

U4 Expert Answer



Literature review on corruption in cross-border business

Query

Could you please provide an overview on the different forms of corruption in cross-border business, both with regards to the implication of public authorities and the private sector? I would appreciate a review of relevant literature, if possible including academic literature.

Content

1. Corruption at the border and in customs authorities
2. Corruption, money-laundering and international financial flows
3. Multinational firms' involvement in corruption

Caveat

Given the urgency of the request, this paper only gives a snapshot of existing literature. The list should not be considered exhaustive. Moreover, from the public sector perspective, it mostly looks at the involvement of customs and border control authorities. It should be noted that cross-border business operations can also involve other public authorities, similarly to domestic business activities.

Summary

The globalisation of the economy has led to an increase in cross-border business transactions involving on one hand countries with different laws on bribery and corruption, and on the other hand multinational companies with different ethical and business conduct standards. This creates vulnerabilities, grey areas and opportunities for corruption.

This paper provides an overview of literature regarding corruption in public authorities involved in cross-border business, namely border control and customs; corruption in the supply chain; corruption risks related to cross-border financial flows and money-laundering; and companies involvement in bribery.

Author(s): Sofia Wickberg, Transparency International, swickberg@transparency.org
Reviewed by: Dieter Zinnbauer, Ph.D., Transparency International, dzinnbauer@transparency.org
Date: 22 August 2013 **Number:** 391

U4 is a web-based resource centre for development practitioners who wish to effectively address corruption challenges in their work. Expert Answers are produced by the U4 Helpdesk – operated by Transparency International – as quick responses to operational and policy questions from U4 Partner Agency staff.

1. Corruption at the border and in customs authorities

Corruption in border control and customs authorities is quite common. 15% of the respondents to Transparency International's [Global Corruption Barometer 2013](#) who interacted with such institutions reported having paid a bribe to the customs/tax authorities in the last 12 months.. Similarly, almost 15% of firms interviewed by the World Bank's [Enterprise Survey](#) expected to have to give gifts in order to obtain an import licence.

The discretionary power of officials and their monopoly over the flow of persons and goods, combined with weak accountability and difficult supervision are some of the reasons explaining the incidence of corruption in customs authorities.

Corruption in border control and customs authorities most often manifests itself either as a collusive form of corruption to avoid taxes and tariffs (e.g. the company offers the bribe), or as coercion to speed up routine procedures (the public official requests the bribe).

Displacing corruption: evidence from a Tariff liberalisation programme

Sequeira, 2013

http://personal.lse.ac.uk/sequeira/Displacing_Corruption_Sequeira.pdf

The author uses the data set from her previous empirical study on 1,300 shipments to analyse the effect of a progressive tariff-lifting that took place in 2007-2011. She shows that the reduction in tariff rates was associated with a significant decline (60%) in bribery to customs officials for tariff evasion on imported goods. However, this also led to a 70% increase in average bribes per transaction, which can be considered the consequence of a displacement from collusive to coercive forms of corruption. This displacement effect can have an economic impact, as firms are likely to adjust their sourcing strategy accordingly and source a higher percentage of their input domestically, with potential implications on firms 'performance. This important substitution effect may diminish the long run impact of trade liberalisation and tariff reduction on bribery, as corrupt officials adapt and find other bribe extortion strategies.

Study on anti-corruption measures in EU border control

Center for the Study of Democracy, 2012

http://www.frontex.europa.eu/assets/Publications/Research/Study_on_anticorruption_measures_in_EU_border_control.pdf

This study starts by identifying the main forms of corruption in border guard services across the EU, including organised crime related corruption (selling information, facilitating the passage of illicit goods, obstructing investigations), petty corruption in the form of border traffic extortion to speed up/facilitate routine processes and administrative corruption (kickbacks, nepotism-based recruitment and promotion, etc). While in a small number of countries there are specific anti-corruption measures and codes of conduct designed for border guards, in most countries, there is no specific anti-corruption infrastructure in place targeting border services, which are subject to broader public sector measures and policies.

What do we know about corruption (and anti-corruption) in customs?

Michael and Moore, 2010, World Customs Journal

<http://www.worldcustomsjournal.org/media/wcj/-2010/1/Michael-Moore.pdf>

This article discusses lessons learned in the last decade in fighting corruption in customs. The authors suggest that some basic elements of anti-corruption prevention and enforcement need to be in place for customs to be effective. This includes criminalising corruption, measuring and mapping corruption risks, adopting codes of conduct for customs officials, setting up internal inspectorates, conducting internal audits, requiring assets declarations and conflicts of interest statements from customs officials, handing internal investigations, recording and monitoring data such as import times, inspectors name, etc to create the paper trails needed for domestic and international investigations. The authors conclude with the need for more research to understand the impact of such measures in different contexts and the underlying causes that prevent some countries to make progress in fighting corruption in their customs administration.

