

BRIBERY AND  
CORRUPTION IN  
THE OSCE REGION

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HEARING  
BEFORE THE  
COMMISSION ON SECURITY AND  
COOPERATION IN EUROPE  
ONE HUNDRED SIXTH CONGRESS  
FIRST SESSION

JULY 21, 1999

Printed for the use of the  
Commission on Security and Cooperation in Europe  
[CSCE 106-1-10]



Available via the World Wide Web: <http://www.house.gov/csce>

58-820CC

U.S. GOVERNMENT PRINTING OFFICE  
WASHINGTON : 2000

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**COMMISSION ON SECURITY AND COOPERATION IN EUROPE  
WASHINGTON, DC**

The Commission met at 2:00 p.m in Room 138 of the Dirksen Senate Office Building, the Honorable Ben Nighthorse Campbell, Co-Chairman, presiding.

*Commission Members present:* Hon. Ben Nighthorse Campbell, Co-Chairman; Hon. Frank R. Wolf; and Hon. Patrick A. Mulloy.

*Witnesses present:* Hon. Patrick A. Mulloy, Assistant Secretary of Commerce, and Commissioner of the CSCÉ; Dr. John D. Sullivan, Director of the Center for International Private Enterprise; Dr. Louise I. Shelley, Director of Transnational Crime and Corruption Center of American University; Lucinda A. Low, Esq., Board of Directors of the Transparency International USA; and Peter Grinenko, Partner for Staysafe Security Corporation of New York.

**OPENING STATEMENT OF  
HON. BEN NIGHTHORSE CAMPBELL, CO-CHAIRMAN**

Senator CAMPBELL. I am pleased to open this afternoon's hearing examining the issues of bribery and corruption in the OSCE region, an area stretching from Vancouver to Vladivostok. In economic terms, rampant corruption and organized crime in this vast region has cost United States businesses billions of dollars in lost contracts abroad, with direct implications for our economy here at home.

I might say from the outset that Chairman Smith has a bill on the Floor of House and will probably not be able to attend today's hearing.

Bribery and corruption have an overall chilling effect on much-needed foreign investment in the transitional countries of Eastern and Central Europe and the Newly Independent States. Corruption and organized crime are by no means limited to those countries in transition.

Beyond the pure economic impact, official and unofficial corruption are an affront to the core principles of the OSCE: human rights, democracy, and the rule of law. Given the strategic importance of the OSCE region to the United States, it is essential that we provide critical leadership in combating organized crime and corruption if genuine democracy and market economies are to take firm root in those countries.

While valuable work has been undertaken by a number of multi-lateral organizations, including OECD, the stakes are such that combating organized crime and corruption must receive priority attention.

The comprehensive nature and membership of the OSCE make it ideally suited to contribute to this effort. If the OSCE could make a major contribution in promoting military transparency and openness during the Cold War, as it did, then certainly it should be able to undertake a similar effort in the economic dimension, especially in such OSCE countries as Russia and Ukraine.

Several Commission members recently returned from St. Petersburg, where I co-chaired the U.S. Delegation to the 54-nation OSCE Parliamentary Assembly. While in St. Petersburg, I had an opportunity to sit down with U.S. business representatives to learn from them first hand their experiences, and gain a deeper insight into the obstacles they face in doing business in Russia.

The OSCE Parliamentary Assembly adopted two amendments that I proposed, underscoring the importance of combatting organized crime and corruption in the OSCE region. A key element of that package was my proposal for convening an OSCE Ministerial meeting to pursue practical forms of cooperation in this area.

Clearly, an essential ingredient in the fight against bribery and corruption is political will. No amount of technical assistance will be effective if the necessary political will is absent. Accordingly, I intend to urge the Administration to make combating organized crime and corruption a priority agenda item when the presidents and prime ministers from the 54 OSCE participating States hold their summit meeting later this year in Istanbul.

Forging an effective partnership between governments, the business community, and civil society in the OSCE region will prove crucial if we are to meet the formidable challenges of fighting corruption and establishing a level playing field for international business.

I look forward to hearing the expert witnesses assembled today. The first witness will be our Department of Commerce Commissioner, Assistant Secretary Patrick Mulloy, who was recently appointed to this Commission.

I might inform all of the witnesses, looking through the statements that have been placed for the record, that the full text will be included in the record. Accordingly, you may wish to abbreviate your testimony and summarize the written text. I would encourage you to do that.

Please proceed, Secretary Mulloy.

**TESTIMONY OF PATRICK A. MULLOY, ASSISTANT SECRETARY  
OF COMMERCE AND COMMISSIONER**

Sec. MULLOY. Thank you, Senator.

As you know, my name is Patrick Mulloy. I am a newly appointed Commissioner of the Commission on Security and Cooperation in Europe. There are three Executive Branch Commissioners, one from DOD, one from State, and one from Commerce. I was recently appointed the Commerce rep. Normally, DOD takes the lead on security issues, State on human rights issues, and the Commerce Department on economic issues.

I am testifying, however, in my capacity as the Assistant Secretary of Commerce for Market Access and Compliance. What that means, Senator, is that my unit has the principal responsibility for monitoring and enforcing our rights under trade agreements, so that our companies and our workers gain the benefits of what we bargain for in international trade agreements.

As you know, Senator, I spent 15 years of my career up here on the staff of the Senate Banking Committee. So it is a great honor for me to have the chance to appear before you and other members of this Commission to talk about one of the more important issues. That is, how do we deal with organized crime and corruption and combat that. Because what it does—it can undermine democratic institutions around the world. It is very important for us to work together to try and change that.

What I hope to do—and I will be brief—is to just talk about the corruption problem in general, and then how we in the Executive Branch are trying to combat it, from both the supply side and then the demand side of the problem.

Eradication of bribery and corruption in international commerce has been a key U.S. trade objective for many years. Bribery is a barrier to trade; it hurts our economic interests. A competitive advantage is provided to those countries which condone bribery of foreign officials. It is also a practice which undermines good governances and detracts from economic growth in many reforming and developing countries.

In the CEE and NIS region, corruption impacts trade and investment, and impedes our ability to work with those countries on our common objective, which is to develop market-based democratic societies based upon the rule of law.

Systemic corruption in the region has deep historic and socio-economic roots. These societies have been based on the rule of men instead of the rule of law. They have had ineffective law enforcement institutions, inadequate legal and regulatory infrastructures, and weak democratic institutions. Now, efforts to eradicate corruption under these circumstances will be very difficult, but we must make every effort to try to do it.

While the pervasiveness of corruption varies from country to country in the region, it is clear that when people see that their officials who have been honored with the public trust are taking bribes, it really undermines the legitimacy of governmental institutions and the faith of people in their democratic institutions.

The United States has gone after this issue in two ways. One, let's talk about the supply side. A key element of our international strategy to fight bribery and corruption has been to convince other major exporting countries to agree to have a convention banning and criminalizing the use of bribes to gain sales in international trade.

The American Congress has taken the lead in this area. My former boss, Senator Proxmire, wrote the original Foreign Corrupt Practices Act in 1977. That was not an Administration initiative. That was a Congressional initiative. Congress led the way. Many corporations didn't want that legislation. They said it would handicap them. But the Congress said it is very important that we—our corporations and the United States Government—do not condone methods that undermine democratic institutions abroad. The Congress passed that legislation in 1977.

In 1988, again the Congress took the lead. There had been some efforts to address bribery in a multilateral effort in the U.N. and some other international fora; but it was the Congress in 1988—in the 1988 trade bill—and it was a provision that Senator Proxmire worked to have put into the bill, that directed the Administration to go to the OECD with the idea that its members are the countries that have the corporations which make bribes, and to get a convention to ban those corporations from doing it.

It took a while, but I have to compliment a couple of people. Dan Tarullo, who was the Assistant Secretary for Economic and Business Affairs at the State Department, and a former staffer for Senator Kennedy, took a key role in this Administration pushing it. Then there was my boss, David Aaron, who was our ambassador to the OECD at that point, and a former staffer to Senator Mondale, who pushed it on the ground in Europe.

Then the last 2 years, Secretary Daley made a major effort himself to push this. We finally got the OECD Anti-Bribery Convention. It was moved through the Senate very rapidly last year. Chairman Helms made it a high priority. It was ratified as a treaty.

Then the Congress last year moved immediately and very quickly to pass the implementing legislation. We had to make certain changes to our own law to be in full compliance with the new treaty. That was done and was moved through the Congress very quickly last year.

Now one of the things that the Congress did last year, when it passed the implementing legislation, was to require the Commerce Department to give the Congress an annual report on how other countries are doing in terms of implementing the OECD Anti-Bribery Convention. We just issued that first annual report in July. I think my staff got it up to you prior to your going on your trip to Eastern Europe and Russia. We have copies of that report and we'll make it available after this hearing.

Let me just give you some general findings of that report. Fifteen of the 34 signatory countries deposited an instrument of ratification with the OECD and put in place the legal requirements to criminalize the bribery of foreign officials. So 15 of the 34 have done it. Twelve of the 15 countries which have deposited their instruments of ratification are also OSCE participating States.

We generally found that efforts were being made to address all the requirements of the Convention. We found that signatories of the Convention had made great strides in eliminating any tax-deductibility for bribes to foreign officials. That is the key thing.

Not only did countries permit their companies to make bribes, they actually gave them a tax deduction. It was a cost of doing business that they could deduct. We worked very hard to get the OECD to condemn that practice as well.

Still, there are four countries—Australia, New Zealand, Luxembourg, and Switzerland—which have not yet completed efforts to disallow the tax deductibility of bribes. We want to highlight that. I think that those countries ought to move ahead pretty quickly to come into compliance with that OECD commitment.

As the Assistant Secretary for Market Access and Compliance, my unit is charged with monitoring and enforcing this Anti-Bribery Convention. You can be sure that we are going to make it a top priority. We are also taking other steps to monitor the Convention so that we

get the information we need to be able to report to the Congress in an accurate and timely fashion. We are strengthening our outreach to business groups and non-governmental organizations interested in bribery-related commercial activities. We are enlisting the cooperation of about 70 business and labor organizations that participate in our compliance liaison program.

This is part of our regular monitoring and enforcement of trade agreements. We reach out to the business and labor communities to help us understand what the problems are in the agreements we negotiate and where we ought to be putting our effort. So we are going to use those same contacts now to reach out and help us monitor what's going on in the bribery area.

We are adding bribery problems to the Trade Complaint Hotline. We have a website, and we provide U.S. business and non-governmental organizations a direct channel to our monitoring and enforcement, including any complaints that they want to make regarding violations of these anti-bribery-related conventions.

In addition, our Trade Compliance Center and Office of General Counsel will support increased diplomatic and public affairs activities on the Convention—in other words, to make this a higher visibility item in the international arena, for this is an important area which merits additional publicity.

Now what about the demand side? We are working on several initiatives, both globally and regionally, to combat the demand side of bribery. One of them, the first one I can talk about, is related to our WTO Ministerial, which is coming up in Seattle in November of 1999. We are pushing for an agreement on transparency in government procurement. The government procurement market has been estimated at about \$3 trillion, and it generally accounts for about 10 to 15 percent of each country's GDP. The Asian Development Bank recently reported that corruption can add between 20 and 100 percent to government procurement costs for goods and services.

The aim of a transparency agreement in government procurement would be to discipline member countries and their procuring entities by requiring them to adhere to such basic procedures as publishing the laws and regulations regarding government procurement; publishing procurement opportunities—so people know what's out there and what they can bid on; basing award decisions on published evaluation criteria; and having some kind of an independent review mechanism. So that's one thing.

We have also developed a number of programs to help countries in the region address the sources of corruption. We have something called the Commercial Law Development Program, which is a Department of Commerce initiative, funded in part by USAID, which is one component of our effort to support economic and political reform in the Eastern European area.

This program provides rule of law training and services to lawmakers, regulators, judges, lawyers, and educators seeking assistance in the evaluation, revision, and implementation of evolving legal systems in the area of corruption. This program also assists foreign governments to address areas such as government procurement, reform of their judiciary, government ethics issues, transparency, and regulatory reform.

My Market Access and Compliance unit has identified the development of the rule of law for business in the Newly Independent States as a key priority for opening these markets to U.S. companies. When there's bribery and corruption, that really is an impediment to American companies, because our guys need to follow our law (and we are vigorous in enforcing it). So it works both to help those countries and keep faith in our democratic institutions. It also is something that can be a commercial advantage to American firms.

USAID has been very active in providing anti-corruption assistance to Central and Eastern European countries and the Newly Independent States of the former Soviet Union. Our own General Counsel's office has worked very hard on these programs, in which we are trying to train the officials over there and give them whatever help we can in their own efforts to build the rule of law and institutions and regulatory systems that can help deter corruption and bribery.

I just want to finish by saying how much I look forward to working with you and the other Members of the Commission. My own view is that some of the best ideas and initiatives will come from the Congress in terms of what we ought to be doing to better monitor and enforce our trade agreements. The hearing that you are holding today, in which you are bringing in so many knowledgeable people, will be very helpful for us. We'll study that testimony. We'll also be looking for your recommendations.

At our meeting this morning, you mentioned your recommendation about this Ministerial meeting. I will follow up with this in the Executive Branch. I mean it makes some sense to me personally, and we'll see whether that would be something that the Executive Branch can get behind, Senator.

So I thank you very much for this opportunity.

Senator CAMPBELL. I thank you.

In your capacity as Assistant Secretary, I would like to ask you a couple of questions. At the conclusion of that, in your capacity as Commissioner, I would invite you to join me at the dais for the rest of the hearing.

You indicate we are making some progress, at least that's what your comments allude to. But also, it seems like some countries have made pretty great progress while other ones have not. I have been to a number of countries, lived in several foreign countries. I'll tell you, some of the countries I have been to—I mean bribery is virtually an institutionalized form of doing business. It just is the normal part of doing business. Kickbacks, nepotism: things of that nature are almost taken for granted. Here, I guess, because of many of the laws we have and the free press watching everything pretty carefully too, that helps prevent such practices in this country.

But I wanted to ask you a couple of questions. Why do we have such a success in some countries, such as Poland and Hungary, and so little success in Russia and Ukraine, when we're talking about reducing the level of corruption?

Sec. MULLOY. I'm not sure. I'll try something. I think Poland—before it went Communist and was taken over really by Russia—had some independent institutions and Western traditions, whereas Russia unfortunately never had any of that. They have always had a pretty arbitrary system of government and institutions. So maybe it goes back to just factors like that.

Senator CAMPBELL. When we try to pursue transparency in government, as an example, what are the difficulties we face in countries like Russia?

Sec. MULLOY. My understanding is that in Russia you haven't had any traditions of transparency, and you have had a centralized authoritarian regime which acted arbitrarily and capriciously. They have been in power for 70 years, so it's really hard then to come in and free up a lot of the economy. The American economic system really depends upon a lot of institutional factors which keep it from becoming Darwinian in nature. Unfortunately, those institutions are not present in some of these countries. It is so important for us to help transmit some of those institutional reforms so that when we do push free markets and free enterprise, we also push some institutional restraints—such as restrictions on bribery.

Senator CAMPBELL. If they have never known any other way, they have nothing to compare it with.

Sec. MULLOY. That is going to be a real effort for us. That's why I think your idea of moving this up to a higher level is very important.

SENATOR CAMPBELL. You were mentioning when you talked about supply and demand, that on the supply side there are several countries that still give tax breaks for bribes?

Sec. MULLOY. Yes.

Senator CAMPBELL. Or not tax breaks, some kind of—

Sec. MULLOY.—tax deductibility—

SENATOR CAMPBELL.—tax deduction if you paid a bribe—

Sec. MULLOY.—paid a bribe as a business expense.

Senator CAMPBELL. What are the countries again? Australia you said? Did I hear you mention several countries?

