

# **Good Governance and Social Responsibility**

## **Lecture 10: Corporate Social Responsibility and Corruption in a Global Context**

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## Lecture Learning Objectives:

At the end of the lecture, you will be able to:

1. Understand global corporate social responsibility and relate how CSR affects developing countries.
2. Enumerate and discuss the CSR issues in International business
3. Understand and explain the impact of corruption involving large multinational companies
4. Enumerate some of the initiatives to deter this wholesale corruption perpetrated by International business and host countries

## Corporate Social Responsibility

**Corporate social responsibility (CSR)** has gained currency. Companies are adopting 'ethical policies' or 'codes of conduct' stating how they intend to "behave". More companies are signing up to such initiatives as the United Nations Global Compact or the Fair Labor Association. They are joining bodies such as the World Business Council for Sustainable Development and CSR Europe. On both sides of the Atlantic, there are myriads of conferences and initiatives, where corporate CSR Executives, some even from companies with a long anti-union record, meet up with campaigns, NGOs and indeed trade unions.

In the 1990s, McDonald's, the hamburger corporation, took two campaigners through a long and exhausting libel court case in London after they criticized its corporate practices. Then, there was the 2004 film 'Super-Size Me'. Its public image thoroughly dented, today McDonald's leaflets in the UK show happy local farmers producing organic crops for healthy meals. Or, the oil company Unocal, which was severely criticized for knowingly using forced labor to construct a pipeline in Burma, a country run by a vicious regime and subject to an international boycott. US labor rights' groups took Unocal through the courts. Unocal now has a huge area on its website devoted to CSR.

In fact, **CSR** means different things to different people. However, certain ideas are becoming commonly accepted. One is that **CSR** is not about philanthropy or charitable work. It refers to something much more fundamental. It is about how companies take responsibility for their actions in the world at large. Conventional CSR watchdogs include labor unions, consumer groups, environmentalists, NGOs, and all 'stakeholders' watching over their interest as opposed to 'stockholders' only.

The role of business worldwide and specifically in the developed economies has evolved over the last few decades from classical profit maximizing approach to a social responsibility approach, where businesses are not only responsible to its stockholders but also to all of its stakeholders in a broader inclusive sense. One can identify so many reasons for shifting the role of business from classical concept to a responsible business

concept, but negative impression of the stakeholders on the enterprise would get a higher priority among others. In one hand, enterprises create wealth and job opportunities for the society and on the other, they pollute and destroy environment and ecology with devastation impact on human health and biodiversity worldwide. To address the social problems or the problems of the stakeholders, the business community evolved a new approach in their business strategies named CSR. Through CSR, enterprises are intent to strike a balance between economic and social goals, where resources are used in a rational manner and social needs are addressed responsibly.

CSR can be viewed as a comprehensive set of policies, practices and programs that are integrated into business operations, supply chains and decision-making processes throughout the company and include responsibilities for current and past actions as well as adequate attention to future impacts. CSR focuses vary by business, by size, by sector and even by geographic region. The umbrella of CSR is quite big and it includes all the good practices that increase business profitability and can preserve interest of all stakeholders. To cite, Lotus Holdings defines CSR as “The integration of the interests of the stakeholders-all those affected by a company’s conduct into the company’s business policies and actions, with a focus on the social environmental, and financial success of a company, the so-called triple bottom-line with the goal being to positively impact society while achieving business success.” Thus, the whole range of stakeholders is considered as integral parts of CSR.

One important aspect of CSR is that it is not a legal obligation but rather a voluntary social and environmental positive initiative to establish an image of environmentally and Socially Responsible Business (SRB) that also encompasses MSMEs as well as giant corporations. The motivation and drive to pursue is chiefly a result of pressure from well-organized consumer rights movement, specifically in developed world that acts as a watchdog and hardly hesitates to impose consumer boycott against a company that violated established CSR practices. An example is the consumer boycott imposed on purchasing Bangladesh ready-made garments on the ground that these are produced by under-aged child labor. Despite the fact that in the not-so-distant past, CSR was more of a charity by affluent or socially responsible business organizations without expecting any financial return, today, it very much a planned investment in creating positive image to enhance profitability. Under the CSR concept, companies decide voluntarily to contribute to a better society and a more sustainable environment. As evolved primarily in the western world, most of the rising companies practice CSR to enhance the image and acceptability in the community (Green Paper, 2001). There are driving forces behind CSR that include new concerns and expectations from citizens, consumers, public authorities, and investors in the context of globalization. Social criteria are increasingly influencing the investment decisions of individuals and institutions both as consumers and as investors. Increased concern about the damages caused to the environment by economic activities; transparency of business activities brought about by the media and modern information and communication technologies are all contributing to the changing scenario regarding CSR. According to Green Paper (2001), "Few trends I could so thoroughly undermine the very foundations of our free society than the acceptance by corporate

officials of a social responsibility other than to make as much money for the stockholders as possible." (Friedman, 1962)

## **CORPORATE SOCIAL RESPONSIBILITY IN A GLOBAL CONTEXT**

### **CSR AND DEVELOPING COUNTRIES**

The concept of corporate social responsibility (CSR) aims to examine the role of business in society and to maximize the positive societal outcomes of business activity.

In practice, much of the business activity that has so far been labeled CSR has been driven by the concerns of investors, companies, campaign groups and consumers based in the world's richest countries. National CSR agendas in middle and low-income countries have been less visible internationally and have often not been labeled CSR. The result has been CSR practices that are largely framed in rich countries, then internationalized and transferred to other businesses and social settings through international trade, investment, and development assistance. The strategic challenge for governments at national and local levels is how best to shape an agenda that has been largely market-driven and responsive to concerns of rich country stakeholders.

