could become a non-performing asset.

272. *Powerline* (India), October 2001, Volume 6 No 1, "Five years and still fighting: accusations abound in the Spectrum saga", p.15. According to US investors in the project, Rolls Royce Industrial Power recently passed the accounts of SPGL despite knowing that the lead Indian financial institution, the Industrial Development Bank of India, had raised serious concerns about these accounts.
273. Affidavit of Mr Mohan Rao, July 1998, in the High Court of Delhi.
274. M Anandam & Co on behalf of ICRA Advisory Services, "A report on examination of completed Capital Cost and Other issues of Spectrum Power Generation Ltd", February 2000.
275. *Economic Times* (India), 4/9/02, "A power project that floats on air". In May 2003, the Andhra Pradesh government turned down SPGL's request for the revised capital cost to be cleared by the Central Electricity Authority (CEA) (*The Financial Express*, 7/5/03, "The Red In The Spectrum: AP Govt Says No Revision in Power Project Cost").
276. *Power Line*, March 1999, "Spectrum: CAG criticism".
277. M Anandam and Co, Report on Examination of Completed Capital Cost and Other Issues of Spectrum Power Generation Ltd, February 2000, Submitted to ICRA Advisory Services.
278. ibid.
279. *Economic Times* (India), 9/5/02, "Spectrum stares at debt trap as UK Co invokes guarantee".
280. *Economic Times* (India), 4/9/02, " A power project that floats on air"; *Economic Times* (India), 9/5/02, "Spectrum stares at debt trap as UK Co invokes guarantee".

In May 2003, local sources told the Indian newspaper, *The Financial Express,* that RR Godavari Power Limited would have "to wait for ever to see any dividend payment". SPGL's latest accounts, meanwhile, showed that the company's debt stood at Rs 8 billion ($170 million), although under the Power Purchase Agreement its debt should not have exceeded Rs 2.7 billion ($57 million).[281]

Rolls Royce has yet to answer detailed questions put to it by The Corner House. Its only comment to The Corner House was the same as that given to *The Observer* newspaper in February 2003: "This matter is the subject of legal proceedings and concerns disputes between the principal promoters of the Godavari project. The project began over 10 years ago and the disputes have been the subject of litigation between the promoters in the Indian Courts since 1996. The allegations against Rolls-Royce are being vigorously contested. The claim against Rolls-Royce was rejected by the High Court in London in 2001 and the Claimants' appeal is not being actively pursued."[282]

When SPGL began to default again on its loans in May 2002, the ECGD was forced to invoke a guarantee from the State Bank of India, which had guaranteed the ECGD's own guarantees on the project.[283] The ECGD did not therefore pay out any claims for Godavari, but only because Indian financial institutions picked up the tab.

The ECGD was clearly and consistently negligent in ascertaining whether Godavari was a financially well-managed and viable project before it backed it. The ECGD could well have been negligent as well in finding out whether this contract involved bribery. If the two Rolls Royce subsidiaries declared their commission payments to Towanda Services while applying for ECGD support, the ECGD should certainly have raised questions as to why they were paying commissions to an offshore company with no previous experience of agency work.[284]

The ECGD has said that it is unable to answer questions in Parliament on whether it was aware of the agency agreements, on whether the commission payments to Towanda Services were included in the overall contract price supported by the ECGD and on what action it intends to take with regard to the payments because the case is before the court of appeal in the UK.

281. *The Financial Express* (India), 7/5/03, "The Red in The Spectrum: AP Govt Says No Revision in Power Project Cost".
282. Antony Barnett, *The Observer*, "Rolls-Royce accused of bribery", 2/2/03, p.10. The Corner House's understanding, however, is that an appeal is likely to be heard later this year and that the High Court rejected the claim against Rolls Royce, not on the merits of the underlying case but on jurisdictional issues.
283. *Economic Times* (India), 9/5/02 "Spectrum stares at debt trap as UK co invokes guarantee".
284. Offshore centres impose little or no taxes, offer themselves to non-residents to avoid taxation in their own country, do not exchange information, and attract shell companies – businesses "with no substantial activities". Because of the secrecy with which they operate, offshore centres have become favoured places to launder the proceeds of crime and corruption. Many offshore financial centres are located in UK Overseas Territories or British Crown Dependencies. Arms dealers often use offshore bank accounts to hide their tracks. *See* Susan Hawley, *Exporting Corruption: Privatisation, Multinationals and Bribery*, Corner House Briefing 19, June 2000, pp.9-10, www.thecornerhouse.org.uk/briefing/19bribes.html.

Godavari Power Plant, Andhra Pradesh, India

Date of ECGD guarantee: 1995

Date of corruption allegation: 2001

Source of corruption allegation: Minority shareholders in the company that was awarded a contract and to whose managing director bribes were allegedly paid.

Failures of ECGD response:
a) Serious negligence with regard to commission payments made by a UK company and its use of an agent based offshore.
b) Serious negligence with regard to financial mismanagement of the company to whom the ECGD backed loan was made.

Cost to Indian taxpayer of ECGD guarantee: None so far

Cost to Indian taxpayer of corruption: Unknown, but includes higher cost of power tariffs in the state of Andhra Pradesh

Case Study 7
Defence Equipment Package, Qatar, 1996

In November 1996, the ECGD opened an extended line of credit for military equipment, known as Project Nile, as part of a £500 million ($800 million) defence equipment deal with the Middle Eastern country of Qatar. It was signed by the then UK Minister of Defence, Michael Portillo (now a non-executive director of BAE Systems), on behalf of the UK government.[285] The deal involved several UK companies and included the sale of 40 Piranha light armoured vehicles from engineering company GKN, an unknown quantity of Starburst short range missiles made by Shorts Missile Systems, 40 Challenger 2 tanks manufactured by Vickers, two patrol vessels from Vosper Thorneycroft and up to 12 Hawk trainer aircraft from British Aerospace (BAe).[286] BAe[287] acted as the lead contractor.[288] The only part of the deal that has been completed, however, is the delivery of the 40 GKN Piranha light armoured vehicles because of diplomatic tensions that arose between the UK and Qatari governments from about 1998 onwards.[289]

Answers to questions posed by UK Members of Parliament in 1999 make it clear that between 1996 and 1997 the ECGD gave two guarantees for military equipment sold to the government of Qatar, worth £5.5 million ($8.8 million) and £222.9 million ($356.6 million) respectively.[290] These guarantees appear to have been to BAe for the sale of the GKN Piranhas and to Vosper Thorneycroft, which delivered four Vita patrol boats in 1997 ordered by Qatar back in 1992.

By May 2001, the authorities in the offshore financial centre of Jersey, one of the UK's Channel Islands, were investigating, under the 1999 Proceeds of Crime Law (Jersey), the possibility that various UK, French and Italian defence and engineering companies had made allegedly "corrupt" payments worth at least £100 million ($160 million) and that these had been channelled through Jersey bank accounts. These payments were made into trust funds owned by the Foreign Minister of Qatar, Sheikh Hamad bin Jassim bin Jaber al-Thani.[291] The payments into these trust funds, named Yaheeb, Yaheeb No 2 and Havana, were first reported in July 2000 to the Jersey authorities by the trust holders, ANZ Grindlays Trust Corporation (which has now become part of the Standard Chartered Bank Group).[292] By the end of 2001, Jersey investigators believed that they had enough evidence to link one payment of £7 million ($11.2 million) made by BAe to an arms contract with Qatar.[293] The Jersey authorities are also believed to have asked questions of Vosper Thorneycroft during their investigations.[294]

Sheikh Hamad has admitted in various affidavits that he accepted substantial commissions from companies, but he has always denied that these payments were bribes. He says he received authorisation from the Emir of Qatar for the payments and that he was acting in a private capacity when he received the commissions, despite being a government minister. The accuracy of the affidavits that Sheikh Hamad put before the Jersey court, however, was called into question by Jersey's Attorney-General, William Bailhache, who suggested to the court that the Sheikh had deliberately misled the court about the nature and beneficiaries of the trust funds. The judge presiding over a December 2001 hearing on the payments, Sir Philip Bailhache, meanwhile, noted that "bribery

285. *Middle East Economic Survey*, Vol 31, No 61, 25/11/96, "Qatar and Britain in $825 million arms deal"
286. *Middle East Economic Digest*, 7/3/97, "MEED Special Report: Defence"
287. British Aerospace changed its name in 1999 to BAE Systems. This report refers to the company as BAe when it was called British Aerospace and as BAE since it has become BAE Systems.
288. *RNS*, 11/9/97, "British Aerospace Interim Results".
289. This allegedly occurred after the International Criminal Tribunal in The Hague found in favour of Bahrain rather than Qatar regarding sovereignty over the Hawal islands.
290. *Hansard*, 25/1/99, Commons Written Answers, Column 29, Mr Wilson to Mr Lock MP.
291. Anthony Lewis, *Jersey Evening Post* "Investigation into Middle East 'sweetener' fund", 25/5/01
292. According to *Private Eye*, Standard Chartered has subsequently paid up to £20 million ($32 million) to Sheikh Hamad as compensation for the embarrassment caused to him over the revelation of the trust funds in Jersey. Sheikh Hamad is Standard Chartered's business partner in Qatar (*Private Eye*, "In the City" column, 2/4/03, pp.28-29.)
293. Antony Barnett, "Riddle of sheik's £100m secret fund", *The Observer*, 2/6/02. It is not clear whether BAe made the payments for the whole of the package (which would represent a 1.5 % commission payment) or just for the sale of the Piranhas (which, since the Piranhas cost roughly £50 million ($80 million), would represent a nearly 20% commission payment). It is also not clear whether BAe made the payments on its own behalf or on behalf of other companies for which it may have acted.
294. *Financial Times*, "Row threatens relations between UK and Qatar", Jimmy Burns, Michael Peel and Andrew Parker, 8/12/02

and corruption and misuse of public office for gain, are offences equally under the law of Qatar as under the law of Jersey. An investigation cannot be stifled because it is the cause of political embarrassment."[295]

In June 2002, however, the Jersey authorities dropped their two-year investigation, and Sheikh Hamad, even though he has denied any wrongdoing, agreed to pay £6 million ($9.6 million) to the Jersey authorities for any "damage perceived to have been sustained in the events that have happened". A statement from the Jersey Attorney-General's office said that "Her Majesty's Attorney-General takes the view that there is material which shows that an offence may have occurred", but that pursuing the case was "not in the public interest".[296] Reasons given for this conclusion were that there were difficulties in obtaining assistance from France with the investigation, that an International Court of Justice ruling in February 2002 stating that foreign ministers are immune from prosecution would undermine the ability of the Jersey authorities to prosecute Sheikh Hamad, and that the length of the investigation "may affect adversely relations between the State of Qatar and the United Kingdom and States of Jersey".[297] There have also been some suggestions in the press, denied by the Attorney-General of Jersey, that diplomatic pressure from the UK government may have helped to end the investigation, particularly since Qatar is seen as an important US and UK ally in the "war against terrorism".[298]

The UK government admitted in 2002 that it knew as far back as 1998 that BAe had paid Sheikh Hamad "commissions in connection with a defence equipment package signed in 1996".[299] The UK's Secretary of State for Trade and Industry, Patricia Hewitt, answering questions in Parliament in 2002 about the ECGD's knowledge of bribery allegations in relation to the deal, has also declared, however, that "no allegations have been received by ECGD, although the Department is aware of allegations in the press." In the same response to Parliament, she also stated that "ECGD responded to enquiries made of it by the Jersey authorities".[300] It is, therefore, clear that the ECGD did know that an official investigation was being pursued by the Jersey authorities into potentially criminal payments made by UK companies on contracts that it had supported. Some light may be shed on the UK government's overall silence on this case, and the ECGD's equivocation, by suggestions made by police sources to The Corner House that BAe may have received government clearance before making the payments.[301]

BAE Systems refused to answer questions put to them by The Corner House about why the sale of the Hawk jets to Qatar did not take place, whether the £7 million ($11.2 million) was a commission payment, whether BAE Systems had guidelines on commissions and whether the company generally discloses the services for which commissions are paid and the percentage of the contract they represent. They said only that "BAE does not violate the law in any of our business activities".[302]

In the late summer of 2002, according to some sources, the original 1996 government-to-government agreement on the sale of defence equipment between the UK and Qatar was being resurrected. As of June 2002, the Qatari government still owed the UK government £36.2 million ($57.9 million) (down from £151.4 million [$242.2 million] in 1999) in claims and future maturities for military equipment.[303]

295. For Attorney-General William Bailhache's submission, *see* Royal Court (Samedi Division), re Yaheeb v 14 December 2001, Para 5. For comment of presiding judge, *see* ibid, Jersey Royal Court Judgment by Sir Philip Bailhache.
296. Anthony Lewis, *Jersey Evening Post* 24/5/02, "Sheikh pays £6 million as investigation is abandoned".
297. Press Release by her Majesty's Attorney-General for Jersey, 24/5/02.
298. Antony Barnett, *The Observer*, 9/6/02, "Straw faces grilling on arms 'bribes'"; Anthony Lewis, *Jersey Evening Post*, 26/3/03, "AG denies UK pressure over Qatar inquiry".
299. *Hansard*, 12/7/02, Commons Written Answers, Column 1257W, Mr O'Brien to Norman Baker MP.
300. *Hansard*, 29/7/02, Commons Written Answers, PQ No: 2001/5840, Ms Hewitt to John Austin MP.
301. According to a 1999 overview of the Defence Export Services Organisation (DESO), a government department attached to the UK Ministry of Defence, companies exporting defence equipment are required to refer any request for special commissions to DESO for clearance (*See* "Defence Export Services Organisation, 16.19, www.ams.mod.uk/ams/content/docs/toolkit/ams/policy/mcm/mcm16-1.htm). It is not clear whether this requirement was in place at the time of the Qatar deal. If it was, it suggests that the government would have known and even gave clearance for the payment to be made.
302. Telephone conversation with David Colthart, Head of Media, BAE Systems, 2/10/02. While BAE says it has not violated the law, if the payment to Sheik Hamad was authorised within the UK and was illegal, or "criminal", as the Jersey authorities' case implied, then the legal situation may not be quite so clear. This depends on whether BAe's payment represented a legitimate commission. The line between a legitimate commission and a bribe is notoriously difficult to draw (*see* this report, p.12 and footnote 49). A legitimate commission would normally be paid to an independent agent rather than a government minister. If BAe sought and obtained UK government clearance before making any such payment, such clearance would obviously be a legitimate defence for the company's actions.
303. *Hansard*, 4/7/02, Commons Written Answers, Column 473W, Ms Hewitt to Dr Cable MP.