Sec. MULLOY. Switzerland is one of them. That's an amazing one. You would think that country would know better.

Senator CAMPBELL. Luxembourg.

Sec. MULLOY. I have them Senator.

Senator CAMPBELL. That's all right. Just as long as we have those for the record. I would like to remember that.

Sec. MULLOY. Yes. Australia, New Zealand, Luxembourg, and Switzerland.

Senator CAMPBELL. During the 105th Congress, I introduced legislation S.1200, the International Anti-Corruption Act, providing for annual reporting on the business climate in countries receiving U.S. assistance. The concept basically was that if we have some way of monitoring how they were treating U.S. businesses, these countries would have less chance of getting American aid. I am going to reintroduce this bill soon.

Have you had a chance to look at that legislation?

Sec. MULLOY. Senator, I have read a statement on it, some analysis of it. I have not read the bill itself. I know that the last time you introduced it, the Administration as a whole did not endorse it. I think part of it was that the Administration was really focusing all of its efforts on getting the OECD supply side, Anti-Bribery Convention done.

I will be happy, when you introduce that legislation, to take it back and try and get another look in the Administration at the legislation. I do note that on the whole, it would affect mainly the programs of

the Agency for International Development. So probably they would be the key people who you would want to work with in trying to get a view. But I will take it back and talk to our people about it.

Senator CAMPBELL. Also, it looks like we are going to be pouring substantial money into the rebuilding of Kosovo.

Sec. MULLOY. Yes.

Senator CAMPBELL. Do we have any specific programs put in place yet to ensure that the monies that we are going to be sending over there go to the intended projects instead of ending up in the Swiss bank accounts for some of the officials that are supposed to be administering such programs?

Sec. MULLOY. We have put forward four ideas that would govern the development assistance. We are going to have a meeting of what we call the donor countries. The first one is going to be on humanitarian aid, and that's going to take place, I think, later this month. Then there is going to be a second one in the fall on the major reconstruction projects. Then there will be one next spring on rebuilding the economies or developing the economies as a whole.

Senator CAMPBELL. Will part of those meetings be focused on how to follow the money trail, to make sure it's getting to the intended objective?

Sec. MULLOY. I think that would be incorporated in those donor conferences. I'll make note of that. But our proposal, which we have been pushing in these international meetings, is that all parties in these projects should publicize, in a timely manner, the rules for participation. What we don't want is that the donors will say we'll provide this much money to rebuild but then tie it all to their own companies.

The United States paid a major portion of the military operation. We don't think that countries which are now going to help in the reconstruction should just tie whatever they are going to give to their own companies.

So we're pushing for a public tendering. We are asking that technical specifications for specific procurement opportunities be based on industry-accepted norms rather than criteria describing specific products offered by a specific company, so that you don't get it. And we want to have all parties follow international procedures on notification, consultation, surveillance, and dispute settlement related to ensure fair, prompt, and effective enforcement of the international provisions on procurement. That is going to be our major effort. We are putting considerable effort to bring the reconstruction opportunities available, to publicize those in our own country so that American corporations could be out there bidding, and then to have it all done in a very transparent fashion in order to limit the corruption that might go on.

Senator CAMPBELL. Then let me ask you a two-part question. Are there governments in the OSCE region that have been particularly successful in fighting corruption, and have there been any major arrests or convictions of corrupt officials in those countries that you know of?

Sec. MULLOY. In the report that we just issued to Congress, we do not have any enforcement actions by other OSCE governments to report on.

Senator CAMPBELL. None?

Sec. MULLOY. But that is something we will keep an eye on. If we see that laws are on the books and then we're getting reports that companies in those countries are not complying with the law, we are going to bring those issues to the attention of the other governments. Then we will report to you next year; we'll have a better idea of what is happening in each of these governments. We will report to the Congress next July.

Senator CAMPBELL. Okay. I thank you.

Sec. MULLOY. Thank you, Mr. Chairman.

Senator CAMPBELL. Would you join me up here? We'll go to our witnesses, if I can find my witness list.

Our second panel will include: Dr. John Sullivan, Director of the Center for International Private Enterprise; Dr. Louise Shelley, the Director of Transnational Crime and Corruption Center of American University; Lucinda Low, a Member of the Board of Directors of the Transparency International USA; and Mr. Peter Grinenko, Partner for Staysafe Security Corporation of New York.

I would repeat that the complete text of your written testimony will be included in the record. If you would like to abbreviate, we would appreciate that. We'll go ahead and start with Dr. John Sullivan, since you are the first one on the list.

**TESTIMONY OF DR. JOHN SULLIVAN, DIRECTOR,  
CENTER FOR INTERNATIONAL PRIVATE ENTERPRISE**

Dr. SULLIVAN. Thank you, Mr. Chairman.

Let me begin by thanking the Commission for inviting us to testify here today. The Center for International Private Enterprise has put the struggle against corruption really at the center of our program approach for a number of years now. So we really welcome the opportunity to be here to share with you some of our experiences around the world.

As you mentioned, I am the Executive Director of CIPE, as we call it for short. We are an affiliate of the U.S. Chamber of Commerce, the principal business association here in the U.S. Since our inception in 1983, we have completed more than 550 projects in some 70 countries around the world and have conducted business association and management training programs in a wide range of countries.

Much of this work has been supported by the National Endowment for Democracy, which is, I'm sure, known to you, Mr. Chairman. I want to thank you on behalf of the U.S. Chamber, as well as the NED, for the support that you have given us over the years in the Senate.

Before going on to the testimony, I just wanted to take a second and compliment Secretary Mulloy. You brought up tied aid, which is something that's very important to us. Your efforts in this behalf, I think, are important—not just to my center, but to the U.S. Chamber and to all of our members. So I compliment you on that. If there's anything we can do in that area, in Kosovo or elsewhere, we would be delighted to work with you.

Let me just give you an example of some of the organizations that we have worked with throughout the OSCE region, to give you a sense of the partner organizations, because our approach really is focused on formulating partnerships with indigenous think tanks, business associations, and the like, to take on projects like combatting corruption, promoting good governance, and democratic development.

Some of the groups we have worked with are the Gdansk Institute of Market Economy in Poland, the Strategic Alliance of Business Associations in Romania, and the Reinvest Institute in Kosovo, which has been at the forefront of pushing for market development and many of the issues we are talking about today.

Now we realize at CIPE that it is very important—indeed vital—to focus on enforcement actions and strengthening penalties for corrupt acts through the criminal justice system and through other efforts to catch those who violate the law. Many of my colleagues on the panel here today will speak to these issues, as has Secretary Mulloy.

However, I would like to add a complimentary focus, which we believe also offers great potential. Namely, to start working on eliminating the institutionalized causes of and opportunities for corruption, which, again, Secretary Mulloy had referred to as well.

What I would like to address are some of these root causes and how they affect business, some of the internal reforms corporations can and should make through areas like corporate governance, and our view on the importance of the OECD Convention. I would just mention briefly—because it is a value I think we all pretty much agree upon—that promoting democracy in these regions will have a dramatic effect on reducing corruption. I will then give you some examples of concrete actions that the indigenous private sector in the OSCE region can take.

I hope to be able to show you by the end of my brief summary—and I will summarize my remarks—why we feel that combatting corruption can be a key issue for business in efforts to improve the business climate and further the process of economic reform and democratic development throughout the OSCE region.

I think it is well known and commonly accepted, corporations—not just U.S. corporations, but the multinationals in general—have learned a powerful lesson from the Asian crisis and the Russian collapse. They are becoming much more wary of where they invest and the internal climate there toward business. The business community, as we have seen in country after country, is signaling to lawmakers that they are tired of corrupt dealings and that it is time for a change. As I'm sure that Dr. Shelley and others will talk about today, corruption is one of the leading causes of the lack of foreign investment in Russia, Ukraine, and, more generally, in the countries throughout East Asia and the Eurasian region.

Some of the root causes of corruption I think are well known. The first thing I would like to say is that the approach that we have taken is not that corruption is endemic to certain societies or cultures or histories, but rather that corruption thrives in situations where the legal systems are just now beginning to evolve along the lines of transparency and openness, where the rule of law is not embedded within cultural norms, or where the law allows for a substantial amount of discretionary authority.

For root change to occur, the system must be changed; and all participants have to be involved in making that change. I would like to give you just one short example of how this can happen. I realize I am reaching outside of the OSCE region, although I will give you examples within the region in a moment. In Ecuador, the National Association of Businessmen launched a program several years ago to

look at the root causes of corruption. They had just had their president removed from office and substantial amount of systemic-wide corruption in the country.

They discovered that within Ecuador over 97,000 laws had been passed since the inception of the Republic, and that some 55,000 of them were still on the books. Many of these laws conflicted with each other, undermined each other, or in various ways were subject to interpretation, thus allowing a tremendous amount of discretionary power to the people who decide which law applies in which circumstance.

In order to try to root out this issue, root out this problem, they recommended and got approved within the new draft constitution—which has subsequently been adopted—the formation of a Commission of Jurists with the power to reconcile and simplify these conflicting, overlapping, and duplicative laws. That one action alone offers the potential not of removing or eliminating corruption but of substantially reducing the incidence of corruption.

I would like to point out also that corruption is not just a problem for multinational corporations. It has a substantial impact on domestic companies in these countries and a really phenomenal impact on small and medium-sized business—not to mention the poor, who must forego services from government which would otherwise be made available.

To illustrate the dimensions of the problem within Central and Eastern Europe, one of our partner organizations, the Ukrainian Center for Independent Political Research, has found that there are 32 laws, 30 presidential decrees, and over 80 resolutions on the books with which small business has to comply. Further, 32 ministries and departments have the authority to issue licenses for various business activities.

In some cases, a small firm will have to undergo 78 separate inspections by various ministries during the course of a year. In some cases, they have tax authorities stationed within their companies to collect the taxes on a daily basis. That kind of situation no firm can legally and completely comply with.

Senator CAMPBELL. Excuse me for interrupting, but those 78 agencies you are speaking about—do they all require some kind of a fee or a tax or something to implement some paper processing?

Dr. SULLIVAN. Of course, or sometimes the individual is prepared to bargain on the spot to forgo the fee. That's the nature and that's the root cause in that situation of much of the corruption we see in Ukraine, which is endemic at extremely high levels.

Some of the internal reforms that I have mentioned that we are recommending be put in place within the corporate community itself—and to an extent within the small business—can be summed up under the heading of corporate governance. This is an issue and an area that we have been promoting throughout the region with many of our partner organizations.

Together with one of the Soros Foundations, we published and developed a course on corporate governance because as we have seen privatization unfold throughout the region, one of the real problems is that the boards of directors are not trained, the laws are not in place, security registries are not there. This is much more of a prob-

lem in Russia, Ukraine, and the rest of the Newly Independent States. It is being addressed now, thankfully, in Poland, Hungary, and Bulgaria.

Of course, this goes over issues that many of us are familiar with, like establishing an independent board, and protecting shareholders—and particularly minority shareholders—rights. It also includes implementing standards of accountability through independent audits and internal audit processes within companies, and forcing those audits to be public, and commitments to fair and honest dealings.

I would just—in the interest of time—not go through everything I have mentioned here in my testimony about the OECD Convention. I would just mention that we did form a partnership with the OECD's Development Center and with USAID to sponsor a conference here in Washington in February, bringing in people from a number of different countries, including the Newly Independent States and Central and Eastern Europe, to focus on this Convention, and to come up with new ideas and approaches on how that Convention can be looked at, not just from the governmental side, but from the private sector side.

Attached to the testimony is a list of programs that we funded in a number of countries. You will see in there that in Bulgaria, for example, we have been working with the Center for the Study of Democracy. Similarly in Romania, we are working with a group there and in Slovakia. The idea being to take advantage of having this OECD Convention to have private groups start monitoring this process and to start looking at the other ways that it can be implemented and how the enabling legislation that has to be put in place can be made much tougher and stronger in each of these countries.

I would strongly underscore the remark you made, Mr. Chairman, in your opening comment, that the development of democracy throughout the OSCE region is an extremely important part of making this fight against corruption actually take hold.

If nothing else, developing independent media with the skills and the know-how to conduct what we call investigative journalism, fair reporting, and have analytical skills that they can look at a press release and not just reprint it in the paper, is a big part of what we're trying to do here. We have done press training to this end in a number of countries, but I would urge that much more be supported.

I promised I would keep it short, so I will just end up by mentioning a few of the projects that we have supported in this area. In Bulgaria right now—in addition to the program I mentioned where they are working on shareholder registries—we are also working on developing some standards of corporate governance that we're recommending to government.

Part of this has to be implemented through law: things like the independent accounting standards and coming up to the Internationally Accepted Accounting Principles. Most of the countries in the NIS have not adopted these yet. They are at some distance from doing that. So it's very difficult—even when you do get the books—to figure out what's in those books, what they really represent.

In Slovakia, one of the groups that we have been supporting for a number of years now is following the privatization process. They call it their Clean Hands Program. The point is that they are blowing the

whistle. A lot of NGOs, I think, can do this when they come across corrupt privatization transactions, where you don't have public bids and tenders and the like.

Then, as I mentioned, the press training programs are extremely important. We're following up on those.

Corporate governance is an area that we hope to be able to put into place. We have an office in Moscow. It's still amazing to me, but it's in the Russian Chamber of Commerce. The Soviet Chamber was disbanded and a new Chamber was put together. Although we often don't work with Chambers of Commerce in other countries—because they tend to be an arm of the government in many European societies—in Russia it is an independent organization.

Through our office at the Russian Chamber and through our work in countries like Kosovo and Bulgaria, Hungary, we are going to continue trying to put together regional efforts to promote good corporate governance, adoption of corporate governance legislation, and transparency.

Most business people will say, "If my opponent or my competitor is bribing, I end up with a strategic disadvantage if I don't. But if all of us have to publish our books, then we have got a level playing field." That level playing field, as I mentioned in my opening testimony, really is where we can start looking at combating corruption and encouraging corporate governance to push forth the whole area of economic reform and democratic development.

Senator CAMPBELL. We'll now go to Dr. Shelley. But I might mention, before I do—Dr. Sullivan, are you familiar with the legislation that was spearheaded by Senator Stevens this year to start an exchange program to bring Russian elected officials to the United States at all levels, Duma members right down to city council people and so on? The intent, apparently, is to have these officials try to learn our system of doing government. Are you aware of that?

Dr. SULLIVAN. Yes. I believe it is being implemented through Mr. Billington at the Library of Congress and the American Foreign Policy Council. It's a great idea.

Senator CAMPBELL. Dr. Shelley, please proceed.

**TESTIMONY OF DR. LOUISE SHELLEY,  
DIRECTOR, TRANSNATIONAL CRIME AND  
CORRUPTION CENTER, AMERICAN UNIVERSITY**

Dr. SHELLEY: Thank you for inviting my participation here.

The Center for the Study of Transnational Crime and Corruption is an academic center at American University.

Senator CAMPBELL. Pull that microphone over just a little closer to you.

Dr. SHELLEY: But we also run programs in Russia and Ukraine to deal with the problems of organized crime and corruption. It started with private funding from the McArthur Foundation. We are now funded and administered through the Department of Justice. One of the foci of our research is on corruption throughout Russia and in Ukraine.

One of the most striking elements of the problem is the lack of political will to fight corruption. This is true not just in Russia and Ukraine; it is true of the other States in the NIS, and, to a lesser extent, in countries of Eastern Europe that are also a part of OSCE.

As the Russian expression goes, “The fish rots from the head.” That is what we are looking at. Many of the leaders of these Newly Independent countries have talent to address ethnic conflict. Some of them are more successful in promoting foreign investment, particularly in the oil sector, but they very much lack interest in dealing with the issue of corruption.

There are anti-corruption working groups that are operating at high levels in Ukraine and Georgia; but I would not say that this was an initiative that came from within those countries, but very much a response from external pressure from the United States or from the World Bank that these issues need to be addressed.