The challenge of combating corruption in customs administrations

Ferreira, Engelschack and Mayville, 2007

<https://openknowledge.worldbank.org/bitstream/handle/10986/6848/399850REPLACEM101OFFICIALOUSE00NLY1.pdf?sequence=1>

Given the monopoly of customs over the flow of goods, the potential for corruption in customs administration cannot be overstated. After providing an overview of the detrimental impact of customs corruption on a country's revenue collection, trade operations, competitiveness, importation of illegal goods, smuggling, organised crime and security, the authors provide a customs corruption risk map with examples of integrity challenges for selected customs functions. For each customs function selected by the authors, ranging from processing declarations, assessing goods, inspecting cargos to conducting post-clearance audits, a number of forms of corruption are described, involving bribery of customs officials.

Integrity in Customs

McLinden Gerard, 2005, Customs Modernization Handbook , World Bank

Similarly to other studies, the author notes that customs authorities are vulnerable to corruption because the nature of the work puts customs officials in situations in which they have sole authority and responsibility to make various important decisions, in an environment where supervision and accountability are difficult.

The study gives an overview of various forms of corruption in customs authorities, mainly "routine corruption" where private agents bribe the authorities to speed up routine procedures, "fraudulent corruption" whereby customs officials are paid to turn a blind eye on illegal practices often involving taxation, and "criminal corruption" that involve purely criminal activities such as trafficking. The author also differentiates between "petty corruption" generally involving junior staff, "grand corruption" involving senior officials and nepotism within the administration. He also cites misappropriation as a form of corruption happening in customs authorities which includes a wide range of behaviour such as theft, embezzlement, falsification of records, and fraud.

Corrupt behaviour can range from the individual to the widespread and systemic. Many observers note that corruption in customs is often well organized into networks, with members of the networks sharing the

obligation of distributing the profits from corrupt practices with colleagues and superiors.

2. Corruption in the supply chain

The supply chain is a central element of companies' operations and presents several risks and opportunities for corruption, especially for Multi-National Companies (MNCs), particularly for those that operate in countries where governance is weak. Operating across borders and in multiple jurisdictions increases corruption risks. Factors increasing corruption risk for MNCs include: lack of information regarding local regulations; weak or poorly enforced corporate compliance systems; poor implementation of anti-corruption and anti-bribery legislation in many countries; resource imbalances between MNCs and certain developing countries governments; and other factors.

Fighting Corruption in the Supply Chain: a guide for Customers and Suppliers

United Nations Global Compact, 2010

http://www.unglobalcompact.org/docs/issues_doc/Anti-Corruption/Fighting_Corruption_Supply_Chain.pdf

Global business is accomplished through the elaborate networks of the supply chain — the persons, entities and infrastructure that transform materials and human capital into intermediate and finished products and services for customers and consumers. This report demonstrates how the problem of corruption affects every business in the supply chain.

Businesses face very significant corruption risks in their supply chains. One significant category of this risk stems from instances of collusion between suppliers, and government officials, such as kickbacks, fraudulent billing and various fraudulent purchasing and sales schemes. Businesses also face the risk that suppliers may engage in corrupt practices involving governments and other public actors, corruptly bypassing health and safety requirements, avoiding necessary licensing, or otherwise evading legitimate law enforcement.

According to this report, in countries with high levels of corruption, the supply chain for MNCs very often consists of small and medium size local businesses. These businesses typically have a more direct experience with corruption because they face more opportunities. And as smaller businesses, they may lack the leverage to resist corruption and influence local institutions for change.

Managing Corruption Risks among Suppliers and Distributors
LRN, 2010

<http://www.lrn.com/operational-guidance-whitepapers/managing-corruption-risks-among-suppliers-and-distributors>

Global business is accomplished through the elaborate networks of the supply and distribution chain and, increasingly, companies – particularly large multinational companies (MNCs) – are being held responsible, both legally and in the court of public opinion, for the corrupt activities of their suppliers and distributors.