Defence Equipment Package, Qatar

Date of ECGD guarantee:	1996, 1997
Date of corruption allegation:	2000
Source of corruption allegation:	Jersey authorities
Failures of ECGD response:	a) Inadequate due diligence regarding risks of bribery in defence deals in the Middle East. b) Failure to acknowledge or investigate bribery allegations.
Cost to Qatari taxpayer:	Unknown

Case Study 8
Dabhol Power Plant, Maharashtra, India, 2000

In February 2000, the ECGD gave £30.5 million ($48.8 million) worth of re-insurance to construction company Kier International to build a liquefied petroleum gas port terminal for the Dabhol Power Plant.[304] The ECGD has also provided small amounts of Overseas Investment Insurance (OII) for three UK banks that have invested in the Dabhol Power Plant, although because of the confidentiality of OII arrangements, the amounts, dates and recipients of the insurance are not publicly known.

The Dabhol Power Plant is a $2.9 billion project in the state of Maharashtra in India. It is the largest foreign investment project in India, and one of the biggest electricity generating plants in the world. The Dabhol Power Company (DPC), which built and ran the plant until it closed in June 2001, was a joint venture between three US energy companies: the now collapsed Enron, General Electric and Bechtel Corporation. Enron originally held an 80% share in the company, but its share was reduced to 50% in 1998 when the Maharashtra State Electricity Board (MSEB) bought a 30% share from Enron. General Electric and Bechtel each hold 10% shares.[305] One-third of the financing for the project came from foreign lenders, including Bank of America, Citibank and the Dutch bank, ABN Amro. Much of their investment is guaranteed by Indian banks, whose exposure on the project is $1.4 billion.[306] The project was also supported by $300 million worth of loans from the US Export Import Bank, and by loan guarantees and risk insurance from the US Overseas Private Investment Corporation (OPIC) worth $360 million.[307]

The Dabhol Power Plant has always been controversial, both in India and abroad. Soon after a Memorandum of Understanding (MoU) for the project was signed in June 1992 between Enron and the Maharashtra State Electricity Board, a review of the MoU, conducted by the World Bank and commissioned by the government of Maharashtra, found many irregularities and concluded that it was very one-sided in Enron's favour. In April 1993, the World Bank refused to provide funds for the plant, questioning its economic viability.[308] Experts at the government of India's Central Electricity Authority who examined the MoU in 1992 also concluded that it was extremely one-sided and found numerous

304. The ECGD gave reinsurance for Kier International's involvement in Dabhol to the Belgian export credit agency, OND, rather than to the exporter directly.
305. Human Rights Watch, "The Enron Corporation: corporate complicity in human rights violations", January 1999.
306. PSIRU News item 4609, "Export credit agency threatens to call in guarantees to Enron".
307. Minority Staff report, Committee on Government Reform, US House of Representatives, 22/2/02, "Fact Sheet: Background on Enron's Dabhol Power Project".
308. Human Rights Watch, "The Enron Corporation: corporate complicity in human rights violations" January 1999.

irregularities, including certain clauses that did not meet requirements under Indian law. In particular, the tariff on electricity produced by the plant was set so high that, if the purchasers had paid it, the company would have received $26 billion over the course of the 20-year project despite spending only $2.9 billion to set up the plant[309] and despite the plant costing 50% more than equivalent power projects in India.

The Maharashtra State Electricity Board (MSEB) was locked into a Power Purchase Agreement with the plant, signed in 1993, that ensured that it would pay for power even if it did not need it and even if the power was not produced by the plant.[310] The MSEB was required to pay between $1.2 and $1.3 billion a year for Dabhol's electricity – a tariff that the Central Electricity Authority described as more than twice as high as it should be. This Power Purchase Agreement was guaranteed initially by the State of Maharashtra and after 1994 by the government of India, ensuring that if the MSEB could not pay, one of these two entities would do so. The tariff was to be paid in US dollars, not Indian rupees, ensuring that the Dabhol Power Company was protected against any international currency fluctuations, but that the MSEB or the guarantors could be faced with a spiralling debt burden.

The haste with which the project was agreed, the lack of transparency and the absence of competitive tendering resulted in a plethora of corruption allegations surrounding the project from the outset. The Memorandum of Understanding between Enron and the state of Maharashtra was agreed in just three days, despite the size of the contract and despite the government of Maharashtra having little relevant expertise.[311] In May 1995, a newly elected Maharashtra government appointed a sub-committee, known as the Munde committee, to review the project. Its findings led the government of Maharashtra to file a court case in September 1995 against both the Dabhol Power Company and the Maharashtra State Electricity Board, alleging that bribes had taken place in the awarding of the contract and thus pleading for the contract to be declared void. The Maharashtra government made much of Enron's admission in 1993 before the US House Appropriations Committee that it had spent $20 million on "educating" Indians as to how capitalist business should work.[312] But in early 1996, after extensive negotiations with Enron, a new Maharashtra government withdrew its case and accepted a renegotiated deal for an even larger power plant than that originally planned with almost equal haste and on equally, if not more, disadvantageous terms.

In April 1996, the Center for Indian Trade Unions (CITU) and an energy analyst, Abhay Mehta, filed a public interest litigation against the Mahrashtra government, alleging corruption, lack of transparency and lack of due process. After several irregularities in the appointment of a court to hear the case, one of the presiding judges ruled that more than 1,200 pages of evidence submitted by CITU and Mehta were inadmissible. The judges refused to rule on either the corruption allegations or the Maharashtra government's decision to go ahead with the power plant, but they did say in their final statement that "We find enough indications in the Munde Committee report which suggest corruption by those who were responsible for the deal and the PPA [Power Purchase Agreement]." Because of political interference in the courts, however, the allegations of bribery and corruption have never been fully subjected to the scrutiny of a court of law.[313] A judicial commission, headed by retired Supreme

309. ibid.
310. ibid.
311. Munde Committee, Maharashtra government *Report of the Cabinet Sub-Committee to Review the Dabhol Power Project* 1995, cited in Human Rights Watch, "The Enron Corporation: corporate complicity in human rights violations", January 1999.
312. *Financial Times*, 12/1/02, "The Enron Affair: Shadowy Path to State Approval", quoted in Minority Staff report, Committee on Government Reform, US House of Representatives, 22/2/02, "Fact Sheet: Background on Enron's Dabhol Power Project".
313. Human Rights Watch, "The Enron Corporation: corporate complicity in human rights violations", January 1999.

Court judge S.P. Kurdukar, has recently begun hearings into the setting up of the deal and its renegotiation in 1996 and may bring to light at least some of what really happened behind the scenes.[314]

In all, 2,000 people were displaced as a result of the Dabhol Power Plant. There was widespread opposition to it from local environmental groups and communities who feared that the plant would pollute local fresh water supplies and contaminate salt-water areas on which local fishermen were dependent. Protests held by these groups were brutally suppressed. An exhaustive report by a US NGO, Human Rights Watch, in January 1999 found extensive human rights abuses against those opposed to the plant. The report maintained that the Dabhol Power Company was complicit in these abuses because it had paid local law enforcement agencies to suppress opposition to the plant.[315]

By the end of 2000, the critics' predictions had started to come true. The electricity tariffs that Dabhol was charging the Maharashtra State Electricity Board (MSEB) were excessively high. Power from Dabhol was four times more expensive than from domestic power producers, and the state of Maharashtra was spending more on payments for power from Dabhol than its entire budget for primary and secondary education.[316] The MSEB could not legally pass these costs on to consumers and thus incurred huge losses. In December 2000, it was buying power from the plant at 8 rupees per unit but selling it on for only 2 rupees.[317]

Because of these excessive tariffs, the Maharashtra State Electricity Board could not pay its bills. But the crunch came not from the MSEB but from the plant itself in January 2001 when it failed to provide power at full capacity and within a certain time frame as agreed in the Power Purchase Agreement (PPA).[318] This happened again in February and March 2001. The Dabhol Power Company admitted in a letter to the MSEB that it could not meet its contractual obligations.[319] But it refused to give the MSEB the rebate of $300 million that the electricity board was entitled to under the terms of the PPA for the plant's non-performance. Instead, the Company took legal action against the MSEB for non-payment, and invoked guarantees from the government of Maharashtra and the government of India. As a result, the MSEB told the Company in May 2001 that it considered the Power Purchase Agreement void. In the same month, seven months before it went bankrupt, US energy company Enron announced its intention to quit India. In June 2001, the Dabhol Power Company shut down the plant after the MSEB decided not to buy any more power from it.[320] But even after the plant effectively stopped production, the Company was still billing the MSEB $21 million a month.[321]

In the midst of all these problems, in November 2000, the state of Maharashtra appointed another committee of high-powered experts, known as the Godbole Committee, to review the project. This committee's report of April 2001 was again critical of the lack of competitive tender, found the negotiations for the contract to be "suspect", and stated that the demand projections for the electricity produced were based on "patently untenable assumptions". As well as finding that Dabhol was charging high tariffs for its electricity, the report also discovered that Enron had been surreptitiously overcharging the state's electricity board, MSEB, some Rs 930 crore (£125 million/$196.5 million) a year. The committee concluded that it was "troubled with the failure of

314. *The Economic Times* (India), 23/12/03, "Maharashtra supports Enron probe panel's jurisdiction".
315. Human Rights Watch, "The Enron Corporation: corporate complicity in human rights violations", January 1999.
316. Minority Staff report, Committee on Government Reform, US House of Representatives, 22/2/02, "Fact Sheet: Background on Enron's Dabhol Power Project".
317. Kate Bayliss and David Hall, "A PSIRU response to the World Bank's '*Private Sector Development Strategy: Issues and options*", October 2001, p.10.
318. Letter from Vinay Bansal (Chairman MSEB) to Mr K. Wade Cline, Managing Director, Dabhol Power Company, 23/5/01, available from www.msebindia.com.
319. ibid.
320. PSIRU News Item 5026, "Dabhol can restart".
321. ibid.

governance that seems to have characterised almost every step of the decision making process on matters relating to DPC . . . It strains belief to accept that such widespread and consistent failure to execute assigned responsibilities is purely coincidental."[322]

After Enron's collapse following its bankruptcy in December 2001, Dabhol was put up for sale. Among the foreign bidders were BP, British Gas, Royal Dutch/Shell and Gaz de France, alongside four Indian companies.[323] Domestic lenders to the plant and the government of Maharashtra attempted to restart the plant so that they could earn income to pay off some of their burgeoning debts. But foreign lenders have vetoed both the sale of the plant's assets and its restarting on the grounds that both options would jeopardise their insurance cover for the project. The US Overseas Private Investment Corporation is vetoing a sale on the grounds that it would trigger a political risk claim from Enron. As a result, the Dabhol Power Plant has been sitting idle for 18 months. Unless it restarts soon, it could become obsolete and worthless.[324]

Given the history of the Dabhol Power Plant, the corruption allegations, the human rights abuses and the stream of critical reports, it is extraordinary that the ECGD backed the involvement of a British company and British banks in the project. In a meeting in November 2002 with an Indian NGO focusing on energy issues, Prayas, ECGD representatives said that they were still examining the provisions in the Power Purchasing Agreements and related documentation and were waiting for a copy of the findings of the Godbole committee report of April 2001.[325] It is not clear whether the ECGD carried out an in-depth study before supporting British business involvement. According to Prayas, "the ECGD should not have supported this controversial project to start with."[326]

The ECGD's current liability for this project is £40 million.[327]

322. Prayas Energy Group, "Lessons of the Enron Disaster: Democratization through TAPing of Governance as the Remedy", 2001, p.2.
323. *Financial Times*, 9/3/02, Sarah Ross, "BP enters bidding for Enron plant".
324. *Economic Times* (India), 7/1/03, "Foreign lenders veto plan to sell off DPC assets".
325. Prayas Energy Group, Notes of Meeting with ECGD, 30/10/02
326. Personal communication with Girish Sant, Prayas, 17/11/02
327. Personal communication with ECGD Spokesperson to The Corner House, 14/1/03

Dabhol Power Plant, Maharashtra, India

Date of ECGD guarantee: 2000

Date of corruption allegation: 1993, 1995, 1996

Source of corruption allegation: Various, including government of Maharashtra and public interest groups.