Increasingly, when you ask this question—“About how many people have been prosecuted from corruption?”—we are seeing some high level investigations of corruption, but it is often being used as a political weapon. That is how one politician gets at his enemy rather than really getting at the problem of corruption.

Senator CAMPBELL. Those doing the investigating are probably just as corrupt as those being investigated, in some cases, I suspect.

Dr. SHELLEY: Or those spearheading the investigations. This is a real problem in giving integrity to the issue of corruption. It is becoming increasingly a political weapon rather than an issue to be pursued for itself to eliminate corruption.

What we do have is political will at the NGO level, as Mr. Sullivan was talking about. Journalists—we have journalists in this part of the world who are very ready to fight on these issues. I think one of the ways to think about who is ready to oppose this is in some ways analogous to dissidents in the Soviet period. Now the people who are ready to fight corruption are in many ways placing their lives in danger, because it is not a safe activity to do; but people in the human rights community and others—and business community and elsewhere—are monitoring corruption.

There is no uniform problem of corruption in the former Soviet Union. For example, in Russia, which is such a huge country and where the center is falling apart, you have very much a decentralized system of corruption. That makes it also—talking about foreign investment—more difficult sometimes for foreign investors, because they are hit on by many different people. So you come in and you think that you have set up a relationship with somebody, and then somebody else comes into the picture. In some ways, it is easier dealing with centralized corruption where you know who is in the pecking order, and it provides a more secure environment.

Some of this is more concentrated—particularly the centralized corruption—in the Central Asian and a couple of the Caucasian countries, where you are dealing more with a clan structure. Therefore, you have a very limited number of individuals who are participating in the corruption as opposed to in Russia, where you have many more people who are eligible to participate.

A crucial element of this corruption problem is the banking center. Almost all the NIS States have had banking crises in which citizens have lost their savings. Banks are not engines of capitalism providing loans to promote investment, but are mechanisms to move capital out of the country and off shore. That’s where the programs that Mr. Sullivan was talking about—setting up regulation, oversight, trans-

parency—are so important. This has created an incredible impact on citizens, particularly in Russia, some of them who have lost their savings repeatedly as banks have collapsed.

Your question, Senator Campbell, about aid to Kosovo and the need to have safeguards in this assistance, I think, is extremely important, because the aid process in privatization was a tremendous fuel for the movement of capital overseas. When we instituted our aid programs for privatization, we did not put in adequate safeguards to monitor what was going to happen with the property, where the cash was going to go. It has been a mechanism of transferring what was once state wealth to a handful of citizens.

We have been complicit in this problem. Just as you were saying, we need to address this now as we're focusing on aid for Kosovo, because through our assistance programs in AID, World Bank, and others, we have promoted privatization plans without adequate safeguards.

The privatization policies we have pursued may have made Communism irreversible, but they did not make authoritarianism irreversible. Lack of free elections. Because who has the money to fund elections? Independent media doesn't exist in many parts of the former Soviet Union because the oligarchs or other wealthy politicians have bought up the press; and a concentration of economic and political power are consequences of the corrupted privatization process.

So we need to think in broader terms about what is corruption, and what its costs are? We need to make corruption a central issue in the way we engage with countries of the former Soviet Union and Eastern Europe. It is not just a question for the business community and foreign investment, which is very important. But it is a question for our whole strategy of how we relate to these countries, because our failure to recognize earlier that corruption would be a major force created an impediment to the creation of democracy and free markets, has affected this transition process. In many ways, we have lost the window of opportunity that we had in the early 1990s.

The continued failure of the West to acknowledge the cost of corruption means that we fail to do adequate due diligence on the assets received from the former Soviet Union. This is not only a problem in the U.S. but in many of the OSCE member States and their territories. American companies engage in bribery and violation of the Foreign and Corrupt Practices Act, or turn a blind eye to inflated costs—inflated costs because the cost of bribes and other payoffs are presented to their business partners.

For example, I talked with lawyers who were overseeing contracts. There will be a construction cost that they need to pay their partner for, that they know is three times higher than what that cost should be for them to be paying for that construction item. But that's where you stick in bribes, payoffs, and other items. But the American party is not then liable under our Foreign Corrupt Practices Act, because they are just paying for construction expenses.

All right. Complacency in government. In Russia, there has been a dramatic decline in the number of prosecutions of individuals engaged in corruption over the last decade, especially during this period of redistribution of property. People have literally been able to get away with almost everything.

One of our centers did research in the Russian labor camp for former law enforcement personnel and corrupted governmental officials who were sentenced. These were generally individuals lower down on the pecking order. When they were surveyed, 90 percent of them reported that they had to give bribes up the ladder.

So what you are dealing with is an institutionalized corruption. Those who are getting caught are those lower down.

Only under Primakov was there a small period in which you were getting at some of high level military corruption—not at the oligarchs, not at some of the other business leaders—but some of the corruption in the military.

Citizens in the NIS are disillusioned by this corruption. Recent survey research indicates that Georgians seek democratic solutions to the corruption problem, but in some Slavic states citizens are ready to accept authoritarian solutions to the problem, or they believe that there are no likely solutions to this problem of corruption. So this is a real threat to the political development of these societies.

What can be done? I think we have heard some very good ideas on what can be done in the business sector from Mr. Sullivan. So I have concentrated on some others. Our options are limited in our foreign and economic policy. But we can require more compliance in oversight in World Bank and IMF policy in the region. President Wolfensohn has made corruption a central part of his leadership at the World Bank, but adequate safeguards have not been placed in the past on World Bank structural loans or IMF tranches.

Corruption can not only be addressed through anti-corruption programs. We have large anti-corruption programs now running in Ukraine and Georgia. But we need holistic and comprehensive strategies. We need to address this in every part of it. For example, if we are going to go on with more privatization, we have got to provide anti-corruption safeguards.

We should also think that in some cases where there have been gross abuses in the privatization process, maybe these resources need to be taken away from their owners who acquired them illegally and reprivatized in a more equitable fashion.

We also need to be very careful in providing political support for corrupt leaders. We tolerated corruption too much during the Cold War in the sake of fighting communism. We need to understand that support for leaders who are corrupt undermines democracy and makes citizens lose faith in their governments.

Long-term stability cannot be guaranteed if there is a very corrupt leader in place. The lessons of Indonesia do not apply just to South-east Asia.

Long-term policies. Endemic corruption is one of the most pernicious legacies of the Soviet period, and we cannot expect a quick fix to the problem. Sometimes I hear about aid programs where we say we are going to address this in 3 years and get out. We cannot expect to phase out anti-corruption programs in a short period. You need a long-term policy of engagement with countries of Eastern Europe and the NIS on these issues. This is a mutual problem.

In the announcement for this meeting, it was talked about a follow-up to the meeting that was held last July in Paris hosted by the OECD and OSCE. I was in that meeting and was one of the speakers at it on the corruption issue. We need to acknowledge—and that was not done

adequately at that meeting—that this is a mutual problem. In some ways, that meeting turned into a meeting in which Western Europeans were bashing the states of the former Soviet Union, saying, “You are corrupt. That is your problem,” without acknowledging that many of these countries—as you’re talking about Switzerland or others—are repositories for the ill-gotten gains of the corrupt leaders. This provides a problem in engaging these countries in a discussion of corruption.

We need to talk about this as a mutual problem. The corruption issue must not become a new way to foster the divide between the East and the West.

In terms of international measures, the OECD Anti-Bribery Treaty monitoring process needs to be done in a much more expeditious manner. Only a few countries need to report at the moment. It needs to be extended—the treaty—to the entire OSCE region. OSCE could create its own monitoring mechanism or one done in collaboration with the OECD and the business and NGO community. These public-private partnerships are particularly crucial in these transitional societies, especially because we are dealing with such endemic corruption within the government.

Thank you very much.

Senator CAMPBELL. Clearly when the Soviet Union collapsed and we were so interested in trying to help them become a free country and establish a free marketplace, we based all of our assumptions on our own frame of reference. Our frame of reference certainly wasn’t their frame of reference. So it’s like the old story about government here in Washington providing refrigerators to Eskimos. We didn’t do enough study, did we. That’s for sure.

Ms. Low?

**TESTIMONY OF LUCINDA A. LOW, BOARD OF DIRECTORS,  
TRANSPARENCY INTERNATIONAL USA**

MS. LOW: Thank you very much, Senator Campbell, for the opportunity to testify today, and the Commission’s interest in this issue, and your leadership.

I come at this issue from multiple bases of experiences. As you know, I currently serve as a member of the Board of Directors of Transparency International USA, which is the U.S. affiliate of Transparency International, probably the leading non-governmental organization in the world dealing with the issue of corruption.

In my private legal practice, which is in international trade and investment, I currently spend more than half of my time advising companies on compliance with the U.S. Foreign Corrupt Practices Act. I have been involved in this area for more than 20 years, although I will tell you that it has literally exploded in the last 5 years.

I have also been involved with the anti-corruption issue from the perspective of professional organizations, through leadership in the American Bar Association, which has been involved in law reform issues around the world and in trying to encourage the development of standards to deal with corrupt practices in international business. So I will bring all those experiences to bear in the comments I make to you today.

In terms of measuring the extent and impact of corruption in the OSCE region, of course everyone who has been involved at all in the corruption field acknowledges that it is always difficult to measure precisely what is going on. We are talking about an activity which by definition takes place underground.

Transparency International, as you may know, began several years ago to publish an annual index which attempts to measure the perceptions of corruption in different countries around the world. I emphasize the word 'perception.' Transparency's index not only ranks countries of the world (not all countries but an increasing number), from least to most corrupt; but it also scores them based on information that is collected in terms of their propensity to engage in corruption.

It is quite interesting to look at the rankings of the OSCE countries. Indeed, I never really focused on it as a region before, but preparing for today's—

Senator CAMPBELL. I notice that the United States is number 17, which means we're not exactly guilt-free, are we?

MS. LOW: We are not guilt-free. We are not at the top of the list. Believe me, I am often reminded of that fact when I go outside the United States to talk with people from other countries on this issue.

The countries that are at the top of the list are Scandinavian countries: Denmark, Finland, and Sweden; one, two, and three. So this region literally spans the top, and very close to the bottom. Russia is not at the absolute bottom of the list, but its score is less than a third of the score of the countries at the top of the list.

You will see from the breakdown I have of the countries in my written testimony on page 2, that as you go down the list, those countries that we would view as emerging democracies or transitional economies almost as a whole are grouped in the bottom half of the list in terms of their score on this index. They are not completely alone. There are some countries that we would regard as established democracies and non-transitional economies that are there, but it's really quite striking to break out the region and look at them this way.

My own experience in counseling companies that are subject to our Foreign Corrupt Practices Act bears out the conclusion that I think one must draw from the TI index—that there is a substantial problem with corruption in the region. I would emphasize that even the countries in the region that receive the best rankings on the TI index are only at half the score of the countries that are at the top. So they are really in the bottom half of countries in this regard.

In my own experience, corruption issues come up across the board in trade and investment transactions, in privatizations, in the process of companies trying to get licenses or permits or rulings from the government, and in the process of carrying out business operations. I have given several examples in my written testimony. I won't go into those in detail here. But I think they show even in some of those countries that aren't where Russia is on the list, that there really still is very much an embedded culture of corruption.

I have been to the region. I have been there earlier this year, when I was sent by a client to do training of personnel in all its Eastern European offices. The attitudes were evident. You see them in employees. You see them in partners. (You see these attitudes in government officials.)

By the way, I would disagree slightly with what Dr. Shelley says in terms of how U.S. law works. You do, as a company subject to the Foreign Corrupt Practices Act, have to worry if you are paying too much for goods and services that your subcontractor or your partner procures. That is a red flag that can give you liability in some circumstances. So it is an issue that at least some U.S. companies watch very closely.

Now because of this embedded corruption problem—and it's obviously not universal across the region, but still substantial—U.S. business remains at a competitive disadvantage. Until very recently, none of the U.S.'s major competitors have been bound by similar rules that one finds in the OECD Convention; and the issue of tax deductibility has already been mentioned. So what you see is really that corruption in this region is both a supply problem and a demand problem.

The impact—I think economists and others have documented it—it's lost business opportunities, it's overall lost investment, it's misallocation of resources, increased costs to the people of the country, lost revenues in the tax arena, for example, and overall harm to the society and the democracy. It is a very deep-seated problem that implicates the culture and the rule of law.

What to do? There has been recent progress, I think, particularly on the supply side. But we shouldn't be optimistic that what we have done today will be a quick fix or make overnight changes. We have three international instruments, two of which are relevant to this region: the Convention of the OECD, the Anti-Corruption Convention of the Council of Europe, and the OAS Anti-Bribery Convention.

We have the international financial institutions—which until very recently had not focused on the problem of corruption in either their procurement or their project work—beginning to take important steps in this area. But I would like to emphasize that I view these as important, but partial, solutions.

Speaking about the OECD Convention and other OECD measures for a moment: the OECD Convention is a supply side instrument that has already been mentioned by Assistant Secretary Mulloy. It calls for the criminalization of transnational bribery and for countries to take steps in related areas like accounting standards and money laundering. So it's generally analogous in that respect to our own Foreign Corrupt Practices Act.

It also calls for cooperation among the member countries in investigations and enforcement of corruption cases. This may be one of the most important aspects of the OECD Convention. It has the monitoring mechanism that has been mentioned earlier.

What doesn't it do? It doesn't deal with the domestic bribery issues, and it doesn't really deal with the demand side of the issue, except to the extent the cooperation provisions can help in asset recoveries.

So as far as the OECD Convention is concerned, it does have limitations in it. But even with those limitations, it is an extremely important instrument for capital exporting countries. It offers an extremely important discipline, if you will. We should try to get other countries which have signed this Convention, but not yet ratified it, to do so.

There are some very important OECD members in Western Europe—for example, France, Italy, Belgium, and the Netherlands—that have not yet ratified. France, as I understand it, has conditioned its elimination of tax deductibility of bribes on ratification of the Anti-Bribery Convention.

So it is very important to continue to gather additional ratifications. But this is not a universal instrument. Frankly, I think it is less relevant to try to bring into the OECD tent countries that don't qualify as capital exporting countries. Transitional economies aren't going to gain much by becoming parties to the OECD Convention.

What about the Council of Europe Convention? It is a little broader instrument. You may be familiar with it. It deals both with the supply and the demand side of the corruption problem, but its focus continues to be on criminalization, requiring countries that participate to pass laws, criminalizing different kinds of acts of corruption.

It also provides, like the OECD Convention, for cooperation in investigations and enforcement. It does have a monitoring mechanism, something called GRECO, which could be a very important feature.

So for the countries in the region, this again is an important tool. It is an important first step. Its ratification, implementation, and enforcement should be encouraged. There also should be cooperation and discussion—and I know this Commission has promoted some of those—between the OECD and the Council of Europe to promote links between the two, because we should try to evolve toward a system where, particularly as it concerns asset recoveries, you can use these international conventions to try to go after corrupt situations and to go after government officials who have the money in a Swiss bank account.

But both of these conventions are really first steps, limited in scope. They need implementation. They need enforcement. They really don't deal in a fundamental way with the demand side of the problem. That is really where I think many efforts need to focus on now for these transitional countries in the region.

The demand side of the equation includes multiple elements, because, as other speakers have emphasized, the demand side really implicates very fundamental issues in this society: the rule of law, the development of civil society. So, for example, on the civil service side, you want to look at how to professionalize the civil service, how to pay people a living wage, the development of ethical rules, ethics-in-government rules, and disclosure rules that are designed to promote transparency. That is one element.

Another element is the law reform element, which other speakers have touched on. There, at least from a business perspective, some of the priority issues would be government procurement, tax, and customs laws. I would also add to that list administrative law, because following privatization in many industries you need to put into effect a fair and transparent and predictable regulatory structure, an administrative law structure.