Over the past years, governments, companies, and NGOs in many middle-and-low-income countries have accelerated the process of adaptation of the developed-country-driven CSR agenda through greater direct engagement. CSR movements and initiatives have emerged in countries such as China, India, South Africa, Philippines and Brazil among others. Governments of some middle-income countries facing major social challenges have explicitly sought to engage business in meeting those challenges, as with Black Economic Empowerment in South Africa or presidential encouragement of business efforts to tackle poverty in the Philippines.

In developed countries too, there is increasing recognition among companies that a 'one-size fits all' approach to CSR in operations around the world is ineffective in responding to the business drivers of socially responsible behavior. The result has been reinvigorated focus on themes of greater importance in middle and low-income countries including the value of sustainable local enterprise and the role of business in poverty reduction.

### **JUSTIFICATIONS FOR CSR**

There are two broad sets of justifications for public sector actors in middle and low-income countries to engage with CSR: **defensive** and **proactive**. The two are not mutually exclusive. A policy initiative that initially has a defensive justification may quickly become part of a proactive strategy of engagement.

The **defensive justification** relates to minimizing the potential adverse effects of CSR on local communities, environments and markets when it is imposed through international supply chains and investment. Governments of some major economic powerhouses such as China have undertaken a variety of initiatives to ensure that CSR

practices with impact in their countries are tailored to national economic and social interests.

The experience of business-to-business standards is that costs and benefits tend not to be equitably distributed along value chains, with costs of private standards borne by producers whereas benefits accrue to the retailer. These issues are partly rooted in bargaining power disparities between producers and buyers. Similarly, assurance schemes say very little about the responsibilities of sourcing companies, the burden is on the producer to comply. Depending on the strength and durability of ties, however, between buyer and supplier, the former may have an incentive to assist the latter with compliance. Further problems arise for supplier firms that have to comply with multiple, even conflicting, codes of different buyers.

The **proactive justification** for public sector actors to engage with CSR is provided by the opportunity to increase the domestic public benefits of CSR practices in economic, social, and environmental terms.

In countries whose export sectors are closely associated with consumers' social, health or environmental concerns (e.g. in agriculture and textiles), there may be positive opportunities for governments to facilitate market access gains for their producers.

**Foreign investment** offers the potential to transfer technical expertise to local enterprises. Many large companies (encouraged by governments) are interested in exploring practical mechanisms for enhancing the input of local enterprises, and locally hired workers, into their projects. In some cases, this is encouraged through investment incentives (e.g. in Nigeria) or through the terms of foreign investment contracts (e.g. with oil industry investors in Azerbaijan). In others, various kinds of partnership initiatives seek to transfer knowledge and expertise, including on environmental and social issues, between large and small companies.

Finally, a number of analysts and governments are also beginning to explore the hypothesis that promotion of CSR in the domestic economy can bring benefits for competitiveness as a whole. The extent to which this happens, however, is likely to depend on the sector and country-specific features. More broadly, there is also scope for public sector actors in middle and low-income countries to harness enthusiasm for CSR to help deliver public policy goals and priorities. These avenues will be further explored below.

## **POTENTIAL ROLES OF GOVERNMENTS IN THE CSR AGENDA**

From a sustainable development perspective, public sector engagement with CSR potentially spans social, economic, and environmental spheres, including issues of corruption, poverty reduction and human rights. The goals of public sector engagement in CSR are likely to differ from country to country. They might be structured in relation to the underlying drivers for public engagement in CSR.

A first broadly defined goal of public engagement in CSR is the alignment of business activities and public policy to achieve societal goals. A clear government vision of how it wants to address issues where there are potential trade-offs between economic, social, and environmental considerations, as in the case of the use of the country's natural resource endowment for socio-economic development, may increase the likelihood of success of corporate contribution to national development.

## **A MULTIPLICITY OF POLICY INSTRUMENTS**

CSR practice has identified five distinctive roles for public sector engagement with CSR: regulation, facilitation, partnership, endorsement, and demonstration. In practice, there are no bright lines between them, and many of the policy instruments governments wanting to promote a CSR agenda can use could be considered as expressions of more than one of these government roles.

The range of policy instruments used by governments to promote goals related to CSR is wide and reflects varying policy approaches as well as economic circumstances. Some governments may prefer interventionist approaches. Others may prefer to work with the grain of market drivers, including consumer interest or civil society pressure. The factors that may determine the course of action taken by any individual government include capacity constraints; the size of domestic markets for products potentially affected by CSR concerns; the degree of export orientation of the economy in sectors affected by international CSR drivers (e.g. agriculture, textiles, pharmaceuticals); the presence of enterprises willing to champion change; and the degree to which different stakeholders are comfortable working in partnership for commonly defined outcomes.

In the broadest sense of CSR, the entire body of social and environmental legislation in any country can be seen as an expression of public sector engagement with CSR. Other areas of legislation including competition policy, basic investment and enterprise frameworks, and rights of access to information and public participation in decision-making are also important parts of the 'enabling environment' for CSR (Source: UN Sustainable Development Innovation Brief, February 2007).

## **CSR IN INTERNATIONAL BUSINESS**

With globalization, the **international market** is showing some strong influence on the development of CSR. Multinational enterprises' activities are faced with diverse legal systems in each country coupled with new public opinion, more demands on social responsibility, sustainability and transparency. Practicing CSR on a level of sincerity that satisfies the minimum based on shareholders' opinion can make the company noticeable in local and international markets which leads to stakeholders' confidence.