Failures of ECGD response:

a) Gave backing despite well-known corruption allegations and governance problems with the project and well-documented human rights abuses.

b) Gave backing despite well-known concerns with the economic viability of the project, thus risking UK taxpayers' money and increasing the risk of debt to the Indian government and the government of Maharashtra.

Cost to Indian taxpayer of ECGD guarantee: None so far

Cost to Indian taxpayer of corruption: Millions of pounds in extra construction costs, high tariff charges, and the costs of plant failure .

Case Study 9
Defence Equipment, South Africa, 2000

In April 2000, just six months before the ECGD brought in new anti-corruption measures (*see* pp.57ff), the Department awarded a £1.68 billion ($2.69 billion) guarantee to BAE Systems for the sale of 24 Hawk jets to South Africa. BAE Systems bid jointly with SAAB from Sweden, which was to sell 28 Gripen fighters as part of the deal to provide fighter jets to the country. The ECGD acted as the lead export credit agency, while Sweden's Export Credit Corporation (SEK) and Export Credits Guarantee Board (EKN) funded the SAAB component of the deal. The sale was part of a larger £1.8 billion ($2.88 billion) deal for arms, which also included frigates, submarines and helicopters from Germany and France.

BAE's bid was promoted by UK Prime Minister Tony Blair personally on his visit to South Africa in January 1999. At that time, Blair promised a 40% increase in British aid to South Africa, support for South Africa in its trade negotiations with the EU, and £4 billion ($6.4 billion) worth of additional investment as part of the controversial "offset" or "industrial participation agreement"[328] that accompanied the deal.[329] The UK government also seconded an official from its Department of Trade and Industry to South Africa to oversee the negotiations on the offset agreements. BAE Systems and SAAB were named as the preferred bidder in November 1998, and awarded the contract in September 1999.[330]

This arms deal has been highly controversial in South Africa and has been embroiled from the beginning in numerous allegations, now totalling about 50, of corruption, nepotism and misuse of power. Some of the allegations centre on the former South African defence minister, Joe Modise (who died in November 2001)[331] and defence ministry officials, who allegedly pressured foreign arms companies to subcontract to South African firms in which their relatives had large stakes.

The part of the contract won by BAE Systems in 1999 to provide trainer jets for the South African airforce has come in for special criticism. BAE Systems won the contract despite the fact that its bid was £450 million ($720 million) more expensive than that made by Italian defence company Aermacchi for its MB339FD jet and despite the fact that senior South African airforce personnel were said to favour the Aermacchi jets.

In April 1998, then defence minister Joe Modise intervened mid-way through negotiations to change the evaluation of the tenders for the jets from a costed to a non-costed option. This meant that factors other than the cost of the jets were allowed to be taken into account, such as national strategic considerations, including the value of industrial participation schemes offered by the bidders and superior technological capability. The result was that BAE's Hawk jets won the tender rather than the Italian aircraft, which had been the front-runner up until that point, because of the "offset" investments offered by BAE. Upon hearing that the tender had been awarded to BAE, a former South African secretary of defence involved in the negotiations wrote a memo noting that "The Hawk is not the 'best' option from a military point of view . . . The South African Air Force (SAAF) will have to absorb considerably higher operating costs during its life cycle."[332]

328. Offsets, or industrial participation agreements, are agreements that require a supplier to direct some benefits back to the purchaser, whether in the form of work, technology, counter-trade agreements, or investment in the buying country, as a condition of sale. The use of such agreements in all government procurement (with the exception of the defence sector) is prohibited under Article XVI of the WTO Plurilateral Agreement on Government Procurement. Offsets are widespread in the defence sector, however. They have a reputation for raising the cost of acquisitions by around 20%; being difficult to monitor; failing to bring the benefits promised at the time of sale; and contributing to corruption. *See* Catherine Courtney, *Corruption in the Official Arms Trade*, Transparency International, Policy Research Paper 001, April 2002, pp.23-24.
329. *Business Day*, 6/1/99, "Blair to punt BAe contract bid", *Business Report* 10/1/99, "Blair's slick words deliver little substance".
330. *Mail and Guardian*, 2/3/01, "Millions for MK veterans go astray".
331. Modise actually retired as Defence Minister in June 1999, six months before the arms deal was signed in December 1999, but played a crucial role in negotiating the deal.
332. *Joint Investigation by the Public Protector, Auditor-General and National Director of Public Prosecutions into Strategic Defence Procurement Packages*, Report to Parliament, 14th November 2001, Chapter 4, para 4.6.12, p.101.

Critics of the deal have observed that in March 1998, one month before Modise intervened, BAE Systems donated five million rand (£614,000/ $982,400) to the ANC's MK Veteran's Association, of which Modise was a founding trustee and steering committee member.[333] At the time of the negotiations, moreover, Modise also held a controlling stake in Conlog Holdings, a South African company that was set to win a contract under the offset arrangements that allowed BAE Systems to win the deal.[334]

The corruption allegations have led to several investigations. In 2000, the South African Auditor-General, Shauket Faukie, undertook a preliminary study, which described the shift from a costed to a non-costed option in the tender for the aircraft as "a material deviation" and recommended a full forensic audit. [335] But South Africa's President Thabo Mbeki barred South Africa's anti-corruption unit, the Special Investigation Unit (SIU), headed by Judge Willem Heath, from taking part in any investigation into the allegations.[336] This unit is the only body in South Africa with the authority to obtain a court order to cancel the arms contract. Heath subsequently resigned.

A Joint Investigation did go ahead without the Special Investigation Unit, involving the Ombusdsman, the Auditor-General and the National Director of Public Prosecutions. In November 2001, this investigation issued a report stating that the switch in tender criteria was "unusual in terms of normal procurement practice" but not unlawful.[337] It also noted that "fair and competitive procurement procedures" were not followed where strategic considerations played a role, and that there was no "proper audit trail . . . throughout the procurement process".[338] But the report has been called a whitewash by opposition parties and NGOs in South Africa, and there have been allegations that there was extensive political interference in its final results.[339] The former head of the SIU, Willem Heath, stated that "the [investigation] team's primary task was to find out what happened, and this task was not performed properly".[340] The Italian rival bidder to BAE Systems, Aermacchi, declared in the week that the report was published that it was considering challenging the contract award process in court.[341]

Other corruption allegations have been made that another contractor on the deal, EADS (European Aeronautic Defence and Space Company), gave Mercedes Benz cars at a discount price to Vanan Pillay, then director of the offset programme, and to the African National Congress's chief whip, Tony Yengeni.[342] EADS has admitted to helping 30 South African public officials obtain cheap Mercedes Benz cars.[343] In March 2003, Yengeni was sentenced to four years in jail for defrauding parliament. A month earlier, he made a plea agreement with the state that enabled him to be acquitted of the more serious charge of corruption in exchange for pleading guilty of fraud.[344] Michael Woerful, the suspended Managing Director of EADS' office in South Africa, who was facing prosecution on corruption charges alongside Yengeni, was acquitted.[345] In another twist, it was announced in December 2002 that the South African Deputy President, Jacob Zuma, is under official investigation for allegedly asking for a bribe from the French defence company, Thomson-CSF (now Thales), in exchange for protecting the company during the investigation into the deal. Zuma denies the allegations.[346]

The cost of the arms deal has spiralled due to devaluation of the South African rand and inflation from an initial £1.8 billion ($2.88 billion) to

333. *Mail and Guardian*, 2/3/01, "Millions for MK veterans go astray".
334. *Mail and Guardian*, 15/3/02, "Say it ain't so, Joe".
335. *Mail and Guardian*, 2/11/01, "How Modise wangled jet deal".
336. *Business Day*, 11/6/01, "Arms deal public hearings resume in Pretoria High Court".
337. *Joint Investigation by the Public Protector, Auditor-General and National Director of Public Prosecutions into Strategic Defence Procurement Packages*, Report to Parliament, 14th November 2001, para 14.1.6, p.374.
338. ibid, p.376, paras 14.1.14 and 14.1.16.
339. *Focus*, "Arms deal probe: unanswered questions", December 2001, No. 24; *News24.com*, "Report: Threats and disbelief", 15/11/01
340. *News24.com*, "Key issues not addressed: Heath", 17/11/01
341. *Mail and Guardian*, 2/11/01, "How Modise wangled jet deal".
342. *Business Day*, 6/7/01, "The longer it takes, the worse it gets".
343. *Financial Times*, 4/7/01, "S Africa to probe discount car scheme".
344. *Financial Times*, 14/2/03, "ANC politician guilty of fraud".
345. *Reuters*, 19/3/03, "South African ANC politician jailed for fraud"; *The New Zealand Herald*, 9/7/02, "Former South African ANC chief faces arms fraud trial"; *Mail and Guardian*, 22/11/02, "Yengeni on comeback trail".
346. *Mail and Guardian*, 2/12/01, "Zuma denies bribery allegations".

£3.2 billion ($5.12 billion).[347] The offset agreement has not delivered. A South African newspaper report described many of the supposed investments made under this agreement as "a sham, built on loopholes in the rules."[348] In particular, BAE and Saab have claimed $2.3 billion worth of offset credits (about one-third of their obligations) for investing $70 million to upgrade a gold refinery.[349] BAE and Saab are also claiming $171 million worth of offset credits for an investment of $6 million by BAE in a sawmill. Several other projects that were promised have not materialised.[350] The overall effect is that South Africa is receiving little new real investment under the offset agreements, despite having paid out a good deal of money for the arms.

The arms deal has been controversial in South Africa for reasons other than corruption. Opposition politicians have pointed out that the arms deal was unnecessary and was ultimately unaffordable. The money spent on arms could have: doubled the number of police officers; provided 4.5 million of the poorest people with a basic income for a year; provided medical treatment for every child raped in South Africa since 1994; saved the lives of 53,000 babies born to HIV-positive mothers; and provided housing subsidies for 337,500 homeless families.[351] A South African NGO, Economists Against the Arms Race, is currently taking legal action against the South African government, seeking cancellation of the arms deal on the grounds that it is strategically, economically and financially irrational and therefore unconstitutional.

In 1999, the UK NGO, Campaign Against the Arms Trade, passed details of the corruption allegations to the UK Department of Trade and Industry (DTI) on behalf of Economists Against the Arms Race (ECAAR). The DTI in turn passed the matter on to the Ministry of Defence police, which subsequently reported to ECAAR that no offence had been committed under UK law. The Corner House is aware that other corruption allegations were purportedly passed on to the UK government through the British High Commission in South Africa and that no action was taken to investigate these allegations.

The ECGD has a residual liability of just over £1 billion ($1.6 billion).

347. *Mail and Guardian*, 22/2/02, "Bigger Budget slice for arms".
348. *Mail and Guardian*, 8/8/02, "The truth behind the figures (Opinion)", Sam Sole
349. ibid.
350. *The Guardian*, 17/7/02, David Leigh, "The sordid truth behind an arms deal".
351. *Mail and Guardian*, Donwald Pressley, 5/4/02, "States gives nod to full military Monty".

Defence Equipment, South Africa

Date of ECGD guarantee: 2000

Date of corruption allegation: 1999

Source of corruption allegation: Opposition politicians

Failures of ECGD response:
a) Gave support despite corruption allegations.
b) Has made no apparent effort to investigate the allegations or pass them onto the Serious Fraud Office.

Cost to South African taxpayer of ECGD guarantee: None so far

Cost to South African taxpayer of corruption: Unknown, but will include the extra costs of the deal that have not been fully offset by the counter-part investments of the offset agreement, and the higher operating costs of the Hawk jets.

Conclusion

These nine case studies show that throughout the 1990s the ECGD revealed:

- **A persistent failure to take notice of corruption allegations and a deep reluctance to investigate them.**

  In several cases, including the Turkwell Gorge Dam in Kenya, the Lesotho Highlands Water Project and the defence equipment deal in South Africa, the ECGD issued guarantees even after reputable sources had alleged corruption. It is not clear whether the ECGD has formally investigated the corruption allegations made in any of these nine cases, apart from the Coco Palm and La Palma Beach hotel and apartments in Ghana.

- **Inadequate investigatory procedures.**

  Apart from asking the companies for information, it is not clear what investigatory steps the ECGD takes to assess bribery and corruption. It appears that the ECGD does not take steps to contact the authorities in the countries in which the allegations arise.

- **An unwillingness to pass on corruption allegations to the appropriate external investigatory authorities.**

  In only one of the nine case studies (the Coco Palm and La Palma Beach hotel and apartments in Ghana) did the ECGD refer the corruption allegations to the UK's Serious Fraud Office. Given the limits to the ECGD's investigatory powers, to which it readily admits, this reluctance suggests that the ECGD has been less than serious about combating corruption associated with the projects it supports.

- **Inadequate due diligence regarding the potential for corruption in the projects it backed, coupled with complete disregard for international concerns about corruption in countries in which they supported projects.**

  In Kenya, the ECGD backed the Turkwell and Ewaso Ngiro schemes despite clear evidence of and mounting international indignation at deep-rooted corruption problems. Furthermore, the sale of military equipment to Qatar suggests that the ECGD ignored well-known risks of bribery in military deals to Middle Eastern countries. In countries known to have corruption problems, there is no evidence that the ECGD applied additional safeguards, such as applying "no-bribery" conditions or extra due diligence.