The law reform effort should be designed to reduce discretion where it creates opportunities for corruption, to reduce unnecessary regulation, and to provide transparency.

A third plank of this demand side reform is to try to strengthen the judicial system. That's a task that encompasses the judiciary, the police, and the prosecutors. Civil society is a fourth area that needs to be addressed. The NGO sector is an important sector—as others have mentioned in this area—and should be encouraged.

The press plays a very important role. I can tell you from my experience counseling U.S. companies, there is nothing they fear more than having an article about them on the front page of the *Washington Post* or the *Wall Street Journal* saying that they have engaged in some improper activities. The watchdog role of the press is extremely important.

The business community should be encouraged to do the kinds of things one of the previous speakers, Dr. Sullivan, addressed. There needs to be general education in the public about the undermining effects of corruption.

Finally, as I have mentioned in my testimony, there need to be monitoring mechanisms for these special situations like the reconstruction in Kosovo, to make sure that the aid that's given to rebuild that effort reaches its intended goals.

I will stop my remarks there. This is an agenda obviously that will not be accomplished overnight. It is an agenda that requires patience, a long-term view. I think it requires the coordinated efforts of a number of different organizations. It will require country-by-country approaches, I think, that find the right points of entry and the right wedges in particular situations. So it's no small task, but it's really central to the future of those countries.

Thank you very much.

Senator CAMPBELL. Thank you.

When I was in Russia the week before last, the St. Petersburg Economic Development Council invited me to attend one their meetings. They had one—well they had a couple of agendas, but the main one was seeking American investment capital.

When I was listening to them describe all the projects they wanted to do: they wanted to build a new beltway around the city and renovate buildings, and do all these other things—including building a light rail system to Moscow—all these grand projects that are going to cost huge amounts of money, I kept thinking there ought to be some way we could hook that investment capital to reforms in their government. But on the other hand, as you mention, it's not easy.

I mean, because a lot of people are right on the edge, and the law of unintended consequences being what it is, if you withhold all that, if you could do it in the first place, if you withhold it all, you end up with a very bright Russian scientist going to work for Iran or something, because they can't make ends meet. They can't wait for all the reforms to feed their families. They have got to put bread on their table. You take whatever avenue is the one to survival. So it's a very complicated problem. I recognize that.

Our final witness will be Mr. Peter Grinenko. Please proceed.

**TESTIMONY OF PETER GRINENKO, PARTNER, STAYSAFE  
SECURITY CORPORATION, NEW YORK**

Mr. GRINENKO. Thank you.

Senator CAMPBELL. As with the others, Mr. Grinenko, your complete written testimony will be included in the record.

Mr. GRINENKO. Thank you.

Mr. Chairman, I want to thank you for the opportunity to address the Helsinki Commission today on the issue of corruption in the countries of the Organization of Security and Cooperation in Europe. This is a subject with which I have been closely associated in three ways: through my experience as a detective in New York City, as a businessman in the OSCE region, and as an American with ethnic ties going back to Russia and the Ukraine.

Just a little about myself. My mother's grandfather was a gentleman in the Czar's army, and all the male members of her family were killed by the Bolsheviks. My mother was born in 1917 and married my father, a Ukrainian, in the 1930s. After World War II, they managed to escape to Germany, where I was born. I grew up in the United States in an extended family that spoke Russian, French, and English.

In my early years, I spent several years in the company of my great-grandmother and her daughters. They told me about Russia—the value placed on culture and the morality that existed there before Communism. Even then, I sensed that their values were different from my mother's. At the time, I didn't understand the reason for the difference. Then I went to Russia.

In 1987, after over 18 years in the New York City Police Department, I was thinking about retirement. Most of my career in the police department involved property crimes, with over 10 years in the Auto Crime Division. In 1980, because of my ability to speak Russian and the Soviet emigration in the mid-1970s, I had experience dealing with Soviet criminals in the United States. As a result, I was recruited by the FBI for a small task force that dealt exclusively with criminals from that part of the world.

Not only were we very successful in the investigations and prosecutions of these criminals, but this experience greatly enhanced my understanding of the Soviet mentality. At the same time, policies instituted by Gorbachev were opening up the Soviet Union. I already had a number of businesses in the United States. I thought that this was the perfect opportunity to use all my experience to get involved in a new and interesting venture in the land of my ancestors.

I visited the Soviet Union for the first time in 1987. By 1988, I had set up my first joint venture. I still travel there four to five times a year, usually a month at a time. I continue to conduct business in a small and limited way. The main reason that I have limited my exposure is the topic of today's hearing. Based upon my experiences, bribery and corruption in the former Soviet Union are not the exception, they are the norm.

While corruption existed before the dissolution of the Soviet Union, the collapse of political controls and the influx of hard currency have produced post-Soviet business practices that are even more corrupt. The purported advent of capitalism and democracy in that part of the world has not only made matters much worse, it has also had a much greater effect on the public in general.

In 1991, I shut down my largest enterprise, which included operations in Latvia, Russia, and the Ukraine, because I realized that there was no way for me to conduct business in these emerging economies without taking part in the corruption. Combine this with a substan-

tial loss of product due to pilferage by factory workers, among other obstacles, and you begin to realize, as I did, that it was next to impossible for me to make a go of it.

However, I kept trying. Some call it wishful thinking on my part. More times than not, I ran into the same problems. For example, an enterprise in Russia requested I sell them equipment for a small meat-processing plant. I offered to set up a turnkey operation for \$1.2 million. However, the Russian business people with whom I had negotiated on this project chose to accept an offer by an Italian company who set up a much smaller operation, but for \$800,000 more than I had proposed. Why?

As I found out later, the Italian company had paid off the director and his assistants. Even though I didn't consider myself naive at the time, I was still flabbergasted by how blatantly open the corruption was.

It really bothers me to see what has become of the country that my great-grandmother used to speak of with such pride. It has become important to me personally to try to understand what had led to the current state of affairs. In over 12 years of exposure to the Soviet and post-Soviet system, I have learned that there were many contributing factors. Almost all of them can be tied to the effects of 70 years of communism.

The socialist ideal that everyone is equal did not stop people from wanting nice things; but it fostered an environment in which people could not get the nice things they wanted legally, so they resorted to illegal methods. People went to work not just for their salaries, but for what they could steal. They then used what they stole to barter for the luxuries, or sometimes just basic necessities that were in short supply.

By making the absolutely normal human desire to have a criminal activity, communism produced two generations of people for whom corruption became a way of life. Furthermore, there were the legal and sub-legal limitations on religious practices. To be a success in the communist system, you could not be known as a religious person. You could lie, cheat, steal—but as long as you could quote the latest party line and had the right friends, that was the ticket to success.

If you can imagine the result of the morality of that time, then today's situation is even easier to understand. The people who were responsible for all this are still in control now, but today they wear the jacket of democracy.

When I found out several months ago that I might be asked to speak before this Commission, I started questioning people about their personal experiences with corruption. This was not an easy task since most people don't appreciate it when you ask them things like, "When did you first become a thief?"

On one occasion I had a discussion with a woman in Russia. I told her about a case that I had worked on as a detective in New York. We had recovered a quarter million dollars. I explained to her how we went about handling the money. As we spoke, it became abundantly clear to me and to her that she and everyone that she knows would have handled the money very differently than we did. After our discussion, she realized how ingrained her corrupt attitude was and conceded that her attitude was probably indicative of the society in general.

When I asked another woman, a healthcare worker in Latvia, about her first experience with corruption, she tearfully related a story about her child on the *kolhoz*, which is a collective farm, in Belarus. She was about 8 years old, and her father used her as a lookout while he stole grain from the warehouse. She said her father excused what he did by saying that the grain belonged to the state and the people are the state. In addition, he claimed that it really wasn't stealing because the director of the *kolhoz* would also be taking some.

Corruption in this part of the world does not just occur in government. It is not just a problem when trying to conduct business. It is a part of the society and is perceived as a means of survival. Indeed, the situation even exists within the immigrant community in the United States. For example, immigrants from Russia who have organizational and managerial positions in the home healthcare field help more recent immigrants in obtaining the training and certification required for employment. They also help find positions for these immigrants once they are trained. At each step of the process, bribes are expected by the manager. If the immigrant does not have status—that is, an illegal immigrant—the situation is even worse. Typically, those without status are required to pay additional monthly bribes to the managers in order to keep their jobs.

My Chairman, I hope that my testimony has helped to personalize your knowledge of the problem that our business persons and law enforcement personnel face in dealing with corruption in the countries of the OSCE. I also know that the Commission and the Congress would like to hear proposals on combating this problem. I don't think there are any realistic short-term solutions to this problem. Hopefully, some of the legal approaches initiated by the international community to combat bribery will have some effect. But any long-term solutions must address society as a whole.

In my opinion, the only methods that have any real chance of working are those aimed at the younger generation in these countries. It is unfortunate, but it is my experience that most of the older generation have absolutely no confidence in their government or in their own future. They are just concerned with having as much as they can now; and in order to get it, they will do whatever they have to do.

Just teaching students from the former Soviet Union about democracy and capitalism won't work. However, it is my understanding that there are currently programs in which high school and college students come to the United States for a short period of time, go to American schools, and live in American families. I think this is a good idea.

Young people from these countries need to be exposed to our way of life—yes, even with its negative characteristics—so that they can learn about capitalism and democracy firsthand, so that they will get a historical perspective of our freedom and prosperity. They need to understand that delayed gratification and even sacrifice may be necessary before they make their first million.

They also need to see how basic morality and rule of law works to protect property and lawfully acquired wealth, that armed guards are the exception rather than the norm. Their experience here will allow them to see how destructive corruption and bribery are to the moral fiber of their society.

Some of them may not be especially moved by these lessons, but I believe that many of them will return home and share what they've learned. With a large number of students and over a number of years, I am convinced that slowly, changes will occur.

When we send teachers to set up various training programs over there now, they are ineffective because the Russians laugh at our efforts. They look at us as naive and cynical Westerners, getting paid to come to address a culture that we know nothing about. I don't think they will be as quick to laugh at their own family members or fellow citizens.

These opportunities should be available to a large number of students on a continuing basis. I don't know how the system works, but insofar as the United States Government is a sponsor, I trust that there are necessary safeguards in place to assure that the selection of participants is equitable. Otherwise, only those children of the controlling elite might end up being included.

We currently send millions in aid, but those in power only use it for their own purposes. They have had 70 years of communistic teaching and have lived the reality of corruption. The next generation of Russians, Ukrainians, Latvians, et cetera, need to see another type of reality. I don't think they will see it or understand it unless they live it.

Mr. Chairman, our own security and economic interests are enhanced when crime and corruption are reduced in countries that we need to deal with. I hope this hearing will assist the Commission and the Congress in this endeavor. I will be glad to answer any questions that you or any of the members of the Commission might have.

Thank you.

Senator CAMPBELL. I thank you.

I have several questions. I am also going to ask all of you to respond to some of them in writing since we may run out of time. Before I do though, I would like to introduce Congressman Frank Wolf, who is a member of the Commission.

Thank you for coming over, Frank. Did you have an opening statement?

Mr. WOLF: No.

Senator CAMPBELL. I was reading your testimony while each of you were talking. Mr. Grinenko, how did you find out this Italian firm paid—they bid, or I guess they were charged—\$800,000 more to set up a smaller operation. You discovered that there had been some payoff to the director and the assistants. How did you find that out?

Mr. GRINENKO. It's really simple. You would set out a bidding situation. You are dealing with the director of the factory or the plant. In this case it was—

Senator CAMPBELL. Did they tell you?

Mr. GRINENKO. He didn't. People from my side found out.

Senator CAMPBELL. But you had proof that that was done? It wasn't just rumors?

Mr. GRINENKO. Absolutely. I mean the amount of the money might have been exaggerated.

Senator CAMPBELL. You have been back a number of times to the Soviet Union and Russia. Let me ask you two things. Is the situation getting any better or worse in the number of times you going over

there? What advice would you give to an American businessman if they were going over there to the former Soviet Union and trying to do business?

Mr. GRINENKO. I would suggest that the American businessman remain here and invest in the stock market.

But I wanted to mention one other thing. Dr. Shelley mentioned the independent media, and if they would encourage it. There have been several killings of reporters in Russia, unsolved, will never be solved.

Senator CAMPBELL. Is it your experience that the free media might be in jeopardy, but that there are other media that tow the line and are—some of the media themselves are involved in the payoff process?

Mr. GRINENKO. Yes, Mr. Chairman. It is that they have to support their families. I mean there are very few in the media that are going to risk dying, and many have died. There might be the intent to report, but it's not the reality.

Senator CAMPBELL. When the wolf is at the door, it's pretty hard to make all kinds of wonderful high level—

Mr. GRINENKO. Absolutely.

Senator CAMPBELL. Yes. When we were over there, the fellow that was driving our car was a physicist teaching at the local university. He had to drive a taxi at night to make ends meet. He told us that one of the custodians in his university was a thoracic surgeon. When things are that tough, I can understand how it's not too hard to look the other way if you thought you could get some money for it.

Mr. GRINENKO. That's right.

Senator CAMPBELL. You also mentioned that your investigative work in New York City enhanced your understanding of the Soviet mentality. How does that Soviet mentality play a role with respect to corruption? Is that how it was developed over 70 years of communism—that it is sort of ingrained? Is that what you meant by that?

Mr. GRINENKO. That is absolutely correct. It's just moved over. Under socialism, it was a little controlled, a little quieter, not as open. Right now it's wide open. I mean if there isn't some benefit derived for that person—whether it be a warehouseman, whether it be a cab driver—if there is something that has to be done, those people need to be compensated for it beyond getting paid.

Senator CAMPBELL. Fair enough. When we were over there, we visited the National Police Training Academy. I forgot the general's name that was in charge of it, but it's obviously conducted at least in cooperation with the army because the commanding officer wasn't a civilian policeman. He was a major general.

As I understood it, that police academy trains all the police from throughout all the Russian cities—the training goes through that central academy. It's not like the United States, where New York has an academy and L.A. has an academy, and everybody has their own. It's one centralized academy.

He told us that on one of his visits to the United States, while visiting the Chicago Police Department he noted there were three Russian criminals in jail in Chicago, which obviously led me to confirm what I had already believed—that the growth of Russian-American gangs and Russian-American crime is on the rise. Is that your belief too?

Mr. GRINENKO. That whole aura of Russian organized crime is a whole, other subject. I mean, there are three people that really benefit or three groups that benefit from “Russian mafia.” One, the journalists and the people that write about “Russian mafia.” Two, law enforcement, because they investigate very interesting, important criminals. The most important reason that there is a “Russian mafia” is because the “Russian mafia” wants to have a “Russian mafia”, that is, the criminals involved. They use that. They use that aura to frighten others.

Are they organized? No. Are they structured? No. Are they criminals? Yes. Are they violent? Yes. But for the most part, the entire immigration—that is the Russian immigration—and what we’re discussing has an overall economic effect on our society because of the amount of money that is scammed and schemed out of our system.

Senator CAMPBELL. Which way do you think the flow is going when you talk about—this is a little off the agenda, but I am interested in it—the flow of organized crime. Is the flow coming in this direction?

Mr. GRINENKO. Exaggerated.

Senator CAMPBELL. Does that come from Russia this way or do the American criminals recruit that way?

Mr. GRINENKO. The Russian criminals in Russia have a good time committing all their crimes and controlling Russia. For them to come over here—it’s like for the longest time I had—people who were saying that they were recruiting Russian criminals to come here, kill somebody, and go back to Russia. It is like asking me to go to Taiwan to kill a Taiwanese resident. I wouldn’t even know what bus to take or cab to call. The whole concept is ludicrous.