The following are the different ranges of application for CSR in the international perspective where the socially responsible conduct of a corporation can assure the increase in acceptance by the stakeholders.

## **SUSTAINABLE DEVELOPMENT AND ENVIRONMENT**

There is a pressing need to promote a new economic development model that would secure the needs of the current generation without giving any concession on the chance of future generation to enjoy theirs'. As a matter of opinion, today's generation should invest in the future and therefore should stop borrowing from future generations by squandering resources at present.

From the business standpoint, the state regulations cannot always guarantee that the entrepreneurial conducts of these big enterprises are all compliant with such development model. In addition, in some cases, there are outsourcing practices and issues not only in business processes but also in labor and materials which can promote the adoption of standards lower than those prescribed in the home countries. It is in this context that the corporations should go beyond the minimum. Many studies have shown that in the medium-term, this model will bring turn out about better consumer favor, product innovations, process innovations, and the most basic of all the advantages, raw material savings.

## **HUMAN AND LABOR RIGHTS**

Corporations, particularly the larger ones, have a significant influence not only on the economy but also on the social and political life of the country in which they operate. It is therefore expected from a socially responsible behavior standpoint that corporations should be consistent with the principle of fairness and respect of basic rights. In affirmation to this, the entrepreneurial strategy of these large enterprises should be based on the following CSR demands:

### **Be Compliant**

The operational conduct of the enterprise should not be lower than the standards of the host country; for example, with regard to compliance with environmental laws, commercial laws, salaries, benefits, working conditions and many other things directly or indirectly related to any stakeholder of the enterprise.

### **Be Consistent**

Have partners of the same kind. Human and labor rights are ought to be respected anywhere and therefore, multinationals in the host countries should press hard on their partners, both local and international, to adopt the same observance and recognition of rights the enterprise is following when it does business. In this way, businesses will move on the same path towards genuine CSR practice.

To be specific, an enterprise must protect the primary rights of its workers wherever it operates and strive to observe the following:

- Refrain absolutely from making recourse to forced or obligatory labor and intimidation of any form.
- Be an advocate of the abolition of child labor.
- Respect the right of privacy and freedom of opinion.
- Respect the exercise of the political rights and of the trade union activities.

- Refrain from discriminatory treatment by reason of sex, race, religion, political opinion, citizenship or social extraction.
- Provision for fair compensation.
- Provision for a healthy and safe working environment.

However, it is hard to determine as to what extent the above standards could be justifiably attuned on the basis of peculiarities of the host countries particularly on the socio-economic aspects. For example, average employees' earnings differ on a country-to-country basis. Equal opportunity in employment may earn the loudest applauses in many countries but sadly there are still cultures in a number of host countries that are still too far off on this especially in women issue. For instance, in some parts of India, they still have the "**caste system**" which is a social stratification system that separated communities into hereditary jobs. A person borne in a caste will remain in that class unless the person does something extraordinary. These are just some of the pre- defined realities that the enterprise has to deal with in operating internationally.

### **LOCAL ECONOMY AND SOCIETY**

It is undeniable that large international enterprises can bring extraordinary impact on the development of less-developed countries. This is however not without obstacles; for instance, the disparity in technological capability; the host country's lack of capacity to adapt to these technologies that are expectedly advanced in most scenarios. This gap could prevent the local country or economy from maximizing the benefits that these technologies can bring. Another issue would be that the local entrepreneurship might be overwhelmed due to entrepreneurial crowding and higher level of competitiveness of large multinational corporations.

It is necessary to involve the stakeholders in those relevant decisions that would contribute to the development of the territory or to the host country in particular. Involving the stakeholders produces local consensus which reduces investment risks. The following are the typical examples of conduct of multinational companies considered to be responsible and have gained wide positive recognitions:

- Transfer of technology;
- The grant of licenses for the use of intellectual property rights at costs compatible with the local market;
- Granting authority to manufacture products and brands that are protected under international IP laws;
- Training for the development of local skills;
- Development of new products by means of local knowledge and skills;
- Creation of viably durable forms of collaboration with local partners; this will encourage them to gain access to the global market;
- Corporate venturing investment in the local start-up capital.

The real test on the MNCs' sincerity to develop the host economy or country is to invest in fixed asset if allowed by the host. Seeing their buildings and other fixed assets could only mean one thing, they will be here for long if not for good.

A good number of international companies have visible initiatives that can be called "CSR in action", they are manifested by giving out a portion of their income for projects like maintenance of roads, improvements of public hospitals, adoption of a school and many other activities that should have been rendered by the government. These kinds of activities would give a good feedback from the community, create a good reputation for the company and at the same time, propel the societal integration and consolidation of stakeholders and the enterprise.

## **TRANSPARENCY**

**Corporate transparency** is a form of deep-rooted managerial initiative which evolved into a philosophy of removing walls and facilitating free and easy public access to corporate information. It involves openness, communication, and accountability. **Transparent measures** include financial disclosure statements, the freedom of information legislation, budgetary review, audits and religious compliance on reportorial requirements of the authorities.

The success of a corporate policy is closely tied to its "**accountability**" which indicates its attitude "to render account" of its objectives, its activity, and its achieved results. It is a very important function because through these types of declarations the enterprise holds responsibility for what it decides and for what it does, and to some extent, it avoids acting arbitrarily.