- **Inadequate vetting of UK companies and inadequate due diligence regarding consortia, partners and agents used by UK companies.**

  ECGD procedures to vet UK companies that have been involved in corruption allegations abroad appear to be more or less non-existent. In February 2000, an ECGD official told the UK Parliament's International Development Committee that "we have not had any instances in my experience of companies of whom we have had allegations, or indeed proof, of corruption or bribery that has led us to refuse cover."[352] But in the Lesotho Water Highlands Project, many of the consortia partners of the UK companies that were backed by the ECGD had well-known corruption records.[353] The consortia's use of agents based offshore in countries such as Panama should also have alerted the ECGD to potential corruption.

- **Lack of openness and accountability regarding whether it had backed certain projects.**

352. Examination of witnesses by the International Development Committee, for report on "ECGD, Developmental Issues and the Ilisu Dam", published 6/7/00.

353. *see* The Corner House, "Dams Incorporated: The Record of Twelve European Dam Building Companies", February 2000, www.thecornerhouse.org.uk/documents/damsinc.html.

> ECGD's denial in Parliament of involvement in the Kenyan Turkwell dam and Lesotho Muela dam raises serious issues about how diligently the ECGD is prepared to respond to public enquiries and how organised it is in keeping its records in a manner which would make it open and accountable to public scrutiny.

All these repeated failures point to an institutional culture within the ECGD that verges on gross irresponsibility in its handling of public funds. Section Three examines whether the ECGD's new anti-corruption measures are likely to change this culture for the better. As the case studies in Section Two show, however, the ECGD must also develop a proper institutional response to corruption that has arisen or that might arise in projects it backed before it brought in these anti-corruption measures if it is to remedy its history of negligence regarding corruption.

Section Three

The ECGD's Anti-Corruption Measures Thin Veneer or Real Change?

"The payment of bribes to secure overseas contracts is deplorable . . . Bribery is bad for the importing country and also harmful to those who wish to trade with it."

Richard Caborn
Minister for Trade and Industry
June 2000[354]

In 1999-2000, the UK government initiated a 12-month review of the ECGD's Mission and Status. In its resulting *Mission Status Review*, the government made it clear that the ECGD should not only promote British exports but "should also take account of the [UK] government's wider international policies to promote sustainable development, human rights and good governance throughout the world."[355] The ECGD committed itself to deterring bribery and corruption through "promoting full implementation of the 1999 OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions."[356]

Thus in September 2000, the ECGD introduced a new measure requiring companies, banks and investors seeking its support to sign a declaration that "neither we nor to the best of our knowledge or belief, anyone acting on our behalf with due authority or with our prior consent or subsequent acquiescence has engaged or will engage in any corrupt activity in connection with the contract or any related agreement, undertaking, consent, authorisation or arrangement of any kind". This warranty also requires companies to declare that neither they nor any of their directors appear on the World Bank's list of debarred companies, and that they have not "at any time been found by a court to have engaged in any corrupt activity." In the event of a company being convicted of corruption on a project backed by the ECGD, the ECGD is now able to withdraw cover from the company and, in some circumstances, seek compensation for its loss.[357]

In December 2000, the ECGD formally introduced a set of Business Principles that state that it "will combat corrupt practices" and promote implementation of the OECD anti-corruption Convention.[358] Criticisms regarding the ECGD's secrecy and lack of transparency made by NGOs and by the UK Parliament's Trade and Industry Select Committee[359] have led to the ECGD providing a list of the guarantees it has issued (subject to consent from the exporting company) in its Annual Report. Previously, it was possible to find out what projects were supported only if they happened to be mentioned in the Annual Reports of the ECGD, or by asking questions in Parliament. Even then, it was at the ECGD's discretion as to whether to reveal that it had backed a project or not.

354. ECGD Press Statement, 27 June 2000, "ECGD determined to combat bribery in overseas contracts – Caborn".
355. ECGD, 2000, *Mission Status and Review* 1999-2000, DTI, London.
356. ibid, p.34.
357. Email from ECGD Spokesperson to The Corner House, 10/5/02
358. The Business Principles also committed the ECGD to: ensuring its activities did not conflict with the government's international commitments to the environment, human rights, sustainable development, good governance and trade; being customer-oriented; being open and honest in its dealings; and consulting widely while developing its services.
359. "The Future of the Export Credits Guarantee Department", Select Committee on Trade and Industry Third Report, 11/1/00, section 62.

In March 2001, the UK Parliament's International Development Committee welcomed all these steps, but stated that it remained "concerned that internal procedures and controls [at the ECGD] may be insufficient to prevent credits being given to companies with a poor track record and which therefore present a high risk."[360] It recommended that "applications for support should be subject to rigorous scrutiny and there should be in place a system to check that the scrutiny has been carried out". It also called for further action by the ECGD to "strengthen procedural and institutional oversight".

In response to the Committee's report, the government stated that, in addition to the new measures mentioned above, it had also introduced in 2000 "enhanced due diligence procedures . . . to ensure that all applications . . . were subject to checks to identify companies with poor track records and/or contracts/investments that might present a high corruption risk".[361] In addition, the government response to the Committee's report stated that:

- "suspected" corrupt activity or malpractice would be given due weight by underwriters when deciding whether to give cover or not;
- the ECGD was reviewing whether to introduce a requirement that details be provided as to whether the contract requesting support was won by competitive tender or not; and
- the ECGD was reviewing whether or not to strengthen its due diligence procedures "particularly in respect of overseas parties"[362] including buyers, borrowers, guarantors and agents.

The ECGD restated this enhanced due diligence approach to corruption at a seminar in the Houses of Parliament in May 2002 when the ECGD's Business Principles Adviser, David Allwood, described how its due diligence procedures aimed "to identify at an early stage companies with poor track records or contracts that might present a high corruption risk." These, he went on to say, "would then be researched in detail".[363]

The ECGD has also stated that, where there are allegations of corruption, it will investigate them immediately and "would put in place additional post-issue monitoring in cases that caused concern."[364] "Post-issue monitoring" is the job of the ECGD's new Guarantee Management Branch set up in September 2001. This branch is responsible for, among other things, assessing the benefit of ECGD support for the host country and for the UK, monitoring compliance with the conditions of business, and monitoring projects, such as those in construction, to ensure that they proceed on time and within costs.[365] As such, this branch has an important role to play in the ECGD's anti-corruption efforts.

So far, so good. But is this new approach working in practice?

It is perhaps too early to tell how much impact the new measures are having. As the case studies in Section Two illustrate, it can take several years for evidence of corruption to emerge and several more for it to be investigated, let alone brought to court. The case study below, however, suggests that, since bringing in its new procedures, the ECGD has backed at least one project that has been shrouded in significant corruption allegations. The Corner House has learned of another case, currently under investigation by a national government agency in the country concerned, in which a UK company is alleged to have paid bribes on a project

360. International Development Committee, Fourth Report, *Corruption*, March 2001, para 192.
361. Response of the Secretary of State for International Development to Report on Corruption by the International Development Committee, presented to Parliament October 2001, p.26.
362. ibid.
363. David Allwood, ECGD Response to "Beyond Business Principles" Seminar, 23 May 2002.
364. Email from ECGD Spokesperson to The Corner House, 10/5/02
365. Presentation by Graham Newhouse, ECGD to ECGD/NGO Case Process Meeting, 26/2/02

backed by the ECGD since its warranty procedures came into force. These cases suggest that the Department's new anti-corruption measures have not made as big a change in institutional practice as might have been hoped for. Furthermore, significant weaknesses with the ECGD's new anti-corruption measures threaten to undermine their effectiveness, weaknesses that are analysed in detail below.

Case Study A
Blue Stream Pipeline, Turkey and Russia, 2000

"Blue Stream is likely to occupy a sore spot in Turkey's energy sector for years to come."

Dr Ferruh Demirmen
international petroleum lecturer[366]

In October 2000, the ECGD gave backing under its "Good Projects in Difficult Markets" scheme to the Blue Stream Gas Pipeline for the reinsurance of goods and services worth £81.5 million ($130.4 million) provided by two UK-based services and contracting companies, Saipem UK and Sonsub Limited. In 2001/2002, it gave a further guarantee worth £120.9 million ($193.4 million) to Saipem UK for the Blue Stream Project. Saipem UK and Sonsub Ltd are both subsidiaries of the Italian oil and gas company, ENI (Ente Nazionale Indrocarburi), which is still part owned by the Italian government. Their immediate parent company is Saipem International BV that is incorporated in The Netherlands.

The Blue Stream Pipeline has been built to supply gas from Russia to Turkey. It runs 750 miles (501 kilometres) from Izobilnoye, near Krasnodar in southern Russia, to Ankara in Turkey. One section runs 2,150 metres under the sea, deeper than any pipeline has ever been laid before. The Blue Stream Pipeline Company, which has overseen the construction of the offshore section of pipeline and which will operate it, is a joint venture between the Italian oil and gas company, ENI, and Gazprom, the Russian state-controlled oil and gas company.

A natural gas sales purchase agreement that initiated the project was signed between the Turkish and Russian governments in December 1997. ENI and Gazprom formed the Blue Stream Pipeline Company in 1999 in order to implement the inter-governmental agreement. The $3.2 billion pipeline itself was completed in October 2002, three years behind schedule, and gas started to flow four months later in February 2003. Under the 25-year contract, the pipeline will supply four billion cubic metres of gas to Turkey in 2003 and up to 16 billion cubic metres annually by 2008.[367]

From the moment the contract was signed, the Blue Stream Pipeline has been at the centre of a string of as yet uninvestigated and unresolved allegations of corruption in Turkey. Some assert that these corruption allegations brought down Mesut Yilmaz's ruling Motherland Party in Turkey's national elections in late 2002.[368] Yilmaz himself has been accused of lobbying for the pipeline solely to benefit his friends in the construction industry and of awarding contracts to associates in the Motherland Party.[369]

366. Dr Ferruh Demirmen, "Blue Stream: a project Turkey could do without", *Turkish Daily News*, 23/4/01
367. Antonio Tricarico, "The Blue Stream-Black Sea Gas Pipeline Project", Eyes on SACE Campaign, Rome, September 2001.
368. *Eurasianet.org*, 30/10/02, "Scaled-Back Pipeline marks advance in Russian-Turkish relations".
369. *Eurasianet.org*, 31/5/01, "Corruption Scandal threatens to sink Blue Stream Pipeline Project".

Most of the allegations centre on the awarding of a contract with no competitive tender to the Oztas Haznedaroglu Stroytransgaz (OHS) consortium, comprising two Turkish companies and one Russian one, which was contracted to build the section of the pipeline between the Turkish port of Samsun and Ankara. Stroytransgaz is 50% owned by senior Gazprom managers and their relatives. The two Turkish companies in the consortium had close ties to Yilmaz and to the Turkish Motherland Party. BOTAS, the Turkish state pipeline company that issued the contract, meanwhile, made an advance payment of £31.8 million ($52 million) – some 15% of the contract – to the consortium six months before work began. In 2001, investigators from Turkey's Interior Ministry were probing allegations that this payment had been misused, and that the consortium had hired a sub-contractor to build the pipeline at a cheaper price, while charging the Turkish government the full price.[370]

The corruption allegations have already claimed some scalps. In April 2001, Turkey's Energy Minister, Cumhur Ersumer, was forced to resign after he was named in bribery and corruption charges brought by Turkish state prosecutors against 15 officials from his ministry in relation to the Blue Stream pipeline.[371] In July 2001, the head of the Turkish state pipeline company, BOTAS, which oversaw and helped build the Turkish part of the pipeline, was sacked during an investigation into possible corruption in the project. In October 2002, Turkey's highest appeal court, the Court of Cassation, gave permission to the Public Prosecutor's Office to investigate whether two former chairs of BOTAS, Nevzat Arseven and Gokhan Yardim,[372] gave an unmerited payment to the Turusgaz company, a joint venture between BOTAS and Gazprom that handled the Turkish side of the Blue Stream project, and whether they were involved in several other irregularities.[373]

Other controversies have arisen in Turkey relating to questions as to how much Turkey really needs the gas from the Blue Stream Pipeline. In September 2002, because of Turkey's sluggish economy and because gas demand was much lower than forecast, Turkey had already negotiated with Russia that its delivery of gas in 2003 would be halved.[374] Many analysts suspect that Turkey will soon have an excess supply of natural gas; the US-based think-tank, the Centre for Strategic and International Studies, has stated that the Turkish market for gas is already effectively saturated because of over-supply.[375] In the words of one journalist, the pipeline could turn out to be "a vastly underutilized asset, a giant technological feat with little chance of paying for itself".[376] Its effect on Turkey's already fragile economy could be devastating. The country already faces $1 billion worth of penalties under "take or pay" deals,[377] of which Blue Stream is one.[378] The fact that Blue Stream's costs have ballooned from $3.2 billion to about $5 billion will not help matters.[379]

In Russia, meanwhile, the project has also been contentious. The contract was signed before an ecological review was undertaken, despite the fact that such a review is required under Russian law. Critics have raised concerns that the pipeline might not be stable on the corrosive Black Sea seabed and that it has been laid in a seismically active area. The ecological review, finally carried out in 1998 by the Russian State Committee of Environmental Specialists, concluded that any leak in the pipeline could cause an enormous explosion and extensive damage to the marine ecosystem of the Black Sea. The pipeline also went through

370. *AP Worldstream*, "Turkish energy minister sacks top official amid corruption claims", 23/7/01; *NEFTE Compass*, "Italy lays way for Russian gas to power Turkey", 28/6/01, No 26, Vol 10, p3; *NEFTE Compass*, "Turks Probe Blue Stream Corruption Allegations", 10/5/01, No 19, Vol 10, p.3.
371. Energy Information Administration, US Department of Energy, "Russian: Oil and Natural Gas Export Pipelines", www.eia.doe.gov/emeu/cabs/russpip.html
372. *Turkish Daily News*, 10/10/02, "Former Botas Chairmen to face trial".
373. ibid.
374. *Eurasianet.org*, 30/10/02, "Scaled-Back Pipeline marks advance in Russian-Turkish relations".
375. *Turkish Daily News*, 30/9/02, "Blue Stream gas to arrive in December"; *Turkish Daily News*, 20/8/02, "Think tank criticises Turkey's overblown gas deals".
376. *Radio Free Europe, Radio Liberty*, "Russia: Blue Stream Pipeline A Technological Feat, but an economic misadventure", Michael Lelyveld, 23/10/02
377. "Take or pay" deals require the purchaser to pay for goods or services provided whether or not they are used to full capacity.
378. *Turkish Daily News*, 20/8/02, "Think tank criticises Turkey's overblown gas deals".
379. *Eurasianet.org*, 31/5/01, "Corruption Scandal threatens to sink Blue Stream Pipeline Project".

a protected nature-reserve, the Arkhipo-Osipovskoe forest. Local people held several protests to stop the felling of trees in the reserve that contravened federal legislation. The local administration, however, withdrew protected status for this particular patch of forest so that the pipeline could go ahead, an act which critics again claimed was illegal.[380] Russian federal requirements for consultation with local communities and publication of impact assessments appear to have been flouted as well.