Yes, there are gangs. There are criminals. They are a part of the system in Russia. They are used. Prior to the coup, the criminals were used by government. After the coup, there was a little time where the criminals were getting more control. At the moment, we are back to the government and powers in the government controlling the criminals.

Senator CAMPBELL. There is a relationship between the government officials and organized or disorganized crime?

Mr. GRINENKO. Absolutely. They develop deficits. They can blame the criminals for it.

Senator CAMPBELL. Dr. Sullivan, let me ask you about the upcoming parliamentary elections later this year in Russia and the Ukraine. How do you think that that is going to affect the business climate?

Dr. SULLIVAN. The most fundamental problem with the business climate right now is the fact it’s stabilized at about 24 rubles to the dollar. If they can keep it there, we’ll see increasingly the small business, the medium-sized business, moving into a ruble-based economy.

They are actually not doing very badly. I put the same question to one of the vice presidents of the Russian Chamber recently, about how they saw their small business members faring. It wasn’t bad. The big danger will be will it become destabilized. That is where the parliamentary elections and then increasingly the presidential election can throw a monkey wrench into the system.

As we saw in the last presidential election—in the wake of that election and the promises, the side payments, and everything else that went on with it did have that effect of destabilizing the economy.

Senator CAMPBELL. You were over there talking to a number of Russians that spoke English, that—I mean they were pretty open about some of the candidates that are running for president of Russia next year. One candidate in particular—he is just a known criminal. I mean, he has a record of corruption, a record of bribery, a record of being on the take, is a snake. Yet he is running for president. It seems like the people I talked to—the Russians I talked to—were fully aware of it. They knew it. Yet he has an inside chance—they say—of becoming the president of the country. My gosh, if that happens I think we are all going to be in trouble.

Dr. SULLIVAN. I am not sure exactly who you are talking about, but—

Senator CAMPBELL. I am not going to mention who I was talking about. I don't want to meddle in their internal business.

Dr. SULLIVAN. Three or four candidates come to mind, but I'm not sure that that is actually going to happen.

Senator CAMPBELL. One seems to rise to the level of heads and shoulders above the other ones, to the Russians I was talking to.

Dr. SULLIVAN. I am not sure it is going to unfold quite the way that anybody thinks. I mean the prediction horizon is really literally about 48 hours in Russia. Moving beyond that is extraordinarily difficult.

But this is something that traces its roots back to the Triple M scandal. If you recall some years ago, there was a pyramid scheme where a guy named Sergei Movrody ran a pyramid—just flat out stole money, no question about it—and then ran for parliament, got elected, and claimed immunity. So there is a tremendous incentive for people that engage in dubious commercial transactions to do that.

Senator CAMPBELL. Do you know the status of the former Ukrainian prime minister? His name was Lazarenko. I understand he is wanted by the Ukrainian government for corruption, by the Swiss government for money laundering. Do you know where he is? Has he applied for a visa or asylum or anything in this country?

Dr. SULLIVAN. Well, I know that he has applied. I don't know what the disposition of that was. That case kind of disappeared off the radar screen from my personal attention.

Senator CAMPBELL. He has applied?

Dr. SULLIVAN. He has applied. He was, I believe, arrested, trying to enter the United States. He was arrested in Switzerland using a Peruvian or Filipino passport, I remember, and then exported back to Ukraine, and then turned around and left and came here. But I don't know where he is now.

Senator CAMPBELL. Thank you.

Dr. Shelley, when we talk about some of the mistakes we have made, I know it's like un-ringing a bell, but do you think there are steps that the U.S. business could have taken to deal with corruption in the emerging Soviet market? Do you think they are really aware of the pitfalls or did we just have this kind of pie-in-the-sky attitude that the new open markets kind of rush in pell mell without recognizing what we were going to have to go through as American businessmen?

Dr. SHELLEY: I think that very much we ignored this issue.

Senator CAMPBELL. Did we even know it? I mean as I mentioned before, we might have been applying a framework of reference that we didn't—

Dr. SHELLEY: I think while we were looking at the economic growth in Asia—which we all acknowledge—there was a lot of corruption in Asia in the early 1990s, but those economies were growing. It wasn't until we had this meltdown in Asia that I think that corruption has shown up on everybody's radar screen and they have understood it better.

I know now that investors are taking a much more careful look at this issue. I mean when you are commissioning a risk survey for some investors now, they will want a corruption element of this, to understand what they are going into.

I remember several years ago talking to the president of one of our major oil companies who was working—he was based in Moscow and saying he was having the hardest time dealing with this issue of corruption; but he was also having a terrible time dealing with the American Embassy and trying to convince them that this was a terrible problem for him—functioning, competing in this environment as a businessman who was trying to operate in an honest way.

So the people on the ground understood once they got there. But I don't think there was enough understanding back here by the people sending the people out into the field.

Senator CAMPBELL. I mentioned a couple initiatives that we undertook in addition to our formal OSCE agenda in St. Petersburg. One was meeting with representatives of American companies. We met with Lockheed and Gillette, Pepsi Cola and two or three others. I forgot all of them. But some of them—the problems lie over there; and a couple of them—the problems lie over here with getting permits to export items from Russia over here, which we're working on.

I also mentioned that I had gone to the National Police Training Academy and found that they had some interaction with some agencies, but very little when you were trying to track international organized crime. I know that is peripheral to official government corruption, but there is a connection, as we have heard.

Dr. SHELLEY: An enormous connection.

Senator CAMPBELL. I would maybe like to ask you—what is your assessment of the cooperative programs that exist now, or do you know of any?

Dr. SHELLEY: I know of plenty of them. I think that there is a tremendous investment of resources now on training programs. But as Mr. Grinenko was talking about, part of the problem is that we are sending people over for short periods of time. So they go in for 3 days, 5 days. They don't have enough background to go in and understand who they are dealing with.

Senator CAMPBELL. That is our people going over there.

Dr. SHELLEY: Our people going over.

Senator CAMPBELL. What do you think of the idea—I have been thinking about framing up a bill along the lines of Senator Stevens' bill—that allows elected officials to come to the United States on training programs. I have been thinking about a similar initiative for law enforcement personnel to come over here and spend time with our FBI or ATF or even larger metropolitan police departments, etc.

Dr. SHELLEY: Some of that is going on. In Romania, they are having cooperative relationships with Kentucky, where they are sending police over. They have had this for quite a while. So some of these exist. The Estonians have had close relationships with the Baltimore

Police Department. So that has existed very much on a local and regional level. Some of it has been successful. Some of it—there are problems of endemic corruption, the law enforcement that affect this.

Senator CAMPBELL. I have no further questions, but I will submit some in writing. The other Commission members probably will have additional written questions. The Commission will keep the record open for at least a couple weeks. If you could get those responses back, we will include them in the record.

I thank you very much for appearing. This Commission hearing is adjourned.

(Whereupon, at 3:40 p.m., the hearing was adjourned.)

**STATEMENT OF HON. STENY H. HOYER**

Mr. Chairman, thank you for organizing this important hearing focusing on the economic dimension of the OSCE and one of the most daunting challenges to promoting economic growth and stability in the region, particularly for those participating states with economies in transition.

Clearly, bribery and corrupt economic practices do untold harm to developed democracies and market economies. They have even more deleterious effects on those states attempting to construct enduring democratic institutions, encourage democratic values and practices, and put into place viable market-based economies. Bribery and corruption greatly reduce popular confidence in free markets and in democracy. They distort economic decision-making and hinder economic development. Bribery and corrupt practices strike at the heart of efforts to promulgate and implement the rule of law.

The United States mission to the OSCE, led by Ambassador David Johnson has urged the OSCE to address the issue of bribery and corruption and work to promote greater transparency in government and respect for the rule of law through the economic forum of the OSCE.

Mr. Chairman, as you mentioned, you led the effort of the United States delegation to the OSCE parliamentary assembly, held in St. Petersburg, Russia earlier this month, to address ways to combat corruption, bribery and organized crime. I support your call for an OSCE ministerial meeting to address this issue and I also believe that an assessment of OSCE participating states' efforts to combat bribery and corruption should be an essential element of the economic dimension implementation review which will occur prior to the OSCE summit in Istanbul in November.

I want to take this opportunity to welcome our new commissioner from the department of commerce, assistant secretary Patrick Mulloy and our distinguished panel of witnesses. I look forward to their testimony and am particularly interested in recommendations for specific steps which can be undertaken in the OSCE and other regional and international organizations to combat bribery and corruption.

Thank you, Mr. Chairman.

**TESTIMONY OF PATRICK A. MULLOY, ASSISTANT SECRETARY  
OF COMMERCE FOR MARKET ACCESS AND COMPLIANCE**

**INTRODUCTION**

Good morning. My name is Patrick Mulloy and I am a newly appointed Executive branch Commissioner of the CSCE Commission. Today, I am testifying in my capacity as the Assistant Secretary for Market Access and Compliance (MAC) of the International Trade Administration (ITA) at the Department of Commerce.

I am pleased to be here today to speak to the Commission on Security and Cooperation in Europe (CSCE) on the problem of corruption in the Organization for Security and Cooperation in Europe (OSCE) region and to review U.S. Government strategies to combat bribery and corruption. We have all read the stories in the news about institutional corruption, modern day mafias and organized crime rings, so much so that we are becoming immune to such stories. But ignoring the stories will not solve the problems, and that is why this hearing is so important. I hope to bring to the Commission's focus on corruption a perspective on issues of transparency and their importance to the creation of a better business climate.

My testimony will consist of three parts: a general overview of the problem of corruption, what the U.S. Government is doing to address the supply side of the bribery equation by deterring the payment of bribes, and finally what we're doing to address the demand side by helping to combat systemic corruption.

**OVERVIEW**

The eradication of bribery and corruption in international commerce has been a key U.S. trade objective for many years. Bribery impedes trade and hurts our economic interests by providing an unfair advantage to those countries which tolerate bribery of foreign officials. It is also a practice which undermines good governance and detracts from economic growth in many reforming and developing countries. In Central Europe (CEE) and New Independent States (NIS) of the former Soviet Union, we are also concerned about systemic corruption, which seriously impacts trade and investment, and impedes our ability to work with the transitioning countries on our common objectives—the development of market-based democratic societies based upon the rule of law, and enhancing prospects for attracting the foreign investment critical to sustained economic growth.

In our report to Congress on the implementation of the OECD Antibribery Convention, an agreement that deals with the supply side of the equation, and which I will discuss in more detail shortly, we note that from the period May 1994 to April 1999, allegations of bribery were made involving 294 international contracts involving \$145 billion dollars in trade. In addition, these numbers probably underestimate the amount of international contracts affected by bribery of foreign public officials, as bribes often go unreported and are difficult to detect. We believe that the industries most affected by international bribery are: defense procurement (about half the allegedly tainted contracts), aerospace, communications, infrastructure, energy and transportation.

With regard to the demand side of the equation, we are aware that corruption is pervasive in CEE and the NIS and that it is having a negative effect on those economies. The costs of corruption are high: It undermines democracy and economic development. Bribery of public officials also undermines good governance and democratic practices. It slows economic development by raising costs and encouraging purchases of inferior products and services. In a number of countries, the corruption problem is broad and deep; it includes officials at all levels, ranging from the high levels of government to customs clerks. In some cases, corruption pervades much of the civil service and regulatory system. Conflict of interest is a poorly developed concept, and many bureaucrats retain their commercial interests while in power. Corruption results in lack of transparency and predictability in government processes, fosters cozy insider relationships and dealings in the business sector, creates lack of respect for generally accepted codes of business conduct, and fuels organized crime.

In most of these countries, systemic corruption has deep historic and socio-economic roots. These include cynical public attitudes based upon a system of autocratic governance and economic monopoly; a history of a society based on rule of men instead of rule of law; unreformed laws and ineffective law enforcement institutions; inadequate legal and regulatory infrastructure and weak democratic institutions; and an undeveloped civil society.

There is a high correlation between the existence of corruption and the lack of strong institutions founded upon the rule of law. Developing countries that do not enforce the rule of law tend to allow their government officials more discretion. The World Bank reports that the higher the degree of regulatory discretion, the higher the incidence of bribery of officials. Bribery and corruption also create a risky and costly investment climate. Studies by the World Bank indicate that corruption slows foreign direct investment. Investing in a relatively corrupt country, as compared with an uncorrupt one, is equivalent to an additional "private" tax on the investment. Developing and transitioning economies that can least afford these burdens are often hurt the most.

Detailed studies on the effects of corruption conducted by the World Bank illustrate that there is systemic corruption in the region. Such corruption "hurts public welfare, taxes private sector activity, and is deeply institutionalized." The types of corruption that the studies found were prevalent were embezzlement of public funds, theft of state property, and bribery in several areas, including government procurement. The World Bank study also emphasized that firms were hurt by corruption, which cost them money. We encourage states in the region to address corruption as a serious impediment to business and their own efforts at economic reform.

## II. U.S. GOVERNMENT RESPONSE

### A. U.S. GOVERNMENT ACTION TO DETER THE SOURCES OF BRIBES

#### *USG Support for OECD Convention*

Since the 1970's, a key element of our international strategy to fight bribery and corruption has been to convince other major exporting countries, particularly members of the Organization of Economic Cooperation and Development (OECD), to enact legislation criminalizing corrupt practices, as Congress did in the Foreign Corrupt Practices Act (FCPA). Under the FCPA, persons who offer, promise or pay a bribe to foreign public officials can be prosecuted and receive stiff penalties, including jail sentences and substantial fines.

If all governments of countries with large exporting companies enacted and enforced such legislation, we could staunch the flow of bribes and help importing countries, many of which are developing or transitioning economies, to promote good governance and sound business practices. After several years of intensive diplomatic effort involving many senior U.S. officials, including Commerce Secretary William Daley and Commerce Under Secretary and former Ambassador to the OECD David Aaron, the United States succeeded in getting other nations to follow our lead and commit to enacting antibribery legislation.

The OECD Antibribery Convention, signed by thirty-four countries (the twenty-nine OECD member countries and Argentina, Brazil, Bulgaria, Chile and the Slovak Republic) obligates the world's largest economies to make it a crime to bribe the public officials of other countries in international business transactions. It is aimed at proscribing the activities of those who offer, promise or pay the bribe. For this reason, the Convention is often characterized as a "supply side" agreement, as it seeks to effect changes in the conduct of companies in exporting nations. Twenty-six OSCE participating States are also OECD Antibribery Convention signatories (see attached chart). The Convention obligates the Parties to criminalize bribery of foreign public officials, including officials in all branches of government, whether appointed or elected. The definition of a public official covers any person exercising a public function, including for a public agency or public enterprise; and any official or agent of a public international organization.

The OECD Antibribery Convention entered into force on February 15, 1999, for the twelve countries that formally ratified it by that date: Iceland, Japan, Germany, Hungary, the United States, Finland, the United Kingdom, Canada, Norway, Bulgaria, Korea, and Greece. Austria deposited its instrument of ratification with the OECD on May 20, 1999, becoming the thirteenth country to formally ratify the Convention, followed by Mexico on May 27, and Sweden on June 8, bringing the number of countries that have deposited to 15. The Convention enters into force for Austria, Mexico and Sweden on July 19, July 26, and August 7, respectively.

Many other key signatory countries still need to ratify the Convention, particularly France, Italy, the Netherlands, and Belgium. Also, the OECD is continuing to address the issues of bribes to political parties and candidates and the role of foreign subsidiaries in bribery transactions, as well as other issues. In addition, we will con-

tinue pressing the OECD Convention signatories who have not already done so to end tax deductions for overseas bribes. By signing the Convention and moving forward to implement it, each of the signatories has recognized the harm bribery imposes on both sides of the bribery equation, the bribe givers and the recipients.