## **LEGALITY**

The adherence to the applicable set of laws in force is the minimum requirement. The prerequisite of CSR is to go beyond the law provisions in order to contribute to the establishment of fair and sustainable development. Therefore, it is clear that a socially responsible enterprise rejects conducts and practices such as unfair competition, corruption and tax evasion that put at risk the growth and development of societies.

The enterprises that prefer a CSR strategy declare to the public and to the stakeholders that they do not participate to illegal engagements of financial market manipulations and insider trading, as well as tax evasion through the practices of transfer-pricing, facilitated by their transnational structure.

## **CONSUMERS**

Since the first environmental movements took stand in the 1960s, and in the following decades, the consumers' movements have begun to assert themselves at the international level, with the increasing support of the scientists who denounced the harmfulness of some productions for the mankind and the environment.

Consumers' organizations point out the importance of reliable information on the conditions of production and sale of the products, including any indication of the potential risks arising from their use and consumption. All enterprises know that their reputation and, therefore, their success depends on their commitment towards consumers, but those that have chosen a socially responsible behavior not only watch the consumer-stakeholder as a client, but also as a "collaborator" in pursuing their CSR strategy.

The "**aware consumption**" represents, therefore, a new approach to the social responsibility of enterprise and of consumers that are acquiring growing importance in the market by promoting a production that is safe and compatible with a sustainable and fair development. The consumers' demands not only concern health and eco- sustainability of the goods and of all the productive phases, but also the attestation that they are not produced by means of exploitation of human resources.

## **SUPPLY CHAINS**

Due to market globalization, supply chains have become very complex, often outsourced in countries where human right protection is low or there are no environmental regulations, or tolerance of hard labor is high due to absence of choices (an ugly head of exploitative conduct). This situation represents a critical point for enterprises that have chosen to adopt socially responsible conduct. The lack of ethical control over the supply chain is becoming not only a commercial risk but also a financial one.

On the contrary, companies able to guarantee the observance of ethical behaviors through the whole production cycle by binding all of their supply chain partners to their own ethical code, may have many positive effects in terms of:

- improvements in market reputation through specific certifications or quality labels;
- confidence of the ethical investors and of the consumers;
- good relations with institutions and social organizations.

## **CORRUPTION IN INTERNATIONAL BUSINESS**

According to George Soros, International Financier *"There is always somebody who pays, and international business is generally the main source of corruption."*

## **GLOBALIZATION OF CORRUPTION**

**Corruption** takes many different forms, from the routine cases of bribery or petty abuse of power that are said to "grease the wheels" to the amassing of spectacular personal wealth through embezzlement or other dishonest means.

For MNCs, **bribery** enables companies to gain contracts (particularly for public works and military equipment) or concessions which they would not otherwise have won. Every year, Western businesses pay huge amounts of money in bribes to win friends, influence, and contracts. These bribes are conservatively estimated to run to US\$80 billion a year; roughly the amount that the United Nations believes is needed to eradicate global poverty. In 1999, the US Commerce Department reported that in the preceding five years, bribery was believed to have been a factor in 294 commercial contracts worth US\$145 billion. In 1996, the magazine World Business reported that the bribes paid by German companies alone were over \$3 billion. Not just companies are involved. According to a French secret service report, the official export credit agency of France paid around \$2 billion in bribes to foreign purchasers of "defense equipment" in 1994.

Such bribery may be pervasive, but it is difficult to detect. Many Western companies do not dirty their own hands, but instead pay local agents, who get a 10% or so "success fee" if a contract goes through and who have access to the necessary "slush funds" to ensure that it does. Bribery is also increasingly subtle. It often takes the form of semi-legal fees or "commissions" and inflated or marked-up prices. In contracts guaranteed by export credit agencies, such "commissions" are included in the costs and thus, in the total contract value covered by the guarantee. "It is obvious," comments Transparency International, "that this practice constitutes an indirect encouragement to bribe which, in future, brings it close to complicity with a criminal offense." Until recently, bribery was seen as a normal business practice. Many countries including France, Germany and the UK treated bribes as legitimate business expenses which could be claimed for as tax deductions.

## **EXPORTING CORRUPTION**

The corrupt practices of multinational corporations affect other countries in many ways. They undermine development and exacerbate inequality and poverty. They disadvantage smaller domestic firms. They transfer money that could be put towards poverty eradication into the hands of the corrupt. They distort decision-making in favor of projects that benefit the few rather than the many. They also increase debt; benefit the company, not the country; bypass local democratic processes; damage the environment; circumvent legislation and promote weapons sales.

### **Increasing Debt**

Bribes increase the prices of projects. When these projects are paid for with money borrowed internationally, bribery adds to a country's external debt. Ordinary people end up paying this back through cuts in spending on health, education and public services. Often, they also have to pay by shouldering the long-term burdens of projects that do not benefit them and which they never requested.

The US company, Westinghouse Electric Corp., provides an infamous example. Westinghouse won a contract in the early 1970s to build the Philippines' Bataan nuclear plant. It was alleged that it gave President Ferdinand Marcos US\$80 million in kickbacks. The plant cost \$2.3 billion-three times the price of a comparable plant built by the same company in Korea. Filipino taxpayers have spent \$1.2 billion servicing the plant's debts-even though the plant has never produced a single watt of electricity because it was built at the foot of a volcano near several earthquake fault lines. The Philippine government is still paying \$170,000 a day in interest on the loans taken out to finance the nuclear plant and will continue to do so up to the year 2018. The Philippine Treasurer Leonor Briones commented recently:

*"It is a terrible burden which never fails to elicit feelings of rage, anger and frustration in me. We're talking of money that should have gone to basic services like schools and hospitals."*

## **Benefiting The Company, Not The Country**

Bribing high-level officials ensures profits and helps off-load risks. In many power projects in Asia, for example, there has been, according to the World Bank, both "a high level of corruption" and a tendency to overestimate demand for electricity.