Gazprom, the Russian state oil and gas company, has long been a byword in Russia and internationally for corruption and asset stripping. In May 2001, President Vladimir Putin sacked the chair of Gazprom's board after a string of allegations that some £2.6 billion ($4.16 billion) of Gazprom assets were being transferred each year to family and friends of top management officials.[381] In January 2002, Russian prosecutors trying to track down funds allegedly siphoned out of Gazprom arrested the deputy chief and two top executives of a subsidiary.[382] In April 2002, the Russian prosecution service was investigating Gazprom for misappropriating state funds.[383]

The ECGD's backing for this project appears to be riddled with serious failures of due diligence, all of which raise questions about its commitment to combating corruption, particularly in its "Good Projects in Difficult Markets" scheme. There is no suggestion that there was any impropriety in the UK-backed section of the project, or by either of the two UK-based companies backed by the ECGD. But the ECGD's generous backing for Saipem UK is surprising. As of March 2002, four of Saipem UK's six directors and its company secretary were based in Italy and had Italian nationality. Only one of its directors, Rossano Tomaselli, had British nationality. Given that the ECGD's aim is to "benefit the UK economy by helping exporters of UK goods and services", its support for a subsidiary of a foreign company run mainly by foreign nationals is puzzling.[384]

What also makes Saipem UK a surprising choice for ECGD backing is that in its Directors' report for 2001, Saipem stated that it was facing a number of class action anti-trust cases[385] brought by several major oil producing companies. The report states that these cases "involve alleged anti-competitive practices in the bidding process for installation projects during the 1990s".[386] Such liabilities do not suggest a company with a good track record, again raising questions about the ECGD's due diligence procedures.

How Could the ECGD Improve Its Anti-Corruption Measures?

As the Blue Stream Pipeline case study suggests, there are still weaknesses in the ECGD's implementation of its anti-corruption measures. While the new anti-corruption measures are a vast improvement on the ECGD's previous laissez-faire approach to corruption, there is still significant room for improvement. In particular, the ECGD needs to:

1. Take further steps to fulfil its commitment to promoting the implementation of the OECD Convention on Combating Bribery in full, and to complete the steps it has agreed to under the OECD Export

380. Antonio Tricarico, "The Blue Stream-Black Sea Gas Pipeline Project", Eyes on SACE Campaign, September 2001.
381. *BBC News Online*, "Europe's need for Gazprom's gas", 30/5/01
382. Vladimir Isachenkov, "Prosecutors detain Gazprom Execs", *Johnson's Russia List*, 10/1/02
383. *BBC Monitoring Service*, 29/4/02, "Russian prosecutors say R42 bn lost to budget through abuse of state assets".
384. Sonsub, likewise has only one British Director. The rest are Italian.
385. Anti-trust cases are brought against companies trying to form or abuse a monopoly, or engaging in anti-competitive behaviour. Class actions are where one or more parties file a complaint on behalf of themselves and all others who are in the same position as themselves.
386. Saipem UK Ltd, Directors' report and financial statements, 31 December 2001. These lawsuits were brought by several Norwegian oil companies against Saipem in December 2000 and accused Saipem of violating the 1953 Norwegian Pricing Act in connection with projects in Norway (US Securities and Exchange Commission, Form 10-K, Annual Report of McDermott International, Inc. http://media.corporate-ir.net/media_files/NYS/mdr/reports/MDR_ar01c.pdf)

Credit Group's Action Statement on Combating Bribery in Officially Supported Export Credits;

2. Examine its procedures to ensure that its new warranty is enforceable, and look seriously at instituting a proper debarment policy;
3. Review its enhanced due diligence procedures to ensure that they screen out buyers, companies and projects that have poor records on corruption and governance; and
4. Deepen further its increasing commitment to transparency.

1. The ECGD needs to take further steps to fulfil its commitment to promoting full implementation of the OECD Convention on Combating Bribery.

As a government department using taxpayers' money, the ECGD can, and must, play a major role in enforcing the OECD Convention on Combating Bribery and thus in deterring British businesses from engaging in corrupt activity abroad. Corruption poses a serious material as well as reputational risk to the ECGD and, by association, to the British government and to British business in general. As *The Economist* noted recently, "a company that keeps securing deals through bribes may become less and less competitive. Bribes also undermine a company's reputation".[387] They undermine a country's reputation as well.

The ECGD is uniquely placed to make a real impact on the behaviour of British exporters. As a UK government department, the ECGD should be fostering compliance with the 2001 Anti-Terrorism, Crime and Security Act,[388] the UK law that now implements the Convention. Only by doing so will it achieve its commitment to promoting full implementation of the OECD anti-bribery Convention.

Fostering Compliance

To foster compliance, the ECGD should and could be doing more to educate companies about the UK legislation that makes bribery of a foreign official a criminal act.[389] Under the OECD Action Statement on Bribery and Officially Supported Export Credits, the UK has agreed that the ECGD will inform applicants of the legal consequences of bribery in international business transactions. Currently, the ECGD is one of only four export credit agencies whose anti-corruption warranty does not specifically spell out the legal consequences of bribery. Adding this specific language to the warranty would be an important educational tool to ensure that UK companies are aware of the criminality of bribery.

The ECGD could also foster compliance by actively requiring, as a condition of cover, that companies prove compliance with the new UK legislation through a properly implemented and monitored code of conduct governing corruption and bribery. The ECGD could in particular find out at the Impact Questionnaire stage[390] of the application process whether companies have appropriate codes of conduct.

Codes of conduct vary dramatically in quality and effectiveness, however. As the 2002 Friends Ivory and Sime survey of business practice by EU firms showed, most companies have such codes but many of them are extremely weak or are ignored.[391] BAE Systems, for instance, which

387. *The Economist*, "Odd Industry Out", 18/7/02
388. Prior to 2001, the UK claimed that its existing corruption legislation was sufficient to implement the OECD Convention on Combating Bribery. Pressure from the OECD, which criticised this legislation for its lack of an explicit reference to bribery of foreign public officials, and from the US, led the UK to add a section to the 2001 Anti-Terrorism, Crime and Security Act (Chapter 24, Part 12), which made it clear that acts of bribery committed abroad were a criminal offence under UK law and thus could be tried. The Act came into force in February 2002. The UK government plans to introduce a new corruption bill, a draft of which was published in March 2003. This bill, which is meant to update existing corruption legislation, is currently under consideration by a Parliamentary Joint Committee, and will come before Parliament for debate in autumn 2003.
389. It is worth noting that while the 2001 Anti-Terrorism, Crime and Security Act made it explicit that an offence would be committed even if the act of bribery was carried out "in a country or territory outside the United Kingdom", under the previous corruption legislation, if "any relevant act" of the offence of corruption took place in the UK, it could also be tried in UK courts. This means that if a bribe were authorised by a senior management person in the UK, then that would be an offence under the previous UK corruption laws.
390. In January 2001, the ECGD introduced a case impact analysis process, which included an Impact Questionnaire to be filled out by all civil, non-aerospace applicants requesting cover. The Impact Questionnaire asks whether the project will have environmental, social or human rights impacts, and whether it will meet recognised environmental, and health and safety standards. It does not ask any questions relating to corruption.
391. Friends Ivory and Sime, "Governance of Bribery and Corruption: A survey of current practice", February 2002, http://www.friendsis.com/uploadFiles/Area%20of%20Engagement%20-%20Bribery%20%20Corruption%20%20Report%20Feb%2002.pdf.

has received the lion's share of ECGD cover for many years, has a policy on Integrity in Business Dealings, but describes this policy as "confidential". Confidential codes of conduct cannot be monitored by shareholders, government departments or public interest groups.

Therefore, The Corner House believes that the ECGD should:

- **amend the wording of the warranty so that it spells out the legal implications of bribery; and**
- **require information at the Impact Questionnaire stage as to whether companies have:**

  1. a publicly available code of conduct that shows full compliance with UK legislation on corruption and that covers all areas of corruption, including facilitation payments, commissions, gifts and donations;

  2. proper management systems and training programmes to ensure that the code is implemented effectively;

  3. information in their annual reports on their policies and performance on combating bribery, including any investigations and allegations they may face for corruption and the number of staff disciplined for corruption;[392]

  4. signed up to the Extractive Industries Transparency Initiative (EITI),[393] thereby agreeing to publish all payments made to governments, including taxes, royalties and signature bonuses; and

  5. adequate systems of internal accounting controls.

2. The ECGD needs to examine its procedures to ensure that its new warranty is enforceable, and to look seriously at instituting a proper debarment policy.

Having to sign a statement declaring that it has not been involved in corruption on the contract for which it is seeking ECGD support will cause a company to stop and think twice about bribing. The warranty introduced by the ECGD is an important new step that brings it into line with the OECD Action Statement on Bribery and Officially Supported Export Credits. Indeed, the ECGD has gone further than the Action Statement by requiring companies to affirm in addition that they have not been convicted in court of corruption and that they do not appear on the World Bank's list of ineligible firms.

The ECGD's warranty is not, however, as stringent as it at first appears. In particular, the ECGD's lack of proper investigatory powers and a failure to refer all suspected cases to the police and Serious Fraud Office means that there is a risk that the warranty is not being effectively policed or enforced. The failure of the ECGD to debar companies found guilty of corruption, meanwhile, means that it is falling behind international best practice and ignoring a crucial and effective sanction against bribery.

Strengthening Investigatory Procedures

Unless the companies backed by the ECGD know that the risk of bribery is not worth taking because the likelihood of being found out is so high, then they are likely to carry on taking that risk. At the moment

392. This particular requirement would ensure that the ECGD followed the OECD's 1997 Revised Recommendations on Combating Bribery in International Business Transactions that "member countries should encourage company management to make statements in their annual reports about their internal control mechanisms, including those that contribute to preventing bribery" (V.C.ii). Shell currently follows this policy.

393. The Extractive Industries Transparency Initiative is a UK government-backed initiative, announced by Tony Blair in September 2002, at the World Summit on Sustainable Development in Johannesburg. A UK government hosted international conference in June 2003 will invite companies, governments and international institutions to sign up to a voluntary compact on transparency in the extractive industries. *See* http://www.dfid.gov.uk/News/News/files/eiti_core_script.htm.

there is a distinct lack of clarity about how the warranty is being enforced.

The ECGD has shown a reluctance to investigate corruption allegations (as the case studies in Section Two illustrate), a reluctance which has persisted despite the introduction of its new anti-corruption measures. Over the past seven years, the ECGD has received on average one corruption allegation each year on projects it has backed.[394] In only two known instances in the last seven years, however, has the ECGD referred the allegation to the UK's investigatory authorities, one of these being in the last few months. Given that the ECGD admits that it has "no legal investigatory rights in a way that the SFO or Police do,"[395] this is a matter for concern.[396]

The ECGD's Internal Audit and Assurance Department is responsible for investigating allegations of corrupt practices and, in the words of the ECGD, determining "whether there is genuine cause for concern".[397] Given its lack of investigatory powers, however, it is not clear what its procedures are, whether they include making contact with the authorities in the country in which the corruption is alleged to have taken place, and whether they require all documentation from the companies implicated by the allegations.

According to the contract signed between the ECGD and the companies it backs, while the ECGD may enter the premises of a company that it gives support to and review its records, it must give five business days notice before doing so, and must "hold in confidence any information or copy record obtained . . . and destroy such records or if requested return them". These restrictions suggest that the ECGD's Internal Audit and Assurance Division has its hands tied in such a way as to seriously undermine its ability to check whether companies are complying with the warranty.