At the January 15-16, 1998 Fifth Session of the West-East Conference of Ministers of Economy, Industry, and Trade (the "Muenster Conference"), all Muenster countries pledged to increase transparency in business dealings by combating bribery and corruption. Specifically, these 23 countries endorsed the OECD Convention on Combating Bribery of Foreign Public Officials in International Transactions. The Sixth Session of the Muenster Conference will take place in Moscow, Russia on November 15-16, 1999. We intend to place the issue on the agenda for Muenster VI as a priority for the United States.

#### *Monitoring Process*

The OECD has established a rigorous process to monitor implementation and enforcement of the Convention. Our experience with the first stage of the process confirms that it is a serious undertaking that will encourage parties to fulfill their obligations under the Convention. We will continue to take an active role in this multilateral monitoring process, and we are confident that the monitoring regimes in place and each country's self-interest will move each signatory to faithfully implement the Convention.

#### *U.S. Monitoring and Congressional Report on Implementation of the OECD Antibribery Convention*

The U.S. Government is also devoting considerable resources to monitoring implementation of the Convention independent of the OECD process. Monitoring other signatories' compliance with the Convention is crucial for achieving our shared goals. An important element of the U.S. monitoring process involves preparation of the Secretary of Commerce's annual report to Congress under the International Anti-Bribery and Fair Competition Act of 1998 (IAFCA). The International Trade Administration's Market Access and Compliance organization prepares the report, working closely with the Department's Office of General Counsel, the State, Justice and Treasury departments, and the Securities and Exchange Commission. The report reviews progress on implementing and enforcing the Convention, including an examination of laws criminalizing bribes to foreign public officials and disallowing the tax deductibility of bribes. It summarizes efforts that the United States is taking to strengthen the Convention. And it assesses antibribery programs and transparency in major international organizations. Our report is now posted on the Trade Compliance Center Website at

Our first annual report to Congress, released on July 1, 1999, found encouraging progress on signatories' implementation of the Convention. As mentioned above, fifteen of the 34 signatory countries had deposited an instrument of ratification with the OECD and put in place the legal requirements to criminalize the bribery of foreign public officials. Twelve of the fifteen countries who have deposited their instruments of ratification are also OSCE participating States. Most

of the remaining countries are well advanced in their internal approval and legislative processes and are expected to deposit an instrument of ratification with the OECD by the end of 1999.

In the first eleven countries whose implementing legislation we examined, we generally found that efforts were made to address all the requirements of the Convention. With a number of countries, however, questions emerged from our analysis that require further examination. We also found that signatories to the Convention had made great strides toward eliminating any remaining tax deductibility for bribes to foreign officials. Still, four countries—Australia, Luxembourg, New Zealand and Switzerland—had not yet completed efforts to disallow tax deductibility, and in some others questions remain about the implementation of the laws ending deductibility. The Treasury Department is closely tracking changes in signatories' tax laws.

We are encouraged by these findings. Our task now is to ensure that all signatories complete ratification of the Convention as quickly as possible and move ahead to enforce their antibribery laws.

#### *MAC Monitoring of the Convention*

As Assistant Secretary for Market Access and Compliance, I can assure you that monitoring compliance with the Convention is a high priority for the Commerce Department. We are determined to make the Convention an effective tool to fight bribery and corruption. In addition to preparing the annual report to Congress, the Department of Commerce is taking other steps to monitor the Convention and track international developments on bribery that affect U.S. business.

- The Trade Compliance Center, which serves as the Department's focal point for monitoring compliance with international trade agreements, will give increased attention to bribery and implementation of the Convention. The Center is strengthening its outreach to business groups and nongovernmental organizations interested in bribery-related commercial problems. The Trade Compliance Center is also enlisting the cooperation of about 70 business and labor organizations that participate in its Compliance Liaison Program to provide information on foreign competition involving bribery of foreign public officials and on difficulties encountered because of foreign shortcomings in implementing the Convention.
- We have added bribery as an issue to the Trade Complaint Hotline on the Compliance Center Website. ( With this link, U.S. business and interested nongovernmental organizations now have a direct channel to the Commerce Department to report bribery-related problems.
- Working with the State Department and other foreign affairs agencies, the Trade Compliance Center and Department's Office of General Counsel will support increased diplomatic and public affairs activities on the Convention. Senior officials will include points on the Convention in their meetings with foreign government officials and speeches to U.S. and foreign audiences. U.S. diplomatic missions will be kept informed of current developments on the Convention so they can effectively participate in the monitoring process and engage foreign governments in a dialogue on key bribery-related issues.

- Improved research and analysis of current developments on international bribery will also be part of our monitoring plan. The Trade Compliance Center will track closely information on bribery and corruption in the international press, business publications and our contacts with private sector and non-governmental organizations.
- Also, our Office of the Chief Counsel for International Commerce compiles an informal summary internet document called the Anti-Corruption Review, which describes many of the international anticorruption initiatives I am speaking about today, located at .

The Department of Commerce, in close cooperation with other U.S. agencies, has established an intensive monitoring program that seeks to involve the private sector and non-governmental organizations. We will continue giving a high priority to monitoring implementation of the Convention so that U.S. business can fully realize the benefits of this important international agreement.

#### **B. CORRUPTION ON THE DEMAND SIDE**

The U.S. Government is also working on several initiatives, both globally and regionally, to combat the demand side of the bribery equation, by addressing the problem of bribe soliciting or taking. These programs aim to improve the transparency of government processes and to strengthen the rule of law.

##### *Promoting Anti-Corruption Goals in the WTO*

The OECD has served as an important forum for engaging our West European trading partners and several in Central and Eastern Europe in the fight against international bribery. We have been able to involve a broader group of countries in the World Trade Organization.

The United States is actively working to conclude a WTO Agreement on Transparency in Government Procurement by the time of the WTO Ministerial Conference in Seattle in November 1999. The global government procurement market has been estimated at over \$3 trillion per year, and generally accounts for 10 - 15% of each country's GDP.

A transparency agreement in government procurement would address bribery from the demand side. Such an agreement would discipline Member countries and their procuring entities by requiring them to adhere to such basic procedures as publication of laws and regulations regarding government procurement, publication of procurement opportunities, basing award decisions on published evaluation criteria, and an independent review mechanism. To borrow Vice President Gore's words, "Corruption thrives on ignorance, not information. It needs secrecy, not transparency. It seeks darkness, not light." Therefore, with greater transparency at each stage of the government procurement process, there will be a reduced opportunity for bribery and corruption. This will greatly benefit the economies of developing countries. For example, the Asian Development Bank recently reported that corruption can add between 20 and 100 percent to government procurement costs for goods and services.

Over the past two years, the Working Group on Transparency in Government Procurement—established to conduct a study on transparency in government procurement, and, taking into account national policies, develop elements for inclusion in an international agreement—has made significant progress in identifying elements for a new multilateral transparency agreement in government procurement. In light of this progress, the United States will continue to actively press for the conclusion of an agreement by the Seattle Ministerial. Like the OECD Antibribery Convention, conclusion of a transparency agreement would make an important contribution to eliminating corruption in international business transactions.

#### *Supporting Legal and Regulatory Reform*

The Commercial Law Development Program (CLDP), a Department of Commerce initiative funded in part by the Agency for International Development (USAID), is one component of the US Government effort to support economic and political reforms underway around the globe. After the fall of communism in CEE, CLDP began assisting a number of CEE governments in the establishment of market economies. In 1994 CLDP started working with governments from the (NIS) to achieve the same goal. CLDP continues to work with CEE and NIS countries to establish the legal, regulatory and practical infrastructure necessary to develop and maintain an efficient market economy. CLDP's efforts in this area have focused on two main projects: Combating Commercial Crime and Trade and Investment Reform.

#### Commercial Crime

In Russia, CLDP has been actively supporting the Government of Russia's (GOR) efforts to fight crimes against businesses in the context of bilateral efforts associated with the US-Russia bilateral law enforcement working group and the Business Development Committee (BDC) under the Gore-Stepashin Commission. Examples of CLDP programs in this area include: technical assistance to train specialists in detecting computer-related crimes; technical assistance on how to better implement and enforce intellectual property rights especially with regard to commercial and business transactions; and development of a US-Russia database of law enforcement agencies and contacts to facilitate mutual assistance and coordination of crime fighting efforts as well as a resource for domestic and international business concerns operating in Russia.

CLDP's programs have helped the GOR understand the very complicated nature of commercial crimes, and the ways in which these crimes may be addressed by local, national and international law enforcement entities. These programs also have fostered a dialogue between U.S. and Russian government regulatory and enforcement agencies and private sector businesses and individuals.

#### Trade and Economic Reform

CLDP provides assistance to governments on the laws, regulations and administrative practices affecting domestic and foreign investment and trade, particularly international economic agreements, foreign investment laws, project and trade finance, export controls, intellectual property rights, public procurement, product standards and

government ethics. In this effort, CLDP has worked with the following countries: Albania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Moldova, Poland, Romania, Russia, and Ukraine.

CLDP programs are designed to address the specific problems and needs of each country in their transition to a market economy. A unifying principle, however, is the emphasis on transparency as a foundation for developing a functioning market democracy. In working with foreign government officials on the reform of trade and investment laws, regulations and administrative practices, CLDP has sought to ensure that these government officials understand the principle of transparency, its importance to domestic and international businesses, and how it can be implemented through laws, regulations and administrative practices.

#### *Rule of Law Projects in Russian Federation*

The environment for doing business in the Russian Federation is plagued by a lack of transparency and predictability, private and government corruption, and organized crime. These problems not only affect U.S. company interests, but also the ability of small and medium size enterprises to grow and develop in the Russian Federation as well as the development of a market economy.

MAC has identified rule of law for business in the New Independent States as a key priority for opening the market to U.S. companies as well as supporting development of market democracies. MAC's Russia and Independent States Division (RISD) is initiating, and implementing, several joint projects through the U.S.-Russia Business Development Committee (BDC):

- 1) Basic Guidelines for Codes of Business Conduct to promote good business practices and ethical behavior in commercial relations between private firms as well as with government authorities;
- 2) Handbook on Russian Commercial Arbitration System to assist companies and practitioners in better understanding the existing dispute resolution mechanisms;
- 3) Manual of recommendations on recognition and enforcement of domestic and foreign arbitral awards and court judgments for improving the judicial system for resolving commercial disputes; and
- 4) Development of a Handbook on Corporate Governance to encourage fairness and transparency for shareholder rights and best business practices.

Since voluntary codes of conduct are beginning to gain support in Russia and other emerging economies as a step toward fighting corruption, MAC's specialist on rule of law for business has arranged for Russian cooperation with OECD projects in cooperation with our bilateral Business Development Committee. He arranged for Russian specialists to make presentations at an OECD Conference on fighting corruption in developing and emerging economies in Washington, D.C. in February 1999, and obtained OECD staff agreement to cooperate in implementing the BDC's Guidelines in Russia and presenting them as an example for other transitional economies through OECD's Anti-Corruption Network for Transition Economies. The first project in this cooperative effort is a conference in Novgorod, Russia, July 21-

22, at which NGO's and Russian and foreign businesses will share experiences in implementing codes of conduct, including benefits which can accrue to enterprises.

*Balkan Initiatives*

Although significant political and economic reforms have transformed Southeast Europe over the last decade, anti-corruption legislation throughout the region is only just beginning to prove effective. Business transactions, tax collection, judicial rulings, and customs clearance procedures are still avenues for corrupt practices. There is, however, increased recognition in the region that efforts to combat bribery and corruption must be strengthened.

The United States Government has made fighting corruption in Southeast Europe a priority in its relationships with the countries of this region. Our bilateral assistance efforts and discussions often focus on the need to implement reforms that promote transparency and anti-corruption. The U.S. Government is also working to ensure that Kosovo reconstruction and the broader economic assistance efforts in Southeast Europe are transparent, corruption-free, and based on open competition. Commerce Under Secretary David Aaron has championed a set of principles to govern the procurement process based on these three elements.

*Other U.S. Government programs:*

USAID has been very active in providing anticorruption assistance to Central and Eastern European countries and the New Independent States of the former Soviet Union.

For example, *USAID's Center for Democracy and Governance* is supporting anti-corruption efforts through a grant with Transparency International (TI). The grant targets several countries around the world, including Bulgaria and Ukraine. This grant, initiated in September 1997, provided \$2 million for intensive anti-corruption work in the countries and for regional lessons-learned workshops.

USAID's Europe and Newly Independent States (ENI) Bureau's Anti-Corruption Working Group has formed a partnership with the OECD's Directorate for Fiscal, Financial and Enterprise Affairs (DAFFE) to create the OECD's *Anti-Corruption Network for Transition Economies*. This Network brings together international donors, host-country governments and NGOs, business associations and civil society groups to share lessons learned, and discuss proposed technical assistance strategies designed to impact the enabling environment for corruption. USAID has also created an anti-corruption web site, (located at <http://www.nobribes.org>) for participants to share ideas, lessons learned, and compare strategies in different ENI countries with links to multilateral organizations and NGOs together with complications of recent research undertaken in the field.

USAID and the World Bank Institute co-hosted an Integrity Conference for Georgia in May 1998 and Albania in June 1998. It has worked with the Georgian Government to help create an anti-corruption commission. With the Russian Government, USAID has helped create a partnership between the newly-created Judicial Department of the Supreme Court and the U.S. National Judicial Conference, to assist in judicial training, ethics and organizational development. In Ukraine, USAID contractors have helped to organize and strengthen

public-private partnerships against corruption in Donetsk, Lviv and Kharkiv, designed to both monitor corruption and provide a better investment climate for both foreign and domestic investment.

USAID also sponsored a recent conference in Varna, Bulgaria, to discuss the work of public-private partnerships to fight corruption, attended primarily by NGOs from every Balkan state, including Serbia and Albania, with European Union, World Bank, OECD and Council of Europe participation. Strategies focused on how to collect critical information to uncover lack of accountability in both the public and private sectors. USAID is similarly co-funding an OECD conference in July 1999 in Novgorod, sponsored by the Oblast governor with technical support from the Department of Commerce, on creating codes of ethical conduct for the private sector in the region.

#### Conclusion

In conclusion, let me say that I look forward to working in my new capacity as Commissioner to help build on existing bilateral efforts and ongoing work in multilateral fora in the growing international movement against corruption. The United States has played a leadership role in focusing attention on the issue of corruption. In the Organization for Security and Cooperation in Europe, emphasizing the critical importance transparency plays in establishing stability and security in the region. I look forward to working with you to press this agenda with vigor and persistence as a member of the Commission.

**WRITTEN SUBMISSION OF JOHN D. SULLIVAN,  
EXECUTIVE DIRECTOR, CENTER FOR INTERNATIONAL  
PRIVATE ENTERPRISE**

After years of being tolerated with a mixture of apathy, cynicism, and denial, corruption is now becoming a target of serious international action. As firms around the world face slimmer profit margins due to increased competition; the international business community is becoming increasingly aware that corruption is costing them money—profits. The added cost of corruption, particularly in developing countries where it is more pervasive, has made business change the way it operates globally. Corporations have learned a lesson from the Asian crisis and they are becoming more wary of where they invest and of the internal climate there towards business. As we face these new and severe realities, the business community is signaling to lawmakers around the globe that they are tired of corrupt dealings and that it is time for change.

Business is acknowledging that corruption is an issue that must be faced, and that they, the private sector, have a role in eliminating this disease. However, business is certainly not the only victim of corruption, the citizens of developing countries that are losing valuable resources are victimized to an even greater degree. The poor share disproportionately in the negative affects of corrupt behavior in the form of lost jobs and income. In the developing world resources and funds that could go into infrastructure, education, and other elements integral to development end up lining someone's pocket due to the effects of corruption. Corruption scares away investment that could reach those areas and bring new prosperity.