Corruption in the supply chain can be very costly to firms. According to this paper, the costs of corruption go well beyond bribery of public officials. Fraud, embezzlement and commercial bribery add extraordinary burdens to business independent of any connection to governments. Corruption makes business far more costly by imposing huge inefficiencies and obstacles to growth.

From vulnerable to valuable: how integrity can transform a supply chain
PriceWaterhouseCoopers, 2008

http://www.pwc.com/en_US/us/supply-chain-management/assets/pwc-sci-112008.pdf

PricewaterhouseCoopers surveyed supply chain managers from 59 global consumer and retail companies, large brand-owners particularly sensitive to both the reputational and operational risks of supply chains, and 61% of them identified challenges to business ethics (corruption, money-laundering etc.) as the most significant risk to their business. Corruption can lead to supply share disruption and, as this report shows, this can be very costly for companies that can see their average shareholder value plummeting.

3. Corruption, money-laundering and international financial flows

Cross-border business operations and related financial transactions can create a venue for trade-based money laundering. The international trade system is subject to a wide range of risks and can be exploited by corrupt agents and criminal organisations. Illicit transactions can be obscured by the complexity of foreign exchanges and the large volume of trade flows, making

it possible to move money covertly from one jurisdiction to another, circumventing government scrutiny. This section presents two articles describing trade-based money laundering.

Trade-Based Money Laundering and Terrorist Financing

Zdanowicz John, 2009

<https://datapro.fiu.edu/campusedge/files/articles/zdanowicz3008.pdf>

Money laundering can be defined, generally, as the process of concealing the existence, illegal source, or application of income derived from a criminal activity, and the subsequent disguising of the source of that income to make it appear legitimate. Deception is the heart of money laundering. The use of international trade to move money, undetected, from one country to another is one of the oldest techniques used to circumvent government scrutiny. International trade as a means of laundering money is also a technique generally ignored by most government law enforcement agencies.

This article details how false international trade invoicing is used to move money across borders, undetected. This research details how the statistical analysis of the U.S. trade database can assist in measuring illegal money flows. It also details some statistical techniques that may be used to detect and monitor these abnormal transactions

Trade-based money-laundering
Financial Action Task Force, 2006,

<http://www.fatf-gafi.org/media/fatf/documents/reports/Trade%20Based%20Money%20Laundering.pdf>

Trade-based money laundering is defined by the FATF as the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimise their illicit origins. In practice, this can be achieved through the misrepresentation of the price, quantity or quality of imports or exports.

The international trade system is clearly subject to a wide range of risks and vulnerabilities that can be exploited by criminal organisations and terrorist financiers. In part, these arise from the enormous volume of trade flows, which obscures individual transactions; the complexities associated with the use of multiple foreign exchange transactions and diverse trade financing arrangements; the commingling of legitimate and illicit funds; and the limited resources

that most customs agencies have available to detect suspicious trade transactions.

This study provides a number of case studies that illustrate how the international trade system has been exploited by criminal organisations. It concludes that trade-based money laundering represents an important channel of criminal activity and, given the growth of world trade, an increasingly important money laundering and terrorist financing vulnerability.

4. Multinational firms' involvement in corruption

This section briefly presents the role of the private sector and international firms in corruption, as well as some legal instruments against bribery in international business transactions. Companies are generally the supply side of corruption, or the bribe-giver. There are however forms of corruption where companies are on both sides of the corrupt transaction; this has been named commercial bribery or private-to-private corruption. The third part of this section presents this type of corruption, which is emerging as an area of study.

An increasing amount of academic research has focussed on the factors that influence the incidence of bribery, from a private sector perspective. The articles below demonstrate that both the characteristics of the firm itself (size, educational profile of staff, sector of operation etc.) as well as the environment in which they operate, especially in cross-border transactions, have an impact on the propensity of business people paying bribes.

Firm behaviour and propensity of firms paying bribes

Corruption and firm behaviour Sequeira, Djankov, 2013

http://personal.lse.ac.uk/sequeira/Corruption_Firm_Behaviour_Sequeira_Djankov.pdf

This paper investigates how corruption affects firm behaviour. Firms can engage in two types of corruption when seeking a public service: cost-reducing "collusive" corruption and cost-increasing "coercive" corruption.

Using an original and unusually rich dataset on bribe payments at ports matched to firm-level data, the

authors observe how firms respond to each type of corruption by adjusting their shipping and sourcing strategies. "Collusive" corruption is associated with higher usage of the corrupt port, while "coercive" corruption is associated with reduced demand for port services. The results of this study suggest that firms respond to the opportunities and challenges created by different types of corruption, organizing production in a way that increases or decreases demand for the public service. Understanding how firms respond to corruption has important implications for how we conceptualize, identify and measure the overall impact of corruption on economic activity.