While the ECGD claims that it has no investigatory powers, under section 431 of the 1985 Companies Act, the Secretary of State for Trade and Industry, to whom the ECGD is answerable, is allowed to appoint inspectors to investigate the affairs of a company and report on them.[398] This Act requires companies to produce all books and documents in their custody to the inspectors, to attend before the inspectors when required to do so, and to give the inspectors all assistance. An answer given by a person to a question put by the inspectors may be used in evidence against that person. Indeed, under section 447 of this Act, it is an offence for companies not to produce books or papers for examination by departmental officers. Under the Civil Service Management Code, meanwhile, it is the duty of all civil servants to report corruption cases to the appropriate authorities.[399]

The response of the ECGD to the recent OECD Export Credit Group's Survey on measures to combat bribery shows that the ECGD does have a formal institutional requirement to inform investigative authorities in cases for which there is sufficient evidence of corruption, either before or after giving cover. In April 2003, it revealed through the survey that it had taken the further step of making it a formal institutional requirement to inform investigative authorities of suspicions of bribery both before and after cover has been given. Indeed, in this survey it revealed that it has notified investigative authorities of a suspicion of corruption in the first few months of 2003.[400]

394. *Hansard*, 8/2/00, Commons Written Answers, Column 120W, Mr Caborn to Mr Alan Simpson MP; *Hansard*, 19/9/02, Commons Written Answers, Column 161W, Ms Hewitt to John Austin MP.
395. Email from ECGD Spokesperson to The Corner House, 9/7/02
396. In a recent statement, the ECGD's Chief Executive, Vivian Brown, said that while the ECGD "would normally carry out initial enquiries to seek further information . . . we have no investigatory powers and we would therefore pass any information we received to the relevant authorities, for example the Police or Serious Fraud Office." (*See* Letter from Vivian Brown to the *New Statesman*, 22/9/02, Vol 15, p.36). The ECGD has clarified to The Corner House that it does not refer all information or allegations or corruption per se, but only "substantive information resulting from initial enquiries" carried out by the ECGD (Communication from the ECGD to The Corner House, 21/5/03).

    As this report was going to press, The Corner House learnt that the ECGD has now signed a Memorandum of Understanding with relevant agencies obliging the ECGD "to report any allegation of bribery and corruption to the National Criminal Investigation Service (NCIS)" (*see* Appendices, "ECGD Response to *Turning a Blind Eye*", p.78). The NCIS is then responsible for reporting any such allegation to the relevant national authorities in the country concerned. This is a very welcome step that will go some way towards making the ECGD's new warranty more enforceable.
397. *Hansard*, 21/6/00, Commons Written Answers, Column 183 W, Mr Caborn to Mr Austin MP; Email from ECGD Spokesperson to The Corner House, 10/5/02
398. Law Society, "Legislation the Criminal Code: Corruption", Report 248, 3 March 1998, paras 6.12 following, pp.98-99. The ECGD has told The Corner House that "the mere existence of such a power belonging to the Secretary of State for Trade and Industry does not mean that the ECGD has the power to appoint inspectors." (Communication from the ECGD, 21/5/03). But while the ECGD may not have this power, the Secretary of State for Trade and Industry does have the power, under the 1991 Export and Investment Guarantees Act, to "make any arrangements which, in his [sic] opinion, are in the interests of the proper financial management of the ECGD portfolio." Given that investigating corruption clearly falls under the heading of being "in the interests of proper financial management", the question remains as to why the Secretary of State for Trade and Industry him or herself cannot use his or her power to appoint inspectors with regard to the ECGD's business.
399. Group of States Against Corruption (GRECO), "First Evaluation Round: Evaluation Report on the United Kingdom", 14/9/01, para 24, p.8.

Corruption is a notoriously difficult area to investigate, not least because suspicions of bribery can be broadcast by rival bidders on a contract who lost out or by opposition political parties seeking to make political gain. But in cases where there are well-grounded suspicions from credible sources (particularly if such suspicions are being investigated by government authorities in the country concerned), The Corner House believes that the ECGD should refer such suspicions to the appropriate authorities in the UK.[**]

Therefore, the ECGD needs to:

- **examine whether it may be appropriate to rethink its investigatory procedures, in addition to measures it has already taken, including reviewing whether the contracts it signs with companies need to be rewritten so as to give it greater powers to check whether its warranty is being met by exporters receiving its support; and**
- **consider creating a specialised unit within its Internal Audit Division to investigate corruption allegations.**

Debarring Corrupt Companies

The ECGD says that it would take a corruption conviction "into account" when considering whether or not to provide an export credit and that such a conviction would be "prima facie" grounds for ECGD to refuse cover to a company. Nonetheless, the ECGD maintains that it "is required to consider all applications from exporters on their own merit so we would not automatically debar companies from cover who have been convicted of corruption".[401] In effect, the ECGD holds on to the right to provide cover to a company that has been convicted of corruption, even if it claims it is unlikely to use this right. This undermines the credibility of its warranty system. The ECGD needs to institute a proper system of debarment to bring it into line with international best practice on deterring corruption.

Debarment is used by:

– *Various countries including the United States, Singapore, China and Sweden*

South Africa and Germany are in the process of introducing a system of blacklisting companies found guilty of corruption from public procurement.[402] In the US, companies found guilty of fraud and bribery in government contracts in the US can be debarred from such contracts by both state and national government for three years. Reinstatement is not automatic, but subject to the company (or individual) proving beyond doubt that the problems have been resolved.

– *The US Export Credit Agency, Ex-Im*

Under Ex-Im's new mandate authorised in June 2002, the Agency is required to hold a list of and debar for three years all companies that have violated the 1977 US Foreign Corrupt Practices Act or other named legislation.

– *The World Bank*

Under the Bank's debarment policy, which it has operated since 1997, firms are declared ineligible for World Bank contracts if an investigation by a special unit within the World Bank's Internal Audit Department proves them guilty of fraud or corruption.[403] The World Bank is also in the process of setting up a blacklist for wider use by other multilateral development banks and aid agencies.

400. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on measures taken to combat bribery in officially supported export credits – as of 30 April 2003", 21/5/03.

** As this report was going to press, The Corner House learnt that the ECGD has now signed a Memorandum of Understanding with relevant agencies obliging the ECGD "to report any allegation of bribery and corruption to the National Criminal Investigation Service (NCIS)". *See* Appendices, "ECGD Response to *Turning a Blind Eye*", p.78.

401. Email from ECGD Spokesperson to The Corner House, 10/5/02

402. Donwald Pressly, "MPs to act against shady business", *Business Day* 3/6/02; Hugh Williamson, "Germany goes for the big clean-up", *Financial Times*, 7/5/02

403. One problem with the World Bank procedures is that the World Bank does not automatically debar a company convicted in court for corruption if the Bank's Internal Audit Department has previously cleared it. This is the case now with Acres, a Canadian company convicted and fined for bribery in October 2002 in Lesotho in connection with the Lesotho Highlands Water Project (*see* Section Two, Case Study 4, pp.37ff), a company which a World Bank investigation earlier found innocent of corruption. It is also noteworthy that the World Bank's list tends to be dominated by small firms and consultants, and that no major multinational company has yet been blacklisted. According to former World Bank procurement consultant, Tim Tucker, "Companies really have to be very corrupt to get on the World Bank blacklist" (Personal communication with The Corner House, 29/4/03).

The ECGD argues that it cannot operate a debarment policy at present because its legal mandate requires it to consider all applications for support. But the 1991 Export and Investment Guarantees Act gave the Secretary of State for Trade and Industry who is responsible for the ECGD, considerable flexibility, including the right, under section 3(1), to "make *any* arrangements which, in his [sic] opinion, are in the interests of the proper financial management of the ECGD portfolio, or any part of it" (emphasis added). As proper financial management should require the ECGD not to give cover to companies with a record of corruption, it should be perfectly possible for the Secretary of State for Trade and Industry to institute a debarment policy at the ECGD.

The ECGD, as a branch of the UK government, may in future be required to operate a limited form of debarment if a new EU public procurement directive comes into force. This directive, although still in draft form, comes into force in 2005 and requires EU states to operate a mandatory exclusion from government contracts of any company convicted of corruption within the EU.[404]

The ECGD should therefore:

- **act immediately to bring itself into line with international best practice by debarring from further ECGD cover or insurance for a period of at least three years any company found guilty of fraud or corruption by a government agency or a court anywhere; and**
- **push the OECD Export Credit Group to ensure that a general export credit agency debarment list is held at the OECD.**

3. The ECGD needs to review its enhanced due diligence procedures to ensure that they screen out buyers, companies and projects that have poor records on corruption and governance.[405]

Given that the ECGD continues to give guarantees and insurance to projects in some of the most corrupt sectors of industry, and given that it operates in countries with some of the worst corruption problems in the world, due diligence and post-issue monitoring procedures are of the utmost importance.

The ECGD has enormous power to determine whether a project will go ahead or not by deciding whether or not to back it. Many of the projects backed by ECAs in general would not go forward without their support, because private sector banks and insurance firms are simply unwilling to underwrite the high financial risks involved. The ECGD could, and arguably must, use this power to ensure that there is no corruption in any part of the projects it supports.

The ECGD has stated that its enhanced due diligence procedures are designed to identify companies with poor track records. Yet it has given guarantees over the last two years to several companies that have been implicated in corruption scandals. Two companies implicated in the corruption scandal in the Lesotho Highlands Water project, Balfour Beatty and Kier International (*see* pp.37ff), were both given ECGD guarantees in 2000/01.[406] The UK subsidiary of French engineering company Alstom, meanwhile, was given various guarantees in 2000/2001 and 2001/2002, even though the parent company has faced numerous corruption

404. Mrs Brunca, EU Public Procurement Division, personal communication, 31/10/02. The Directive has to pass a second reading before the EU Parliament and Council of Ministers before it comes into effect. The EU is considering holding a blacklist of companies found guilty of corruption, but it is unlikely to do so for some time.
405. The Canadian Export Credit Agency, Export Development Canada, based its anti-corruption measures on whether it as an institution would stand the legal test of "reasonable diligence and care" if it were taken to court under Canada's anti-corruption legislation. *See* Ran Goel, "Anti-Corruption Measures at Export Development Canada", Independent Study Course, 22/4/02.
406. Balfour Beatty received a guarantee in 2000/01 of £23.4 million ($37.4 million) as part of a consortium building bridges in the Philippines. Kier International received two credits of £30.5 million ($48.8 million) and £17.3 million ($27.7 million) for work in India and Jamaica (as part of a joint venture) plus a £79.5 million ($127.2 million) guarantee jointly with Mirvan Ltd from Account 3 (the account reserved for projects that do not meet normal underwriting criteria) for work in Romania. These guarantees were issued a year or so after criminal prosecution of the official convicted of receiving bribes in the Lesotho case began (*see* Section Two, Case Study 4, p.37ff).

investigations in several countries, including South Korea, Malaysia, Spain and Mexico.[407]

The ECGD has also backed several projects since it instituted its new procedures in which the buyer institution has had serious corruption problems. In Mexico, for instance, the ECGD has an ongoing line of credit open for PEMEX, the state oil company. PEMEX has consistently headed the list of the Mexican Federal Comptroller's Secretariat's investigations into corruption. PEMEX's former head is currently under arrest in the US for embezzling $220 million from the company. In October 2002, a special congressional committee in Mexico was called upon to investigate the transfer of $165 million from PEMEX to the election campaign of the former ruling party, the PRI (Institutional Revolutionary Party).[408] Only in October 2002 did PEMEX commit itself to full transparency in its purchases and tenders.[409] In the Philippines, meanwhile, the ECGD has backed several projects for which the buyer was the Department of Works and Highways (DPWH), which has consistently been found to be the one of the most corrupt government departments in the country.[410]

If the ECGD is to live up to its commitment to combat corrupt practices, it needs to strengthen its due diligence procedures by:

i) moving from a reactive to a preventative model of due diligence by taking sufficient evidence and suspicions of corruption seriously when considering applications;

ii) setting an upper limit to the amount of agents' commission that will be backed by the ECGD and requiring greater disclosure of information from companies on agents;

iii) setting benchmarks for institutional integrity that buyer institutions must meet before a project can be supported in order to ensure that all components of a project to be backed are corruption-free;

iv) introducing a requirement that contracts to be supported are won through competitive tender and are subject to public audit in all appropriate cases and publishing post-issue monitoring reports for projects with significant cost over-runs; and

v) introducing staff incentives that reward underwriters at the ECGD for providing cover to projects that meet enhanced due diligence standards designed to combat corruption and that penalise those who consistently fail to meet these standards.

i) moving from a reactive to a preventative model of due diligence by taking sufficient evidence and suspicions of corruption seriously when considering applications.

"Simply sitting still, doing business as usual and waiting for a legal judgement of bribery means that the sanction comes much too late to have any impact or relevance."

Michael Wiehen
Transparency International[411]

At present, the only apparent criterion that the ECGD uses to establish whether companies have a poor track record on corruption, or whether there has been corruption in a project to be supported, is whether the

407. Engineering company Alstom, which has also been implicated in the Lesotho Highlands Water Project corruption, has received two export credits of £12 million ($19.2 million) and £16.1 million ($25.7 million) for work in Mexico and Turkey respectively in 2000/01. For details of the various corruption investigations of Alstom, *see* Susan Hawley, "Still underwriting corruption? The ECGD's recent record" paper presented at "Beyond Business Principles", Seminar on Export Credit Reform, House of Commons, 23/5/02, www.thecornerhouse.org.uk/document/corrupt.html

408. *EFE*, 7/11/02, "Government seeks extradition of ex-Pemex head, wants to recover funds"; *The News*, 23/10/02, "Pemexgate suspects to be called before congressional committee".