The world has witnessed the new focus being placed on corruption through a series of headlines publicizing the ousting of political leaders. Accusations of corruption have been leveled at officials around the world including in the US and other developed countries. The lack of communication and opaque markets have been identified as major contributors to the Asian crisis which grabbed the attention of even the most developed markets. Today corruption is one of the leading causes for the lack of foreign investment in Russia and Ukraine. No one is arguing that corruption doesn't occur everywhere to some degree; however, there is a fundamental difference in how it affects developed and transition or developing economies. In developed countries the fight against corruption is a fight for fairness and increased efficiency in markets that are already well structured. In developing and transitional countries corruption can be so pervasive that it can undermine the state and markets.

I am the Executive Director of the Center for International Private Enterprise, known as CIPE, an affiliate of the U.S. Chamber of Commerce. CIPE has been very privileged to work and form partnerships with leaders of think tanks, entrepreneurial associations and private sector groups in Central and Eastern Europe and throughout the developing countries.

Let me briefly describe our organization, the Center for International Private Enterprise. Since its inception in 1983, we have completed more than 550 projects in over 70 countries and have conducted business association and management training programs throughout the world. CIPE is supported by grants from the National Endowment for Democracy. We have also received support for specific pro-

grams from IBM, Exxon, Coca-Cola, Ernst & Young, Capitol Health Partners, The Pew Charitable Trusts, RJR Reynolds, the World Bank, the United States Agency for International Development, and the United States Information Agency.

CIPE supports indigenous private sector organizations around the globe that work towards attaining open market reforms and democracy, including groups like the Gdansk Institute of Market Economy in Poland, the Strategic Alliance of Business Associations in Romania, or the Riivest Institute in Kosovo. CIPE's partner organizations share our view that there is a direct correlation between open market economies and the growth of democracy. I am speaking today about the experiences we have gained by working with our partner organizations on projects located around the globe.

Corruption resurfaces time and again as an issue affecting the development of the business climate and increased democratic freedoms in the countries where our partners live and work. Through our programs we have first hand reports about the high costs of corruption on business and that there is indeed a role for the private sector in combating such a widespread problem. Although the focus of this testimony is on transition economies, CIPE has partners that have specifically addressed this very issue in both the transition economies and in developing countries. I'll refer to these programs as they can illustrate the lessons learned and the success

stories in the fight against corruption.

#### **ROOT CAUSES OF CORRUPTION AND ITS AFFECTS ON BUSINESS AND INSTITUTIONS**

Corruption is essentially a waste of resources. International businesses invest based upon the presence of a predictable economic environment, a transparent climate that supports business,

and a stable legal framework. Without these essentials international investment, trade, and growth will be hindered, and resources that could be directed at the developing world will never reach it. Corporations will simply look elsewhere. Corruption constitutes a lack of integrity and transparency, which will undermine the very legitimacy of government and shake the public's trust in democracy.

The root causes of corruption are not to be found within individuals, be they public procurement officers, politicians, or business people. Corruption thrives in markets where legal systems are evolving; the rule of law is not embedded within the cultural norms, or where laws and the judiciary allow employees opportunities for discretionary authority throughout various levels of government. As economies begin to liberalize, the opportunity for corruption exists within the very process of change. For example, privatization is a key part of transitioning an economy from a state-regulated system to one of private business. However, this transition also creates many opportunities for corruption, especially when added to a mixture of low government wages and economic stagnation. Combined these elements create a climate that is perfect for breeding corruption and corrupt systems. Therefore, it is pointless to oust leaders for governing a corrupt system if there are not changes made to that system. Simply educating government leaders is not enough. Thus for real change to occur the

system must be changed and all of the actors within the community need to be made a part of the restructuring process. This is the situation that made CIPE's partner in Ecuador the National Association of Entrepreneurs' (ANDE) program so crucial.

Although Ecuador is outside of the region being discussed today I believe there is value in disseminating the lessons learned by ANDE to organizations operating elsewhere specifically in Central and Eastern Europe. ANDE has been the recipient of great praise in Ecuador for its all-encompassing approach to eradicating corruption. ANDE has issued recommendations on new legal reforms through a series of sessions with government officials, leaders of the business and NGO communities, and even the Catholic Church. Their focus has not been to blame past corruption on any one particular group but rather to initiate reforms that will change the direction of business and institute clean practices. Their studies have found that since the Republic of Ecuador was founded 167 years ago some 92,250 legal norms have been created of which 52,774 were in force in 1997. The sheer number of overlapping, unclear, and contradictory laws has created an environment of legal chaos and leaves the application and enforcement of laws to the discretion of bureaucrats. Several recommendations to clarify the system put forward by ANDE have been included in Ecuador's New Constitution that went into affect last August.

Specifically, ANDE targeted six priority areas where corruption was the most pervasive including the administration of justice, public procurement and contracting, customs practices, privatization, social security, and transparency in financial management of the public budget. For example, ANDE recommended several points within the administration of justice including:

- Eliminating the susceptibility of the judicial system to outside influences;
- Installing a commission of distinguished jurists to codify standards and laws; and
- Amend subsidiary and procedural codes to eliminate double standards being used by public officials.

These recommendations were included in the new Constitution which will establish an independent seven-member commission that will codify and publish laws. The committee will also compile and systematically organize Ecuador's 53,000 laws to eliminate duplication and contradictions and lessen the discretionary authority of public officials.

#### **CREATION OF AN UNFAIR PLAYING FIELD**

When corruption is tolerated or condoned, it creates an unfair playing field in the business arena. Currently, the US adheres to the 1977 Foreign Corrupt Practices Act and prosecutes US businesses involved in corrupt dealings. However, in other developed countries businesses are not prosecuted for such crimes and in some cases they are even compensated through tax deductions for the bribery payments needed to secure contracts overseas. These very businesses that receive tax benefits are direct competitors to US business and many have been awarded contracts due to these activities. Corruption has also cre-

ated an uneven playing field by reallocating scarce resources to the pockets of individuals instead of following the laws of supply and demand.

Recently, the Organization for Economic Cooperation and Development (OECD) developed an anti-bribery convention wherein the signatory countries undertake to eliminate the tax deductibility of bribes to foreign officials and to create criminal and civil penalties for bribery. As will be noted below, the next step is ratification and enforcement. To date, a number of our European allies have not ratified the convention nor have they passed implementing legislation.

Developing countries suffer from a lack of investment and a smaller share of the global economic pie in the first place. Corruption only worsens this position. Investment analysts check for signals indicating corruption before entering into business deals. A high tax rate but a low tax collection rate and overall market transparency are factors that determine the attractiveness of certain investments. Today, competition for investment is tight and corporations don't have to invest in countries known for corrupt practices.

#### **CORRUPTION'S EFFECT ON SMALL- AND MEDIUM-SIZED BUSINESSES**

Putting aside international business for the moment, Corruption in many developing countries makes it difficult for small and medium sized businesses to make a profit. In many cases entrepreneurs are forced into the informal sector leaving fewer and fewer legitimate businesses within the market. Less legitimate business correlates into a smaller tax base and thus the fewer legitimate businesses must pay more than their share in taxes to make up the difference. In this climate there is no incentive for operating a legal business. Legitimate businesses are paying in some countries such a high percentage of their profits in taxes or licenses that it is more preferable to move back into the informal sector. A smaller tax profit means that governments have less money that can go towards improvements in infrastructure, education, or higher wages for government employees, all of which must be considered priorities for real growth.

For example, CIPE's partner, the Ukrainian Center for Independent Political Research (UCIPR), is one of the leading public policy research institutes in Ukraine. UCIPR currently produces a bi-weekly "Corruption Watch," organizes roundtable discussions on key economic policy concerns, and publishes "Research Update," which is a weekly bulletin intended to influence policymakers on vital reform issues. Through its research UCIPR has concluded that during the communist period business managers responded to inefficiencies in the central planning system by cultivating personal relationships with government officials. These corrupt relationships with public officials tended to be more predictable than the government's highly unstable policies. This tendency has been ingrained within the business norms, and adding to the problem today is over regulation of the business sector, high taxes, and frequent government inspections that generally result in bribery. In Ukraine, business activities are regulated by as many as 32 laws, 30 presidential decrees, and over 80 resolutions. Thirty-two ministries and departments have the authority to issue licenses for various business activities. Further research by another CIPE partner in Ukraine noted that firms must respond to an aver-

age of 78 government inspections annually, all of which are opportunities for bribery. The over regulation, high taxes, and numbers of inspections make the informal sector a more viable environment for business. Ukraine's private sector is not fairing well and the informal sector continues to grow, and both Ukrainian partners agree that clear rules and regulations are crucial to the private sector's overall development.

### INTERNAL CORPORATE REFORMS

As economic reforms begin to gain a stronghold the increased transparency and streamlined governments leave less opportunity for corruption. It brings business and government practices into the light of day for all to see and the fear of corporate embarrassment begins to take hold. This leads to self-regulation and business becomes more transparent. After all, what corporation wants to go before its shareholders and say that the company is undergoing criminal investigation for corruption? Transparent business transactions will not only help US business as it seeks investment and new opportunities but the global business community as well. When countries endeavor to restructure their political systems and privatize corporations, they must also be aware that a restructuring process of the private sector must also be initiated. Restructuring of the private sector must include measures to ensure that business operates in a transparent manner. There are varying methods of instituting such internal reforms commonly known as corporate governance.

Although there is not one proven method of corporate governance there are certain principles that can be incorporated into various business structures. Instituting independent auditing and enforcing corporate guidelines are two such methods. The other attributes that contribute to effective corporate governance include:

- Strong independent boards of directors, with a strong audit committee and internal audit functions;
- Laws and regulations guaranteeing shareholder rights, especially the rights of minority shareholders;
- Established and accepted standards of financial accountability and transparency within firms;
- Commitment to honest and fair dealings with all elements of the community (employees, suppliers, customers, and neighbors).

CIPE has recognized the importance of corporate governance as it affects both economic and democratic institutions. Part of CIPE's global strategy includes building an awareness of the inherent value of corporate governance with its international partner network. A significant hurdle in developing markets and those in transition is accessing international experience and best practices of corporate governance policies. CIPE, in response, began an initiative in 1993 to introduce some examples of corporate governance policies, principles, and values to its network, and has continued supporting programs that offer such information.

CIPE's first corporate governance program began with a grant to the Central European University. This joint program brought vital international resources and models to leaders in Central Europe. More recently, in February 1999, CIPE held a corporate governance work-

shop for participants from around the world in conjunction with the National Endowment for Democracy's Building a Worldwide Movement for Democracy Conference in New Delhi, India. The workshop identified and reinforced four shared core values of corporate governance and democracy:

- accountability;
- fairness;
- transparency; and
- responsibility.

These same four basic principles are vital to bringing about reform. A general agreement developed through the CIPE workshop acknowledged that fair market systems cannot function and the public cannot exercise its democratic rights unless information affecting the public interest is made available.

CIPE's initial corporate governance program with the Central European University culminated in the publication of *In Search of Good Directors: Corporate Boards in Market and Transition Economies* in six Central European languages. The publication was intended to inform business owners on the concept of corporate governance and why it is necessary, and the publication included corporate governance principles from actual corporations. For example, General Motors' guidelines were highlighted in the book and they include provisions for:

- Selection of a chairman and CEO;
- Establishing the number and type of board committees;
- Establishing committee agendas;
- Board access to senior management;
- Determining the size of the board; and
- Setting criteria for board members.

CIPE is developing new corporate governance initiatives in Bulgaria, Romania, Russia, Slovakia and in Southeast Asia.

#### **INTERGOVERNMENTAL EFFORTS TO FIGHT CORRUPTION: LEVELING THE PLAYING FIELD**

CIPE has recently focused its global strategy squarely on combating corruption at its sources through a partnership with the OECD Development Centre. The partnership organized a global forum on combating corruption entitled *The Washington Consensus on Corruption—Fighting Corruption in Developing Countries and Emerging Economies: the Role of the Private Sector* held in Washington, February 1999. The conference was a tool to get members of the international business community, policy and lawmakers, and leaders of civil society organizations together to explore a role for the private sector in fighting corruption. Many initiatives have been aimed at cleaning-up government; however, government is not the only source of corruption. This conference sought to craft an action plan for the

private sector. What resulted were concrete steps that businesses and civil society organizations can take to begin their push for greater reforms.

The various players attending the conference added their insights into the general conclusion, known as the “Next Steps” for the private sector. These points included:

- Advocating to some leading industrial countries to end the tax deductibility of foreign bribes (International Chamber of Commerce and the OECD Convention).
- The need to ensure the effective monitoring of the new OECD Convention.
- Work to set international standards in commerce, such as standard accounting regulations, and abide by these standards (Transparency International).
- Action must be taken to educate corporations on how to comply with the new OECD convention.
- There needs to be full ratification of the OAS Inter-American Convention and anti-corruption progress in Asia through ASIAN and APEC. All of these efforts need to be supported and encouraged.
- Introduction of elements to combat corruption need to be added into the Millennium round of World Trade Organization negotiations (Institute of International Economics).
- Aid agencies need further support to be bolder in their anti-corruption work. and the OECD needs to continue work on this issue.
- Securing freedom of information and creating conditions for journalists to pursue investigative reporting is vital to the developing world.

#### **DEMOCRACY AND CIVIL SOCIETY**

Another outcome of the Washington conference was to recommend support for activities that will strengthen the rule of law, which is an integral part of anti-corruption reforms. In order to ensure that such conventions, like the OECD’s convention to combat bribery, do not fall by the wayside and have practical impacts involves two additional steps. These steps include the implementation of legislation turning these provisions into binding national law, and enforcement programs.

Enforcement of the OECD convention must be a priority if results are to be truly lasting. In many cases prominent figures or leaders of countries may be ousted due to corruption only to leave their successors operating still corrupt regimes. Political will is crucial to enforcing initiatives against corruption. However, more must be done. Civil society and the press must push for reforms and for the necessary political will to institute real changes. Education and increased information are both key instruments to getting wide spread support for reform. Civil society and the private sector must ensure that the fight against corruption is rooted in the building of both State and market institutions. Civil society and the press both act as checks and balances for government and the public sector. As political systems differ around the world so will plans to enlist political support for eradicating corruption. The overriding objective of monitoring the

enforcement of such conventions must be to forestall inconsistent approaches to prohibiting bribery. Governments will naturally be reluctant to impose stricter prohibitions on their own companies than those applied to competitors. It is vital that there is prevention to ensure that regulations do not fall to the lowest common denominator. That can only happen if all parties involved are held to the highest standards.

The beneficiaries of corruption must also be addressed before any real change can occur. But ridding government of several high ranking officials on the grounds of corruption is not enough, the system of checks and balances and democratic institutions are key players in ensuring that real change occurs and that democracy and the government are in high regard to the general population. New people must be brought in and the incentive structures governing the workings of government must be well thought out and streamlined, avoiding the inefficiencies that breed further corruption.

Democratic systems are crucial to the eradication of corruption. Opposition parties watching out for misdeeds of the party in power are important elements that should not be neglected. Many of the pillars of democracy support transparent market systems that are not immune to corruption but make it more difficult to go unnoticed.

#### **PRIVATE SECTOR EFFORTS TO COMBAT CORRUPTION**

CIPE has joined forces with private groups in a variety of countries to implement a range of programs. A number of these projects focus on instituting protection of minority shareholders, production of "Watchdog" alerts, and educating journalists. Bulgaria's Center for the Study of Democracy (CSD) introduced shareholder registries to the government. CSD was also responsible for the passing and implementation of legislation that required their use. Shareholder registries decipher the ownership of companies and protect minority shareholders by ensuring that their ownership is known and is considered, thus eliminating one of the leading causes of corruption in Central and Eastern Europe.

Further, as noted earlier, a number of projects designed to promote good corporate governance also can be very effective tools for the private sector to police itself.

CIPE has also supported many legislative alert programs where partner organizations keep watch over the status of reforms and government activity. They report this news back to the business community, the media, and others who have a stake in future reforms. In Slovakia, the Center for Economic Development has been very successful in this approach and in exposing corrupt privatization practices in the last government.