In Pakistan, some 21 Western companies were investigated by the national anti-corruption agency in 1998 for alleged kickbacks to the previous government of Benazir Bhutto and for overpricing. Bhutto's government had signed so many contracts with power companies some of which were for installations in totally inappropriate locations that Pakistan was set to produce far more energy than it could possibly consume until 2010. Yet the government was contractually bound to buy all the electricity produced.

Although all the companies filed sworn statements denying corruption, six of them subsequently confessed to offering bribes. So serious were the allegations that the World Bank sent in a special team of investigators. Yet, far from receiving support from Western governments for its anti-corruption efforts, Pakistan was warned by the British, US, Japanese and Canadian governments that its clash with the power companies put off other investors. The IMF, meanwhile, went so far as to make a new package of would loans at the end of 1998 conditional on the government's dropping the charges against the companies.

## **Bypassing Local Democratic Processes**

Bribery can be a useful way of getting around local opposition to a project and of bypassing the usual democratic processes involved with awarding contracts. Take, for example, the Norwegian mining company, MINDEX, that wants to carry out a nickel and cobalt strip mining on the Philippine Island of Mindoro. The local population believes the mine will seriously damage the environment and ruin their communities.

MINDEX has responded by attempting to buy off local leaders. It gave gold watches to local politicians at a critical stage of the project's Environmental Impact Assessment, which had to prove that the mine was socially acceptable to local people. MINDEX has also paid for local district leaders to go on a "study tour" to a luxurious holiday island, built a new house for a local priest and paid local journalists to write articles favorable to the company. MINDEX claimed the gifts are "signs of friendship." Local people, who oppose MINDEX, believed that such gifts are attempts to manipulate the local tradition of "**utang na loob**" or "**debt of gratitude**" towards those who carry out small acts of generosity and could be against Filipino law.

MINDEX has also gathered local signatures given to mark attendance at a meeting and used them to indicate local support for the project. At least one signature was actually a protest against MINDEX's project. The Mindoro Clergy felt obliged to issue a disclaimer:

*"We refute the categorical statement of MINDEX that the local population of Oriental Mindoro welcomes the mining project. Our people have consistently manifested their strong opposition to mining operations in a series of protest actions... We are one with our people in declaring our vehement opposition against mining activity in our province."*

## **Destroying the Environment and Getting Around Regulations**

Some companies use bribes as a way of getting around environmental regulations. A report into logging in Papua New Guinea in the 1980s reported that companies were "roaming the countryside with the self-assurance of robber barons: bribing politicians and leaders, creating social disharmony and ignoring the laws in order to rip out and export the last remnants of timber." In May 2000, meanwhile, the Asian Development Bank warned that the forests in Cambodia were in an "alarming state" because of corruption. Environmentalists have warned that, at the current rate of destruction, Cambodia's forests will be gone by the year 2003.

Sometimes such bribes come in the form of illegal political donations. A 1999 audit by the Nicaraguan government revealed that a Canadian mining company, Greenstone Resources, which controls 70% of the mining areas of Nicaragua, donated \$20,000 to President Arnoldo Aleman. The company was alleged to have made further donations to other people in Aleman's Constitutional Liberal Party and bribes to local officials in the area where Greenstone was mining. Nicaraguan law states that donations can be given only by Nicaraguan citizens from within the country.

In return for its money, Greenstone has consistently been allowed to get away with flouting environmental laws and regulations. It carries out massive illegal logging around the mining area and pollutes water sources and the local environment at the expense of local people's health. Says Magda Lanuza, a Nicaraguan activist:

*"You can smell the cyanide when you are near mine. Children have headaches, and there are other health problems. The technicians who visited the area with us say the water is harmless but when we ask them to drink it, they refuse."*

Despite such evidence, Greenstone has received favorable environmental impact assessments from Nicaraguan officials. The Ministry of Environment personnel visit the firm's sites only when the company wants them and pays them to do so.

## **Promoting Arms Sales**

Half the bribery complaints received by the US Commerce Department concerns international defense contracts. A 1999 report noted that allegations of bribery were made in 55 contracts between 1998-1999 worth some US\$37 billion (£23.6 billion) in total. Swedish armaments manufacturer, Bofors, was involved in "the biggest bribery scandal in the history of independent India". In 1986, the Indian government paid Bofors \$1.3 billion (£802 million) for 400 Howitzer field guns for the Indian army. Within months of the weapons being delivered, Swedish radio claimed that £30 million worth of kickbacks had been paid to Prime Minister Rajiv Gandhi and his associates. In June 1988, the Indian press published documents from the Swedish auditor-general identifying shell companies that had allegedly channelled Bofors' pay-offs. In October 1999, the Indian Central Bureau of Investigation brought charges of "criminal conspiracy" against Indian business people and Bofors middlemen and employees. Whatever the outcome of this court case:

*"The affair has been disaster for the sub-continent. With all the juicy allegations of larceny and intrigue to savour, it is easy to forget that Bofors guns added to the ever-growing armouries of India and Pakistan, which now face each other in an unstable*