409. *Business News Americas*, 15/10/02, "Pemex signs accord to improve procurement transparency".

410. *The Straits Times*, 24/7/02, "Graft: Filipinos hope to see big fish caught"; *BusinessWorld (Philippines)* 22/7/02, "Special Feature".

411. Michael Wiehen, "Implementation of the ECG's Action Statement of December 2000 on Export Credit Support", Presentation to the ECG, 23/4/03

company concerned has received a conviction for corruption in a court. As noted in this report, there have been few court convictions for corruption around the world, with the exception of the US, due to the difficulty of getting evidence and lack of political will. Considering only convictions for corruption means that the ECGD's threshold for assessing how likely a company is to bribe is very low. It also means that the ECGD's approach to corruption is geared towards reacting to corruption long after it has happened, rather than seeking to prevent it.

At present, the ECGD has stated in its response to the OECD Export Credit Group's Survey on measures to combat bribery that it has no formal institutional commitment to withholding support for transactions if there is sufficient evidence of corruption.[412] It is only one of ten ECAs that has not made such an institutional commitment. By not doing so, the ECGD is failing to fulfil its requirements under the OECD Action Statement on Bribery and Officially Supported Export Credits; by signing this statement, it explicitly agreed to withhold support in cases where there was sufficient evidence of corruption.

The ECGD has also stated in the OECD survey that it has no institutional commitment to withhold support to projects for which there is a suspicion of bribery. In late 2001, the ECGD stated that suspected corruption would be given due weight when it considered supporting projects. But the ECGD has since told The Corner House that "suspected corruption alone is not valid grounds for ECGD to refuse or suspend cover".[413] Given that it is incredibly difficult to prove corruption and that it usually takes a long time before evidence of corruption emerges, it is vital that the ECGD takes seriously suspicions of corruption voiced by reliable and trustworthy sources. Only if the ECGD takes such suspicions seriously can it avoid backing projects in which corruption may have occurred. The ECGD is behind best practice with regard to other export credit agencies on this issue. Eight other ECAs from OECD countries withhold support where bribery is suspected.[414]

In order to be able to gather more information on the track record of companies, the ECGD should consider the possibility of requiring more information from companies at the Impact Questionnaire stage about any investigations for corruption to which they have been subject. In particular, the ECGD could find out whether the company has been subject to investigations by a government agency, parliamentary body or another company. This would provide much more detailed evidence of a company's propensity to bribe than a statement as to whether it has been convicted of corruption in a court or not.

The ECGD should therefore:

- **make a formal institutional commitment to withhold support where there is sufficient evidence of corruption;**
- **formally state that suspected corruption in a project would be grounds for refusing cover; and**
- **require companies to provide information at the Impact Questionnaire stage on whether they have been subject to any investigations for corruption by government agencies, parliamentary bodies or other companies and the outcome of these investigations.**

412. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on measures taken to combat bribery in officially supported export credits – as of 31 January 2003", 10/2/03.
413. Email from ECGD spokesperson to The Corner House, 10/5/02
414. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on measures taken to combat bribery in officially supported export credits – as of 31 January 2003", 10/2/03

ii) -setting an upper limit to the amount of commissions paid to agents that will be backed by the ECGD;
-refusing to back projects in which agents are based, or commission payments are made, offshore;
-increasing due diligence with regard to consortia partners; and
-requiring disclosure of all payments made in relation to a contract.

Given that the vast majority of bribes are likely to be paid through an agent, and given that commissions have in the past been a vehicle for hiding bribes, it is crucial that the ECGD has the highest standards with regards to agents and commissions.

In early 2003, the ECGD brought in some new measures on agents; these require the purpose of commissions to be identified, and the details of the agent to whom commission is payable, and of any relationship between the purchaser and the agent, to be provided in all cases. Previously, the ECGD said that it did "not normally enquire" about the purpose of commissions, nor did it ask for any information about agents besides their country and place of payment.[415] These details are now required in all cases, whereas previously they were required only "on potential problem cases".[416] These new measures are very welcome.

In its response to the OECD Export Credit Group survey, however, the ECGD stated that it does not set an upper limit on agents' commissions, although it would investigate and seek assurances from the exporter were the commission to be in excess of what was normal for the market or the contract. The ECGD lags behind best practice in this respect when compared to other export credit agencies. The ECAs of Canada, the US, New Zealand, Italy, the Slovak Republic and Spain all set a ceiling on agents' commissions for which official support is given.[417]

The Corner House believes that the ECGD, in the interests of transparency, should refuse cover to projects that employ agents who are registered offshore, or where the payment of commission is to be made offshore. The secrecy that operates in offshore centres breeds corruption.[418] As the previous section shows, in several cases in the past the ECGD has backed projects where the agent was based, or commission payments were made, offshore.

In addition, the ECGD should monitor the track record of consortia partners involved in projects it backs. Bribes can be paid by the consortia partners of an ECGD-supported company with or without the knowledge of the UK company. The ECGD should therefore ensure that, when it backs UK companies that are part of consortia, the company's consortia partners do not have a track record of corruption. The ECGD should also require information on all payments (including political donations) made in the course of a project. Even charity donations can, as Transparency International has noted, be a means for companies to direct payments to government ministers, particularly when the minister is directly involved in the charity concerned.[419]

The ECGD should therefore:

415. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on measures taken to combat bribery in officially supported export credits – as of 31 January 2003", 10/2/03
416. Email from ECGD spokesperson to The Corner House, 10/5/02
417. OECD Working Party on Export Credits and Credit Guarantees, "Responses to the 2002 Survey on measures taken to combat bribery in officially supported export credits – as of 30 April 2003", 21/5/03. Spain and Italy set a ceiling of 5% of the contract value, while Canada's ceiling is 10%.
418. For details of offshore taxhavens, *see* footnote 284.
419. Transparency International response to Shell's corruption policy, printed in Shell, *Dealing with Bribery and Corruption: a Management Primer,* p.40.

- **set a threshold of 5% of the contract value for the amount of agents' commission that it will support;**
- **refuse cover when agents are based, or commission payments are to be made, offshore;**
- **increase its due diligence assessments of consortia partners and companies from non-UK countries involved in the project; and**
- **require disclosure of all payments and gifts made by a company in the course of a project**.

iii) setting benchmarks for institutional integrity that buyer institutions must meet before a project can be supported in order to ensure that all components of a project to be backed are corruption-free.

The ECGD has so far taken a fairly limited approach to corruption in its new measures; it focuses on bribery by UK companies, rather than the potential for corruption in any part of the project to undermine the project's viability. To be consistent with the UK government's broader international commitments to tackle corruption, the ECGD should be taking a broader view.

The ECGD can generate considerable reputational damage for the country concerned if that project goes wrong due and corruption is implicated. Such damage can restrict the ability of the country to attract further investment on favourable terms. The ECGD needs to ensure, therefore, that, even if the UK component of any project it backs is clean, the project as a whole is not tainted with corruption. It should be concerned not just with the credit-worthiness of the buyer institution (usually a government department or state-owned company) but also with its record on transparency, accountability and business integrity.

The ECGD therefore needs to:

- **develop benchmarks for transparency, accountability and public participation that buyer institutions must meet before a project will be backed; these should include a commitment to transparency and public disclosure, an ability to account for resources, a proper external audit, and a commitment to transparent and fair public procurement processes; and**
- **make it standard procedure as part of its due diligence checks to get advice from other donor agencies providing funds to the country on the appropriateness of projects and the track record of buyer institutions.**

iv) requiring competitive and transparent tender processes[420] and public audits of project performance for projects to be backed, and publishing post-issue monitoring reports for projects with significant cost overruns.

Prior to April 2002, the ECGD did not require companies to provide any information on whether the contract to be supported had been won through

420. The Corner House acknowledges that, in the context of *public* procurement, competitive tender can be contentious. It has been used as a means to contract out or privatise public services. But the process has brought problems of its own. Preparing bids for a contract is expensive, meaning that smaller companies that cannot afford to bid for projects get squeezed out, and that increased administrative costs are clawed back by raising contract costs. Some studies suggest that, in the context of contracted-out public services, the quality of service or product is sometimes less and certainly no better. Furthermore, savings achieved through competitive tender are often obtained by reducing labour costs, usually by cutting the numbers of staff, and by underbidding, which leads to extra costs further down the line, often at taxpayers' expense. A requirement for competitive tender, meanwhile, has been used by institutions such as the World Bank to ensure that foreign companies are allowed to bid for local services in Third World countries. *See* Sue Arrowsmith and Keith Hartley (eds), "Introduction", *Public Procurement*, International Library of Critical Writings in Economics. Elgar, Cheltehnham, 2002, (www.york.ac.uk/depts/econ/rc/pubproc2.pdf).

competitive tender, or indeed on the tender process at all. This was noted upon by the International Development Committee in its report on corruption in March 2001. Since April 2002, the ECGD has asked applicants to state what type of tender procedure has been used in the awarding of the contract to be supported, and states that two thirds of contracts covered by the ECGD over this period were won through competitive tender.[421] The ECGD has stopped short however of making competitive tender a requirement for projects to be supported. Its reasons are that competitive tender would not be appropriate on projects such as refurbishment of existing plants or infrastructure. Yet such projects constitute only a small percentage of the number of ECGD-backed projects and could easily be exempted from such a requirement through special clauses.

Competitive tender can reduce the cost of projects by between 20-30%.[422] Competitive tendering is considered best business practice, and is required (with exemption clauses for appropriate cases) by all multilateral development banks, and many governments at a national level. What many of the case studies in this report have in common is that their contracts were awarded without competitive tendering, sometimes despite a legal requirement for competitive tender at a national level. Furthermore, research commissioned by the ECGD from National Economic Research Associates (NERA) in April 2000 states that it is only if there is competitive bidding in export contracts supported by the ECGD that there is any benefit or redistribution of resources to the importing country, since competitive bidding would lower the cost of contracts and result in cheaper imports or projects.[423]

The Corner House is aware of one instance, in Papua New Guinea, where the ECGD has backed a project that was not subject to competitive tender despite the fact that local law required a competitive tender process to take place. As a result, there have been accusations that the goods procured from a UK company were overpriced, and the project – the construction of 166 steel bridges by a UK company – has become controversial. Lack of transparency in tender processes can significantly damage the reputation of a project, and fuel allegations of corruption, even where there are none. It is therefore imperative that the ECGD ensure that proper tender procedures are followed in line with national law, and that these procedures are transparent.

Competitive tender by itself does not prevent corruption, however.[424] Nor is it a panacea. Unless tender processes in host countries are governed by rules on transparency, public disclosure and accountability, corruption can severely undermine the competitive tendering process. Furthermore, in the absence of proper public audit, evaluating whether a project was completed satisfactorily within the contract price and timeframe, cost overruns can undermine the savings achieved through competitive tender.

Given that it will be the taxpayers of the host country which will end up paying if the project goes wrong, the ECGD should also seek to ensure that projects it supports, particularly high-risk ones, are subject to public audit of project performance by an appropriate body at the national level. The ECGD should also, for the sake of transparency and accountability, publish post-issue monitoring reports on projects that have had significant cost over-runs.

421. *Hansard*, 1/5/03, Commons Written Answers, Column 627W, Ms Hewitt to Simon Thomas MP.
422. Donald Strombom, "Corruption in Procurement", *USIA, Economic Perspectives*, November 1998.
423. S. Estrin, S. Powell, P. Bagci, S. Thornton, P. Goate, "The Economic Rationale for the Public Provision of Export Credit Insurance by ECGD: a report for the Export Credits Guarantee Department", National Economic Research Associates, April 2000, p.40.
424. *See* Tim Tucker, "A Veterinary College for Afribia", paper on public procurement in the Third World produced for The Corner House, April 2003. Tucker argues that competitive tender can lead to an extra layer of bureaucracy that can actually increase the potential for corruption, and lead to bad deals. In particular, he says, the inability of tender boards to take the track record of companies in to account, means that companies which look best on paper despite having a poor performance record often win contracts ahead of more suitable bidders.

To sum up, the ECGD should:

- **require contracts to have been won by competitive tender, unless appropriate circumstances justify an exclusion, particularly in circumstances where local law requires it;**
- **require in high risk cases where the buyer or the company has a history of corruption that the tendering process is overseen by a monitoring committee involving civil society and stakeholder groups;**[425]
- **ensure that projects, particularly high-risk ones, are subject to public audit of project performance by an appropriate body at the national level in the country concerned; and**
- **publish post-issue monitoring reports on projects which have had significant cost over-runs.**

v) introducing staff incentives, in consultation with staff unions, that reward underwriters at the ECGD for providing cover to projects that meet enhanced due diligence standards for combating corruption and that penalise those who consistently fail to meet these standards.

The importance of combating corruption needs to pervade the whole institutional culture of the ECGD, not just to be ghettoised within the business principles unit. Currently, there is a risk that underwriters in particular may place more emphasis on approving projects than on ensuring that they are free from corruption. To avoid this, the ECGD needs to ensure that it has an appropriate system of staff incentives that rewards good practice and penalises consistent bad practice.