Transparency International, 2011

Bribe Payers Index

<http://bpi.transparency.org/bpi2011/results/>

Foreign bribery has negative effects on both the public well-being around the world as well on the companies themselves. It distorts the fair awarding of contracts, reduces the quality of basic public services, limits opportunities to develop a competitive private sector and undermines trust in public institutions. Moreover, engaging in bribery also creates instability for companies themselves and presents ever-growing reputational and financial risks.

This report ranks 28 of the world's largest economies according to the perceived likelihood of companies from these countries to pay bribes abroad, based on the views of business people. It examines different types of bribery across sectors – including bribery among companies (private-to-private bribery).

Bribery in International Business Transactions

Baughn Christopher, Bodie Nancy L., Buchanan Mark A. and Bixby Michael B. , 2010, *Journal of Business Ethics* Vol. 92, No. 1

Globalization leads to cross-border business transactions between societies with very different norms and regulations regarding bribery. Bribery in international business transactions can be seen as a function of not only the demand for such bribes in different countries, but the supply, or willingness to provide bribes by multinational firms and their representatives. This study addresses the propensity of firms from 30 different countries to engage in international bribery. The study incorporates both domestic (economic development, culture, and domestic corruption in the supplying country) and international factors (those countries' patterns of trade

and involvement in international accords) in explaining the willingness to bribe abroad. The propensity to provide bribes was the lowest when corruption was not tolerated in the multinational firms' home countries, when the firms' countries were signatories of the Organization for Economic Cooperation and Development (OECD) anti-bribery convention, and when those countries traded heavily with wealthier nations. Further, these findings are maintained when controlling for levels of economic development and cultural values in the supplying country. In terms of culture, firms from high power distance countries showed a somewhat greater propensity for providing bribes in transactions with less-developed nations.

Corruption in International Business.
Understanding the impact of anti-corruption measures on company practices and attitudes
 Carr Indira, Outhwaite Opi, 2009, *Agora Without Frontiers* 2009

This paper provides an overview of the findings of a number of empirical surveys on corruption carried out primarily by large auditing or business services firms that examine business attitudes and practices with respect to corruption. The level and experience of corruption varies between surveys, interviewed companies and countries of operations but the authors note that exposure to corruption is systematically put forward as a concern. According to a 2008 PwC survey, interviewed business people listed the most prevalent forms of corruption as follows: indirect payments made through agents, intermediaries or other third parties, followed by inappropriate gifts, payment in company products or services, sponsorships or donations to a particular cause, political donations and bribes made via a corporate or employee credit card.

The findings of the surveys chosen by the authors suggest that at least half of businesses have little or no awareness of key anti-corruption legislations.

Factors Influencing the Incidence of Bribery Payouts by Firms: A Cross-Country Analysis,
 Chen Yanjing, Yaşar Mahmut and Rejesus Roderick M., 2008, *Journal of Business Ethics*, Vol. 77, No. 2

This article attempts to explain what makes firms pay bribes in their operations by exploring micro (dependency on public infrastructure, firm size, activity etc.) and macro level variables (population size, years of schooling etc.) that influence the incidence of bribery. The authors use a rich dataset covering 55 countries and the result of the study demonstrate that various

factors have an impact on the inclination of firms to bribery pay-outs, ranging from the characteristics of the company itself to the environment(s) in which it operates.

Legal framework against foreign bribery

Exporting corruption progress report 2013: Assessing enforcement of the OECD convention on combating foreign bribery
 Transparency International, 2013
http://www.transparency.org/whatwedo/pub/exporting_corruption_progress_report_2013_assessing_enforcement_of_the_oecd

Transparency International's annual report on foreign bribery enforcement presents an independent assessment on the status of enforcement in all of the 40 Parties to the Convention. Results of the report indicate that in half of the countries there is little or no enforcement against foreign bribery and show that Germany, the United Kingdom and the United States have the most active enforcement. The report provides country studies for each of the parties to the convention, as well as recommendations on ways forward.