*nuclear 'balance of power'... The consequences for Indian democracy have been as dire... The Bofors scandal led to Rajiv Gandhi's defeat in the 1989 general election and the emergence of the BJP as the dominant Indian party."*

## **HIDING THE LOOT**

### **Western Banks and Third World Assets**

"**Money laundering** is the handmaiden of international corruption... Those who take bribes must find safe international financial channels through which they can bank their ill-gotten gains. Those who provide the bribes may well assist the bribe takers to establish safe financial channels and launder the cash." - *Frank Vogl, Transparency International*

"America cannot have it both ways. We cannot condemn corruption abroad, be it officials taking bribes or looting their treasuries, and then tolerate American banks making fortunes off that corruption." - *US Senator Carl Levin*

Private banking services and offshore financial centers are the major conduits and repositories for bribes and corrupt gains. An estimated US\$40 billion from poor and former communist economies finds its way into US or European banks every year, much of it illegitimately gained. Some \$30 billion of Western aid "used as part of the Cold War game of winning friends" has ended up in Swiss bank accounts alone. Leaders from some African countries have collectively had up to \$20 billion on deposit in Switzerland's banks. Haiti's "Baby Doc" Duvalier is known to have kept \$300 to \$900 million in offshore banks while Philippine President Marcos salted away well over \$2 billion in Western banks.

### **Private Banking**

Today, private banking, increasingly used for confidential services to international elites, is believed to be worth as much as \$17 trillion worldwide and is experiencing phenomenal growth. Globally, private banking is predicted to grow two to three times as fast as ordinary consumer banking in the next few years.

The private banking boom has its origins in the debt crisis and is a major reason for the continued indebtedness of many poor countries. Because of the debt crisis in the late 1980s onwards, Western banks had fewer opportunities to lend to Third World countries and thus started to pursue wealthy individuals in the Third World to encourage them to place their wealth in private bank accounts. The result was a revolving door. International loans to developing countries were creamed off by those in power and "transferred into banks... ironically often to 'private banking' branches of the very same international banks that had issued the international loan... in the first place." This has been at least as profitable for the banks as for the individuals making the deposits. The average rate of return to banks for private banking accounts is over 20%.

An estimated 80% of loans made by commercial banks during the 1980s never reached their destined countries, remaining instead in US bank accounts. In Latin America, two-thirds of total debt is thought to have been deposited in US banks.

Although the private banking boom is a global phenomenon (in Latin America, for example, the market is already estimated at \$450 billion), the biggest beneficiaries have been US banks. According to Raymond Baker, a financial specialist at the Brookings Institute, the "US has, according to all credible estimates, become the largest repository of ill-gotten gains in the world," not least because of lax or inadequate oversight. A 1999 US Senate inquiry revealed that 350 of Citibank's 40,000 clients were senior foreign government officials or their relatives, including:

- President Omar Bongo of Gabon, who transferred \$100 million through personal accounts in Citibank's New York branches. Bongo had two private accounts in the name of shell (or dummy) corporations as well as a special account to receive payments from oil companies (which included alleged bribes or "donations" from the French government's oil company Elf- Aquitaine). Citibank made more than \$1 million a year net from Bongo's accounts.
- Asif Ali Zardari, the husband of former Pakistan prime minister, Benazir Bhutto, who transferred some \$40 million through Citibank accounts, of which \$10 million is believed to be from kickbacks on a gold importing contract.
- The three sons of Nigeria's General Sani Abacha, who held some \$110 million in Citibank accounts, including some in the name of shell corporations set up by Citibank. The bank lent the two sons \$39 million to deposit in another bank account in Switzerland after the new Nigerian government began investigations into corruption in 1998.
- Raul Salinas, the brother of former Mexican President Carlos Salinas, who transferred \$80 to 100 million in alleged drug money out of Mexico between 1992 and 1994 through Citibank's accounts.

In Switzerland, too, private banks still hide the assets of Bongo's and Abacha's families, as well as those of Mali's Moussa Traore and Zaire's Mobutu Sese Seko. The private banking department at UBS, meanwhile, handles accounts for the family of Kenyan President Daniel Arap Moi.

### **Offshore Banks and Companies**

*"There is no honest reason for being offshore. Bank secrecy and the offshore money industry have no place in a globalized economy."- Jack Blum, Offshore Expert & UN Consultant*

Offshore banks and companies are another part of the system through which money is siphoned out of poor countries and hidden well away from its citizens. Offshore financial centers became prominent in the 1960s with bank deposits in tax havens increasing from \$11 billion in 1968 to \$385 billion in 1978. By 1989, there was an estimated \$1.5 trillion offshore; by 1998, \$5 trillion. In 1999, accounts in some 61 offshore centers around the world held \$8 trillion. In the Caribbean and South Pacific Islands alone, the OECD found that deposits had increased five-fold between 1985 and 1994, to \$200 billion.

Since the 1980s, offshore finance centers or tax havens have been a magnet for money from Third World countries, both clean and dirty. In the mid-1980s, a Morgan Guaranty Trust study of "capital flight" from developing countries found that, in one year alone, a total of \$198 billion disappeared offshore from 18 developing countries. Offshore centers impose little or no taxes, offer themselves to non-residents to escape taxation in their own country, do not exchange information, lack transparency, and attract shell companies-businesses "with no substantial activities."