4. The ECGD needs to deepen further its increasing commitment to transparency.

"Greater openness is not only an essential part of good governance, but also has an intrinsic value. Citizens have a basic right to know."

Joseph Stiglitz and Roumeen Islam[426]

In the past few years, the ECGD has come a long way in trying to be more transparent – but it still has some way to go. It now publishes each year a list of the guarantees it provides, but publication is subject to consent from the exporter. In 2001/2002, two exporters (with guarantees totalling £14.5 million) refused that consent. Since companies are relying on taxpayers' money, it should be a condition of cover that they accept public disclosure rather than it being merely an option.

The ECGD announced in March 2003 that from 14th April 2003, it would provide details of projects with high potential impacts (such as oil, gas, mining, cement, nuclear and thermal power projects as well as large dams, major transport and large-scale forestry projects) prior to deciding whether or not to provide support.[427] This information will normally be provided 60 days prior to a decision to provide cover, subject to consent being given by the exporting company, who will remain anonymous.

While this new disclosure policy is welcome, high potential impact cases

425. *See* Department for International Development, "Making Connections: Infrastructure for Poverty Reduction", Consultation Document, August 2002, p 13, paras 3.8 and 3.9; *see also* Christian Gruenberg, "Is it possible to avoid corruption in public bidding?" Paper for 9th International Anti-corruption Conference about Poder Ciudadano, the Argentinian Transparency International chapter's involvement in a "Programme for Transparent Contracting", which involves holding public hearings on public procurement projects.
426. *World Bank Press Review*, 12/1//02, "Access to information key to development, say Stiglitz and Islam".
427. ECGD Press Release, "Revised Case Impact Analysis Process", 1/4/03.

represented only 12 out of 93 projects supported in 2001. The ECGD should make early disclosure of *all* projects at least two months before it makes a decision, so that potentially affected communities in the countries concerned and public interest groups have an opportunity to register their concerns with the ECGD. By doing so, the ECGD will be able to get more a more accurate picture of the potential impact of the project. From an anti-corruption point of view, it means that people will be able to alert the ECGD to allegations of corruption more easily *before* the ECGD backs a project.

The ECGD's insurance business, meanwhile, including its Overseas Investment Insurance (OII),[428] which together represent two thirds of ECGD business, are, for the most part, treated as "commercial-in-confidence". OII has increased five-fold over the last five years, reaching a record £1 billion ($1.6 billion) in 2001/2002. In the same year, the ECGD's other insurance business totalled £1.1 billion ($1.8 billion). OII, in particular, is issued mainly in developing and transition countries (mainly those of the former Soviet Union), where corruption and unproductive expenditure have a disproportionate impact. OII projects that fall under the high potential impact category will, however, from April 2003, be disclosed under the ECGD's new disclosure policy, again subject to consent from the exporter or investor.[429]

Up to now, the ECGD has argued that it cannot make OII public because "notifying the presence of export credit or investment insurance could induce the buyer to default on their obligations, i.e. the UK government would pick up the tab" and because if OII were known, "it might be felt to imply a certain lack of faith in the buyer's financial position".[430] The fact that the ECGD is now proposing to disclose high potential impact cases suggests that this argument does not hold water.[431] The ECGD should therefore broaden its disclosure policy with regard to all insurance business.

Finally, the ECGD needs to be more open about its investigations into, and procedures for dealing with, corruption. At the moment, the ECGD merely states in its last Annual Report that "to the best of our knowledge, ECGD has not received applications from, or provided support for, any company that has at any time been convicted of corruption or which appears on the World Bank list of debarred companies".[432] In the light of its new procedures, it would be a matter of grave concern if it had. But the ECGD should also state in its Annual Report (in line with current commercial best practice and recommendations by the OECD for internal company controls):

- the number of corruption allegations it has received;
- the number it has investigated;
- the outcome of the investigations (that is, whether cover was terminated or whether the company was cleared of the allegation);
- the number of allegations it referred to the Serious Fraud Office; and
- the number of applications refused export credits because of suspicions of corruption.

Only if the ECGD does this can Parliament and the general public evaluate how effectively the Department's anti-corruption measures are working.

428. Overseas Investment Insurance provides companies with political risk insurance against expropriation, war, restrictions on remittances and, in some cases, breach of undertaking. According to the ECGD in a personal communication to The Corner House, the ECGD would seek to recover the claim via the company it has insured rather than directly from the government of the country concerned. But ECGD officials told the Indian NGO, Prayas, that it would seek to recover the claim through diplomatic means with the government concerned, and that if that did not work, then it would break trade relations with the country (Notes of Prayas meeting with ECGD, 30/10/02, Mumbai). The ECGD has not yet had to pay a claim under OII.
429. Email from ECGD Business Principles Advisor to The Corner House, 9/5/03
430. Email from ECGD spokesperson to The Corner House, 10/5/02
431. It is also not clear why, for example, if the government of a developing country knew that it would face possible trade sanctions or a diplomatic pressure from the UK government were it not to compensate a company in the case of expropriation, restriction on remittances, war or breach of contract, it would be more rather than less likely to default on paying such compensation.
432. ECGD, *Review of the Year & Annual Report and Resource Accounts for 2001/02*, p.41.

To summarise, the ECGD should:

- **let companies know that publication of ECGD backing is a condition of cover not an option;**
- **include in its Annual Report a list of all projects covered under insurance business, including the Overseas Investment Insurance scheme;**
- **publish a list of all projects it is reviewing for cover, not just high potential impact cases;**
- **include in its Annual Report a detailed breakdown of the number of corruption allegations it has received, is aware of, has investigated or passed to the Serious Fraud Office, and the number of projects it has refused to back because of suspicions of corruption.**

Conclusion

The culture of institutional negligence at the ECGD with regard to corruption in the companies and projects it backs has a long and deep history. Despite new measures brought in against corruption in late 2000, the ECGD still faces the fall-out from its many years of backing corrupt projects, fall-out that it has yet fully to address. Furthermore, it is not yet clear that the new anti-corruption measures are making a significant impact either on the Department's operating procedures or on British business practice abroad. Since these measures were introduced, the ECGD has backed at least one project with a corruption problem, and there are some serious weaknesses in the new measures. The ECGD must urgently re-address the issue of corruption and make some qualitative leaps forward. If not, more developing and transition countries are likely to suffer from over-priced projects and greater debt burdens, and the UK's reputation on tackling corruption will be tarnished.

Appendices

ECGD Top Ten Markets For Guarantees

Year	Amount	Transparency International Corruption Perceptions Index Ranking[433]
1997/98	**£ million**	**1997 - out of 52 countries**
China	833.4	41/52
Brunei	580.3	n/a
Oman	424.8	n/a
Russia	313.1	49/52
Indonesia	292.6	46/52
Philippines	249.4	40/52
Saudi Arabia	225.0	n/a
Brazil	208.4	36/52
Qatar	186.7	n/a
Sri Lanka	176.4	n/a
1998/99	**£ million**	**1998 – out of 85 countries**
Saudi Arabia	1,012.4	n/a
China	610.1	52/85
Brunei	580.3	n/a
Indonesia	162.2	80/85
Egypt	135.4	66/85
USA	134.9	17/85
Turkey	134.8	54/85
Brazil	117.7	46/85
Hong Kong	109.1	16/85
UAE	94.4	n/a
1999/2000	**£ million**	**1999 – out of 99 countries**
Saudi Arabia	1,012.4	n/a
Malaysia	890.64	32/99
Turkey	382.28	54/99
South Africa	268.10	34/99
USA	254.10	18/99
Oman	217.75	n/a
UAE	191.37	n/a
Indonesia	155.14	96/99
Switzerland	146.83	9/99
Philippines	136.82	54/99

433. www.transparency.org/cpi. *See* footnote 155.

Year	Amount	Transparency International Corruption Perceptions Index Ranking
2000/01	**£ million**	**2000 – out of 90 countries**
South Africa	1,736.18	34/90
Saudi Arabia	1,017.03	n/a
USA	263.92	14/90
Turkey	259.00	50/90
Philippines	207.38	69/90
Indonesia	164.00	85/90
UAE	161.23	n/a
India	153.58	69/90
Oman	133.21	n/a
Brazil	123.73	49/90
2001/02	**£ million**	**2001 – out of 91 countries**
Saudi Arabia	1,013.48	n/a
Chile	285.92	18/91
Philippines	194.47	65/91
Indonesia	169.12	88/91
USA	151.99	17/91
Turkey	143.95	54/91
Russian Federation	120.92	79/91
Canada	106.53	7/91
India	104.96	71/91
China	92.64	57/91

Source: ECGD Annual Reports and Resource Accounts

ECGD Top Ten Markets – ECGD Exposure

Year	Amount	Transparency International Corruption Perceptions Index Ranking
2001/02	**£ million**	**2002 – out of 102 countries**
China	2,203.7	59/102
Nigeria	1,869.5	101/102
Indonesia	1,554.4	96/102
South Africa	1,287.9	36/102
Russia	1,020.5	71/102
Saudi Arabia	1,008.2	n/a
Philippines	963.1	77/102
Malaysia	954.1	33/102
Turkey	791.7	64/102
USA	762.2	16/102
2000/01	**£ million**	**2001 – out of 91 countries**
China	2,845.1	57/91
Nigeria	1,887.1	90/91
Indonesia	1,554.5	88/91
South Africa	1,493.1	38/91
Russia	1,180.8	79/91
Hong Kong	1,083.5	14/91
Malaysia	1,078.7	36/91
Saudi Arabia	1,008.8	n/a
Oman	949.7	n/a
Turkey	916.5	54/91

Source: ECGD Annual Reports and Resource Accounts

ECGD Response to *Turning a Blind Eye: Corruption and the UK's Export Credits Guarantee Department*, received 28 May 2003

We will prepare a detailed response to the criticisms this report contains in due course. In the meantime, we have some initial comments.

ECGD have always considered bribery and corruption to be unacceptable in the conduct of international business. We take issue with the report's central suggestion that our organisational practises allow corruption to go unchecked. The tone of the report suggests that we have been at best negligent and at worst complicit in our attitude towards bribery and corruption.

The rigorous scrutiny procedures at ECGD have been developed over many years and we are committed to regular review to ensure that these are consistent with or better than international best practice. In September 2000 major improvements were made to strengthen our checks and balances. Subsequently, we have made further amendments to maintain or enhance their rigour. We are confident that these new measures address any perceived weaknesses in our earlier systems.

Inevitably, the report has had to concentrate almost entirely on historical cases, where guarantees or insurance were issued prior to the overhaul of procedures. Even before the overhaul, ECGD were aware of these allegations and were treating them as a matter of serious concern. As a result, our Business Group, Internal Audit and Legal services made a number of recommendations that were incorporated into our processes. The recommendations made in the Corner House report provide some additional suggestions that we will consider in due course along with our own continuing review of this area.

We have also improved our processes to reflect both the OECD Convention on Combating Bribery of Foreign Public Officials, and the recent enhancements to the Prevention of Corruption Acts made by the Anti-Terrorism Crime and Security Act (ATCS 2001).

Our customers must now sign a warranty that they have not and will not engage in any corrupt activity when working on any contract or investment supported by ECGD. Our customers are made aware in the application documents of the serious and enforceable penalties for breaching the warranty: cancelling the insurance policy or requiring the repayment of any claims payments.

ECGD have also signed a memorandum of understanding with relevant agencies obliging us to report any allegation of bribery and corruption to the National Criminal Investigation Service (NCIS). NCIS are, in turn, responsible for reporting any allegation worthy of investigation to the authorities in the jurisdiction concerned.

Prior to underwriting, we carry out extensive due diligence procedures to prevent cover being given to companies who have been engaged in bribery and corruption. We analyse a number of factors that can indicate the possibility of malpractice, including the relationships between the parties to the contract, the exporter's track record, factors in the pricing or make-up of the contract that may indicate a higher risk of corruption, and high levels of agent's commission. Companies applying for support must state the procedure used for awarding the contract (including whether it was put out to tender) and due account is taken of this.

While ECGD cannot blacklist companies, our procedures can produce a similar result, as a company's conviction for corruption or its inclusion in the World Bank's blacklist should be a prima facie reason for refusing cover.

ECGD are fully committed to greater transparency and accountability. More information about our activities and the business we support is available to the public now than at any time in the Department's history. We now routinely publish ECGD exposure and claims outstanding on a market-by-market basis.

We have recently introduced a new section on our website giving details of cases with potentially high impacts that we are actively examining. A list of the guarantees that we issue in support of UK exporters is published in our Annual Report and on our internet site. These actions have been taken in response to consultations with stakeholders, including NGOs and customers, and such consultations now play a major role in our external relations. We are regularly in contact with The Corner House and co-operated extensively in providing information and clarification during the drafting of the report.

ECGD treat sustainable development seriously using the DEFRA definition of "development which meets the needs of the present without compromising the ability of future generations to meet their own needs". ECGD, when considering support, look not only at the payment risks but also at the underlying quality of the project, including its environmental, social and human rights impacts. Our approach in determining whether to support a project is one of constructive engagement, with a view to achieving necessary improvements in the project's impacts. We are also pressing for international reform on sustainable development and human rights issues in relation to export credits.

We hope this response shows that ECGD take the issue of bribery and corruption very seriously. We should stress that, while we are satisfied with our current stance in this respect, we are by no means complacent and are committed to maintaining and enhancing our already rigorous standards. Accordingly, we welcome the publication of this report as a stimulus to further discussion.