Trends in anti-bribery laws
 Martini Maira, 2012, Transparency International,
http://www.transparency.org/files/content/corruptionqas/24_Trends_in_Anti-Bribery_laws.pdf

The OECD Anti-Bribery Convention and the United Nations Convention against Corruption (UNCAC) have played a major role in triggering and guiding recent domestic reforms. The criminalisation of foreign bribery is among the most important trends that can be detected in these new regulations, with the majority of countries either criminalising foreign bribery (e.g.: China, Russia, Chile), or clarifying the scope of existing laws (e.g. Spain, Ireland, Israel). The issue of corporate liability also emerges as a trend, with a significant number of countries introducing criminal liability for legal entities (e.g.: Luxembourg, Slovak), and one country introducing (only) administrative liability for legal entities (Russia). Last but not least, several countries have adopted stronger penalties for bribery of both domestic and foreign public officials. Other changes include the criminalisation of commercial bribery (Ukraine/Russia), whistleblower protection

(Ireland/Turkey), and the extension of the prescription period (Spain).

Recommendation of the Council for Further Combating Bribery of Foreign Public Officials in International Business Transactions

OECD, 2009

<http://www.oecd.org/daf/anti-bribery/anti-briberyconvention/44176910.pdf>

The Recommendation was adopted by the OECD in order to enhance the ability of the 40 States Parties to the Anti-Bribery Convention to prevent, detect and investigate allegations of foreign bribery and includes the Good Practice Guidance on Internal Controls, Ethics and Compliance.

The OECD's recommendations cover, inter alia, the criminalisation of foreign bribery; reporting foreign bribery; accounting requirements, external audit, and internal controls, ethics and compliance; public procurement; export credit and international cooperation.

Commercial bribery, or private-to-private corruption

A qualitative reframing of private sector corruption: Considerations from the natural resource sectors in South Africa

Bracking Sarah, 2013, U4 Anti-corruption Resource Centre,

<http://www.u4.no/publications/a-qualitative-reframing-of-private-sector-corruption-considerations-from-the-natural-resource-sectors-in-south-africa/>

This paper reviews types of private sector corruption in South Africa in order to provide suggestions for the design of anti-corruption policies in the natural resource sectors. The author shows that corruption is not solely a public sector issue and firms are not systematically the victim of public sector corruption.

The author demonstrates that there is a misperception and a misunderstanding of what is considered corrupt and what is not; in particular, a range of practices have emerged that can be understood as new types of corporate corruption, including deliberate bankruptcy, thin capitalization, illicit financial flows, transfer (mis)pricing, trade mispricing, jurisdiction shopping, and tax evasion. The currently used concept of private sector corruption does not cover new types of

corruption that have emerged in response to the increasing complexity of the public-private boundary and the effects of more liberalized markets.

Recognizing and Justifying Private Corruption,

Gopinath C., 2008, Journal of Business Ethics

Vol. 82, No. 3

This article argues that, despite the lack of attention given to commercial bribery in comparison to corruption involving public officials, the former is a significant problem with serious organisational consequences. The author says that there are three conceptual perspectives on corruption: the economic perspective, the legal perspective and the moral perspective, and indicates that the latter is the most widespread view. It is however trickier to apply an ethics to business situations since a number of decisions can be placed in a grey zone. This study shows that individuals (the respondents were all business students from the US) face more difficulties to identify a situation of private corruption than bribery in a public context. It demonstrates a relative lack of clarity in the minds of the respondents with regards to business ethics and a dominance of the justification of business expediency. The study indicates that, for many, cultural relativity also serves as a justification of foreign bribery. The authors draws attention on the need for building skills and capacity in these regards to effectively fight corruption in international business.

Measuring Private Sector Corruption, Rose-

Ackerman Susan, 2007, U4 Anti-corruption Resource Centre

<http://www.u4.no/publications/measuring-private-sector-corruption/>

In this brief, the author describes what commercial, or private-to-private, bribery is and how it manifests itself. She then provides an overview of the potential role of donors, governments and business organisations can be in the fight against such corrupt practices.

Bribery requires both a payer and a recipient and commercial corruption is the scenario in which, contrary to usual perceptions of corruption, no public officials at all are involved. As the private sector grows in importance in developing and emerging economies, many corrupt opportunities are likely to involve private firm employees as both payers and payees. The author gives a few examples, such as sales agents bribing purchasing agents to get business; head office inspectors are bribed by lower-level employees or

franchisees to misrepresent facts; labor union leaders are paid off by management to sell out the interests of the rank and file etc.

Furthermore, as the private sector begins to thrive in many developing and emerging economies, opportunities to pay off public officials are likely to increase as well. Activities that used to take place entirely inside the state are now organized in the private sector, and this frequently requires the state to sign contracts with and award concessions to private firms, creating new opportunities for corruption.