Because of the secrecy with which they operate, offshore centers have become excellent places to launder the proceeds of crime and corruption. They have been implicated in almost all money-laundering schemes. In 1996, the IMF estimated that \$500 billion-between 2 to 5% of global GDP-is laundered offshore every year. Three years later, the IMF put the figure at anywhere between \$590 and \$1,500 billion. A 1997 UN report likewise calculated that laundered global revenues from corruption, fraud, pornography, and prostitution stood at between \$500 billion and \$1,000 billion. Arms dealers also often use offshore bank accounts to hide their tracks.

When dirty money disappears offshore, it becomes more difficult for governments to tackle corruption. The power of crime mafias grows, bringing yet more corruption in its train and helping to turn the country into a "mafia state."

In some offshore havens, new companies can be set up for as little as £100. Companies such as this, which can be set up in as little as 24 hours, are not required to file annual returns or accounts, or to disclose ownership. In fact, in some offshore centers, it is a crime to divulge any information about the ownership of banks, depositors or shareholders of an offshore business. Not surprisingly, wealthy criminals hold much of their money in such companies rather than as individuals. Who these companies really represent becomes even more difficult to trace when they are owned by yet other offshore companies in different jurisdictions.

## **RECOVERING STOLEN WEALTH**

International pressure has been mounting in recent years to return money which has been stolen from public treasuries and stashed away in Western banks and offshore tax havens. Several precedents exist for the return of such funds:

- In 1998, US\$500 million of former Philippine President Ferdinand Marcos' money was returned from Swiss banks to the Philippine government. The Presidential Commission on Good Government set up after Marcos was deposed has recovered overall some \$1 billion of the \$5 billion that the Marcos family squirreled away.
- In March 1999, the High Court in London ordered the freezing of all accounts belonging to former Nigerian ruler Seni Abacha's family. In October 1999, the Swiss government called on five banks to freeze several accounts held in the name of Abacha's son, Mohammed, and thought to contain hundreds of millions of dollars plundered from the Nigerian central bank and oil revenues. In January 2000, Swiss banks froze £390 million in accounts belonging to Abacha and his

associates. Four months earlier, the Nigerian government had announced that it had already managed to recover some \$700 million of Abacha's money. In all, Abacha is believed to have stashed \$1.5 billion in embezzled funds in Western banks.

- In November 1999, the Bank of England identified and froze the London bank accounts of Angola's rebel leader, Jonas Savimbi, who was until recently aided and abetted as an anti-communist "freedom-fighter" by several Western governments, including those of the US and UK.

## **CLOSING THE LOOPHOLES**

More sweeping attempts to recover stolen money will require both promulgating an international convention and closing loopholes that allow ill-gotten gains to leave countries in the first place.

Closing down offshore centers is vital to stopping the laundering of corrupt money and the draining of resources from the Third World. In poorer countries, however, the process will have to be gradual, in order to provide time to build up other local industries. Many small Caribbean and other islands and small states set up offshore centers in the first place only because they needed to diversify out of tourism and agriculture. In the meantime, public disclosure of offshore corporate ownership, as well as filing of company accounts, is an urgent necessity.

## **BLACKLISTING COMPANIES**

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." As of May 2000, there were 54 companies on this list, 36 of them British-by far the biggest country representation on the list.

The UK government could and should take action against companies sanctioned by the World Bank. It could also take steps to help ensure that no Western or OECD company sanctioned by an international financial institution such as the World Bank, or prosecuted in any country in the world, obtains contracts with other international or national institutions. This should particularly apply to contracts with UK government departments such as the Department for International Development (DfID) and the Export Credit Guarantee Department (ECGD). The UK government could also ensure that there are binding anti-corruption clauses or corporate compliance programs in all contracts at a national and international level.

At a broader level, concerted international action on corruption could include creating an international database of 'blacklisted' companies which governments around the world could use when deciding to whom they should award a contract. Such a database could be held at the United Nations, by UNCTAD (UN Conference on Trade and Development), for instance. A model already exists, held by the Information

Coordination Group (ICG), an organization set up by five oil companies to combat illegal information brokering.

The ICG has a database of 2,500 entries gathered from participating companies and other international sources on individuals and companies known or alleged to have been involved in procurement irregularities around the world. Law enforcement agencies already have access to this database and companies use it to make "integrity checks" before pursuing contracts.

NGOs are also calling for an international public index or ranking of corrupt companies. At the moment, the international anti-corruption NGO, Transparency International, publishes an annual bribery perceptions index. The index ranks countries rather than companies. Since it is not countries that do the bribing, this index remains fundamentally flawed.

## **GOVERNMENT ACTION**

All governments need to clean up their act, but they need to do so in an environment in which donors are not imposing inappropriate, over-hasty policy changes; in which resources and time permit genuine participation in social and economic decision-making; and in which international agencies are not adding to the incentives for corruption.

Any successful anti-corruption program has to be built up at a national level, be appropriate to local and national contexts, and have full support from government employees at all levels. In addition, as a 1998 Commonwealth report on corruption argues:

"Action programs need to be designed to meet the expectations of citizens, who need to be informed about the national strategy to combat corruption. Effective action to fight corruption is most likely through programs which are nationally owned, designed to meet national circumstances and built on the foundation of popular empowerment."

Imposing anti-corruption strategies by putting conditions on loans will not work and may even lead to governments implementing cosmetic changes which, at best, do little and, at worse, undermine the anti-corruption efforts. In Uganda, for instance, the Ministry of Ethics and Integrity is seen by some observers as merely a showpiece created to appease creditors who demanded action on corruption. Its responsibility is uncertain and clashes with those of other departments engaged in developing an anti-corruption strategy such as the office of the Inspector General of Governance and the office of the Auditor General. The new Ministry may even draw resources away from these desperately under-resourced bodies and, by diffusing responsibility across government, actually reduce the effectiveness of their work.

In some instances, governments may not be politically committed to reform. But as the Commonwealth report on corruption notes, "where governments are less than enthusiastic in tackling corruption, popular support and the agencies of civil society can still be mobilized in support of an anti-corruption agenda."

Several NGOs are doing just this by, for example, monitoring debt relief funds to see if they are being spent on poverty reduction measures; mobilizing ordinary people and raising awareness; and developing the monitoring capacity of local civil society to keep local governments accountable in a context of decentralization.

In Nicaragua, a new anti-corruption movement, Citizen Action Against Poverty and Corruption, has organized popular marches against corruption; is campaigning to get the President and other ministers and politicians to declare their personal income; and is in the process of producing a popular manual on corruption, which will be disseminated at "corruption hearings."

In Uganda, local civil society organizations including the Uganda Debt Network and the International Anti-Corruption Theatre Movement organize an anti-corruption week every year during which public meetings, plays and a march are held in a general attempt to raise awareness about corruption and existing laws holding politicians and ministers accountable.

One of the most successful grassroots anti-corruption movements is the Indian Mazdoor Kisan Shakti Sangathan (MKSS) or Workers and Farmers' Power Organization in Rajasthan. Since 1988, the MKSS has been organizing with local people to demand access to local government accounts and records. It holds public hearings to examine local development works and to check whether the accounts match up to actual spending. So successful have these hearings been that Sarpanches or local leaders exposed in the hearings as fiddling the books have returned the stolen money.

## **DETERRENTS**

Economic punishments are some of the most effective deterrents to corruption. In Singapore, a middleman was convicted in 1996 of paying bribes totaling US\$9.8 million on behalf of Siemens, Pirelli, BICC, Tomen and Marubeni. Not only did the government ban all five companies from bidding for any government contracts for five years. It also banned "firms associated with the five companies, any new company that the firms may jointly set up, and firms that share the same directors as the five."

Opening development projects to more public scrutiny can be another effective deterrent. In the state of Kerala in south India, a new local government structure, based on massive public participation, has been acclaimed, even by the World Bank:

*"Kerala's decentralization programme is probably the largest of its kind in the world. Three million people (10% of the State's population) take part in meetings. This is a far-reaching, innovative, and courageous new approach to rural development and local governance... It reflects a profound commitment to a total*

*change in which governments govern to empower disadvantaged groups to voice their demands, and to make institutions responsible and accountable to them."*

The system includes massive devolution of funds to local meetings, which are required to draw up plans for deploying them, and a concerted effort to maximize public attendance at such meetings. Eight key democratic principles are central, including: "maximum direct participation of the people; accountability (continuous social auditing of performance) and transparency through the right to information."

The potential for corruption, a problem before the new system, is minimized by a commitment to transparency and openness of all documents and decisions. As The Hindu newspaper notes:

*"Total transparency is the only way to check the danger of decentralization degenerating into decentralization of corruption. All documents on beneficiary selection, reports and minutes of meetings and all documents on works undertaken by the local bodies through contractors and beneficiary committees including bills and vouchers are public documents. Copies are available on payment of a fee."*

In Thailand, meanwhile, a new constitution has strengthened the democratic rights of local communities, illustrated by electricity generation. Before 1997, governments, multinational companies and the World Bank had pushed electricity privatization by building independent power plants with little regard to the interests of local people. The violent breakup of any opposition would often have been the end of the issue. As a result of the 1997 constitution, however, large development projects are now subject to public hearings, and local councils, which are now elected rather than appointed, must give their consent to such projects.

## **RESISTANCE**

Fighting corruption is increasingly engaging the energies of civil society groups around the world. To be effective, they must:

### **Mobilize Ordinary People**

Civil society groups will need to be prepared to take on governments in innovative and sometimes confrontational ways. They will also need to be committed to being transparent and accountable themselves.

### **Push for Freedom of Information (FOI)**

Enable ordinary people to use information. Only if they have the relevant knowledge can citizens hold their governments accountable and ensure that resources that belong to them are used in the right way.

### **Help Increase Citizen Participation in Decision-Making**

In Uganda, a popular phrase is *abantu babisi*, meaning "people who do not know what is going on." It is used to show mistrust of government decisions. Greater participation by groups that represent the poor is a must in decision-making at every level, local, regional, and national. Greater citizen participation is also required in monitoring

and auditing public expenditure. Civil society groups need to play a “critical auditing function. . . if they are to hold the state accountable to their poorer citizens.” In many countries, opposing privatization—for example, water privatization plans in Panama and Brazil—has proved to be one way to remove potential sources of corruption. Where work is put out to tender, it is critical to ensure that there is always an “in-house bid” from the public sector to set against any private contractors’ bids, something that the UK Office of Fair Trading recommends as a key method for avoiding being cheated by a cartel. Ensuring that such bids are made also makes it difficult for a contractor to buy a contract at an artificially inflated price.

Cracking down on bribery will not necessarily make international business more accountable. Nor will it end corruption overnight. But it will help send a clear message that the international community is intent on restricting the “supply side” of bribery. Companies must not be allowed to continue to behave in unethical ways that undermine local democracy and development.

(Source: Exporting Corruption – Privatization, Multinationals and Bribery by Sue Hawley, [cornerhouse.icaap.org](http://cornerhouse.icaap.org)).

### **Textbook:**

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