Training of economic journalists has also been crucial in bringing transparency into government. Journalists across the developing world tend to be oriented towards the status quo or don't understand enough of the workings of economics to know what information is crucial. CIPE has supported programs to educate journalists on the basics of economics, economic terminology, methods of investigative reporting, and of their role in the reform process. CIPE has conducted such programs in Kazakhstan, Vietnam, Russia, Romania, and across Latin America.

Through *Economic Reform Today* (ERT), a quarterly magazine that takes an in-depth look at issues affecting the global business community, CIPE has sought to inform its vast readership of policymakers, business and business association leaders, parliamentarians, and journalists. A special issue of ERT addressed the issue of corruption, its negative affects on the business community, and methods used to combat it at the source. The issue included articles not only from prominent US and western leaders and organizations like Transparency International but from CIPE partners that are currently involved with programs that are meeting the issue head-on. Featured articles were *How to Fight Corruption on the Ground*, Peter Langseth, the World Bank's Economic Development Institute; *Will the OECD Anti-Bribery Convention be Effective*, Eleanor Roberts Lewis, Chief Counsel for International Commerce, U.S. Department of Commerce; and *Corruption Versus Clean Business in Ukraine*, Inna Pidluska, Director of CIPE's program with the Ukrainian Center for Independent Political Research (UCIPR).

CIPE through support from the National Endowment for Democracy was able to bring several representatives from its partner organizations to the Washington corruption conference. CIPE participants addressed main plenary sessions and smaller working groups bringing with them real experience in running businesses and in advocating for increased open market reforms from the developing world. The organizations represented (business associations, think tanks, and NGOs) will play an even more crucial role in determining the direction of reforms. Their role has not been defined and several of them are exploring this role as we speak. CIPE's partner in Ecuador, ANDE, is moving beyond a sole anti-corruption focus and is orchestrating a way to bring all sectors of society together with government to craft a consensus and end today's current political and economic crisis. CIPE is now developing a special section of our Web site devoted to the topic of anti-corruption, located at [www.cipe.org](http://www.cipe.org). This page gives users access to the keynote conference speeches, presentations, research reports on corruption by CIPE partners, and information about CIPE supported anti-corruption initiatives spanning across the globe.

The organizations and businesses attending the conference are defining their own role and that of the private sector in fighting corruption. A number of workable ideas have been developed in various countries in the region and can easily be replicated including:

#### **DEVELOPING PRIVATE SECTOR ORGANIZATIONS THAT PUSH FOR OPEN MARKETS AND MORE**

democratic practices as a means to eliminate opportunities for discretionary authority and corruption. Streamlining government and the hoops that business must jump through, like the need for import and export licenses, lessens the ways that corrupt officials can get money from private business for doing what in reality is their job.

Private sector associations have the ability to advocate for democracy and transparent government on the behalf of business.

Supporting business organizations that lobby for elimination of over-regulation and barriers to market entry. In many countries businesses remain in the informal sector, or work within the black market, because they cannot afford the extra costs of legitimate business

due to corrupt practices. This increases businesses share of the tax burden and it is in businesses' interest to reform government, and bring the informal market into the formal business sector.

Business associations that advocate to government for better a business environment is more cost-effective and honest then having each firm make specific deals with government officials behind closed doors. Dealing behind closed doors is a breeding ground for corrupt practices and likewise expensive for legitimate business. Keep in mind investors look out for such "clubs" when selecting where they allocate their investment funds or enter into joint ventures and tend to avoid countries where these practices are wide spread.

Calling for the privatization of state-owned business creates new profit-oriented businesses, and business associations can advocate for more extensive privatization programs that will make these large state-run firms become competitive and profit oriented. These newly privatized firms will not want to have to make deals that cut into profits, and they will be more willing to go into business ventures with other like minded firms—each determined to boost their margin of profit.

Through actions such as those listed above, business associations become key actors in enforcing the new anti-corruption convention and subsequent legislation. Acting on behalf of their members, they can strive to make sure that practices are enforced and that complaints and infractions of the law are investigated. These associations must ensure that there is equal opportunity for business and that will benefit all of an association's members in the long run.

The fight against corruption is headed away from merely scrutinizing government to a more all-encompassing approach that acknowledges the various roles and players in the fight. Corruption is more than a hot issue that is being focused on today. Corruption can also be a wedge issue that promotes a level playing field and further economic reforms; thus it essentially becomes a win/win situation. As the playing field levels and economies are liberalized, institutions will begin to gain strength and their reputations will improve. The positive effects of reform will begin to be felt by the population at-large. In many regions, particularly Central and Eastern Europe, fighting corruption is one method to reinvigorate the trust of the citizenry and prime the economy for further reforms. Thus combating corruption is one way to bring economic reforms back to the discussion table. As the effects of corruption are so pervasive, so too are the benefits that can be achieved by its eradication.

**ATTACHMENT A—A BRIEF LOOK AT CIPE'S OTHER ANTI-CORRUPTION PROGRAMS**

*Center for the Study of Democracy (CSD), Bulgaria*—Coalition 2000 is the outgrowth of CSD's plan to combat corruption that involves a number of Bulgarian non-governmental organizations (NGOs) working in cooperation with government institutions and individuals. The goals of Coalition 2000 include promoting public awareness of corruption and establishing mechanisms that support anti-corruption efforts, contributing to the development of democratic institutions and by serving as a "watchdog" over the reform process. CSD is organizing these efforts through a large-scale public advocacy campaign, and by organizing expert working-groups. The working groups will develop policy amendments that help to deter corruption and focus attention on practical implementation of transparent and clear rules of the game.

*Center for Public Private Cooperation (CPPC), Nigeria*—CPPC began a legislative advisory service that systematically appraises economic laws and regulations and the impact they have on the Nigerian private sector. This new advocacy framework is vital to educating and mobilizing people behind economic reform policies and opening up the Nigerian policymaking process, thereby increasing accountability and transparency.

*Center for Economic Development (CED), Slovak Republic*—CED implemented a program to eradicate corruption from both the Slovak Republic's public and private sectors through a program based upon seminars, advocacy and research. First CED analyzed the level of corruption by administering a survey to local entrepreneurs and business leaders. Based upon the survey's results CED organized a series of advocacy programs to educate the business community on the negative impacts of corruption. CED developed a series of concise and easy to understand articles detailing the effects of corruption and the need for reform. These articles were subsequently published in CED's Slovak Economic Sheet, where they can be easily obtained and reprinted by local journalists.

*Entrepreneurship Development Foundation (EDF), Azerbaijan*—EDF has just added a new component to its CIPE partnered program that focuses on combating corruption within Azerbaijan. In 1996-1997 EDF carried out a survey of the obstacles facing private business and corruption came out as the top problem. The project is based on those survey results and is composed of three activities the publication of special bulletins, creation of small business informational packets, and corruption research, and polling. The special bulletins will focus on topics relating to corruption and will be distributed to both universities and policy makers. The business informational packets will give local entrepreneurs reliable information on how to register a business and develop a business plan. The corruption research initiative will monitor articles in 24 newspapers for anti-corruption coverage, and an opinion poll will administered to the business community to keep informed of its needs.

*Albanian Center for Economic Research (ACER), Albania*—ACER has undertaken a project to identify the barriers keeping the informal economy from entering into the formal business sector. This research program will move beyond identifying only the barriers to business transition but will then seek to address these barriers through

advocacy and education. ACER has instituted a series of seminars and publications that will contribute to making the informal economy a more focused upon issue. Corruption is a major factor in keeping what could be legitimate business outside of the formal sector. Corruption has therefore become the topic of many of the seminars and subsequent ACER organized discussions.

*Center for Media Freedom and Responsibility (CMFR), Philippines/regional*—CMFR has undertaken the job of improving the flow of economic information throughout Southeast Asia. CMFR organized a conference focusing on the dissemination of information, timed right before the Asia economic crisis that discussed the reforms needed for continued economic growth. CMFR identified the lack of information and the relatively untapped media resources that could be transformed into responsible organizations that keep government and business transparent. Program activities included focus group discussions, and regional conferences and publication of papers.

#### CIPE'S CURRENT CORPORATE GOVERNANCE PROGRAMS

*Center for Economic and Social Studies (CESS), Albania*—Acknowledging the critical nature of effective corporate governance in ensuring successful privatization in Albania, the Center for Economic and Social Studies (CESS) is undertaking a comprehensive research and advocacy program on corporate governance and privatization. The future success of privatization will depend on the introduction of core system of corporate governance principles and practices that will ensure these vital enterprises are managed in an open and responsible manner. The effective exercise of ownership rights in restructuring and managing these firms will be crucial not only to their continued success, but also to contributing to the creation of a new climate of business in Albania. Investors must have confidence that enterprises will be managed effectively, and that government can provide the framework in which ownership rights can be exercised and guaranteed. The CESS project will survey current practices and highlight failures and shortcomings in Albanian corporate governance structures, CESS will conduct a national advocacy program of seminars, publications and media outreach to promote new policies and practices which could help ensure more successful privatization and a smoother transition process.

*Center for Economic Development (CED), Bulgaria*—The Center for Economic Development in Sofia, Bulgaria conducted a pilot program on corporate governance. CED sought to target specific interest groups and to provide them with a general introduction to corporate governance values and principles, broaden the debate on the Bulgarian approach to these issues, and further develop a strategy for corporate governance education. Ignorance of corporate governance principles must be fought at a variety of levels, within SOEs, among capital market institutions, policy makers, and the general public, as well as in the media. However, for those leading the fight for better principles the need exists to define issues, and the scope and extent of the problems to be addressed. CED organized and administered four one-day training seminars to address a variety of issues surrounding corporate governance. The seminars addressed specific groups and discussed their role in creating a society supportive of corporate governance concepts. The seminars served as two-way dialogues, pro-

viding information on corporate governance issues to participants, and promoting a two-way dialogue between CED researchers and affected groups as to the challenges they face in implementing corporate governance procedures, and ways in which CED can further support this transition.

*Center for Study of Democracy (CSD), Bulgaria*—As privatization moves forward in Bulgaria, the issues surrounding corporate governance become clearer and more urgent. Currently there is little information available to Bulgarian privatization officials and enterprise managers in this crucial element of structural reform. CSD has undertaken a corporate governance education program aimed at the key players in privatization, as well as educating interested members of the general public. The program consists of study visits to transition economies, workshops for key private sector representatives, town hall for the general public, and public education campaigns through articles and radio and TV presentations.

*CIPE/In house, Russia*—CIPE—Moscow recently held a roundtable on corporate governance entitled "Shareholder Rights as an Example of Property Rights: Amendments to Legislation on the Securities Market" at the Moscow Stock Center. More than 20 participants representing think tanks, the Duma, the Central Bank, the Federal Securities Commission, Russian securities exchanges, and the media attended the roundtable. The discussion produced concrete recommendations on specific amendments involving shareholder registries and the desirability of holding public hearings on securities legislation.

*Asia—Institute of Management Education of Thailand (IMET)* in conjunction with the Federation of Thai Industries and the Thai Chamber of Commerce will host a regional program on corporate governance. This program will explore corporate governance best practices worldwide and identify specific reforms that are needed to help encourage recovery from the Asian economic crisis and help prevent a recurrence. Business and association leaders from the region will be invited to participate.

*Bulgaria—Center for Study of Democracy, Association of Industrial Capital, Association of Voluntary Pension Funds, Center for Economic Development, Investors' Union, and Securities Holders Association* are initiating the creation of a coalition of Bulgarian non-governmental organizations. This objective of this coalition is to facilitate the adoption of relevant corporate governance standards and procedures that would ensure accountability, transparency, and control in the economy.

*Romania—Strategic Alliance of Business Associations (SABA)* is creating a new business community initiative to create voluntary codes on corporate governance.

*Slovakia—The Center for Economic Development* is developing a research and advocacy program on corporate governance in the Slovak Republic.

**PREPARED STATEMENT BY LOUISE I. SHELLEY, DIRECTOR,  
TRANSNATIONAL CRIME AND CORRUPTION CENTER  
(TRACCC)**

**CORRUPTION IN THE FORMER SOVIET UNION**

The submitted written testimony consists of three parts that reflect the different perspectives by which the Transnational Crime and Corruption Center (TraCCC) approaches the problem. My points provide a regional overview of the problem in a comparative perspective. Dr. Brovkin, a historian and political analyst, provides an analysis of recent events that reflect high level corruption and contributed to the endemic state of corruption in Russia today. He runs the Study Centers on Organized Crime that operate in four cities in Russia and Ukraine. Mr. Keith Henderson, a lawyer, served as Senior Advisor for the Europe and NIS Bureau and the Policy and Program Coordination Bureau before joining TraCCC as co-director.

**THE CURRENT STATE OF CORRUPTION IN THE NIS**

*1) LACK OF POLITICAL WILL TO FIGHT CORRUPTION*

It is very difficult to engage the leaderships of the NIS states on the corruption problem because there is an absence of political will. The Russian expression, "The fish rots from the head" applies to most of the NIS states. While many of these leaders may have political talent to deal with ethnic conflict or promote foreign investment, they uniformly lack a commitment or interest in dealing with corruption. If they do express such an interest, it is usually in response to external pressure from the United States or the World Bank and rarely gets beyond inter-governmental bodies or commissions to deal with problems. Georgia and Ukraine may have the most visible governmental anti-corruption efforts but they have done little to reduce corruption at the ministerial level. The corruption issue is now becoming a political weapon in many NIS states. But the fight against corruption is being used more to tarnish one's opponents rather than to address the overall problem. In fairness to the leadership of the NIS states, endemic corruption is one of the most pernicious legacies of the Soviet period and the concentration of wealth in the hands of the former *nomenklatura* or party elite makes it hard to address the problem. High level governmental posts are still for sale as in the Soviet period, a fact documented by recent World Bank research in Eastern Europe and Georgia.

*2) POLITICAL WILL TO DEAL WITH CORRUPTION LIES AT THE NGO LEVEL*

The only political will to deal with the issue is at the NGO level. In many ways those fighting corruption are the post-Soviet era dissidents. They take great risks to address these issues and face intimidation. Journalists writing on corruption face beatings or even death. Human rights groups throughout Russia are now documenting problems of corruption along with other human rights abuses. The movement addressing corruption is limited, fragile and without resources. Their impact has been marginal and it proved impossible for them to touch the high level corruption or the very serious problem of campaign financing or the silencing of investigative journalists through intimidation and the buy outs of independent media.

3) *THE STRUCTURE OF CORRUPTION—CENTRALIZED VS. DECENTRALIZED*

The countries of the NIS lie along a continuum in terms of the centralization of corruption. In Russia, corruption is most decentralized because of the weakness of the central state, the enormous size of the country, the rising importance of the regions and regional governments. No centrally planned and instituted anti-corruption policy could work in Russia. In Central Asia and Caucasian states characterized by clan structures, corruption is highly centralized among the limited elite who holds power. Ukraine lies in between the two extremes on the continuum.

4) *THE BANKING SECTOR*

A crucial impediment to anti-corruption efforts in all the NIS states and many Eastern European as well is the banking sector. Most NIS states have had banking crises in which citizens have lost their savings. Banks are not engines of capitalism providing loans to promote investment but are mechanisms to move capital out of the country and offshore. The failure of governments to regulate the banks or to close down banks that are engaged in illegal or dubious activity is reflective of the close relationships that exist between government officials and bank officials. Reports this week of corruption scandals in Korea and Mexico in which governmental officials protected corrupt bankers reveal that these problems are not confined to the NIS states. But in the first years of a post-Communist state, they have disillusioned citizens on the possibilities of creating a viable market economy that serves the citizenry.

5) *PRIVATIZATION*

Privatization has occurred at different rates in the former Soviet Union. Russia has privatized the largest share of its economy while Belarus lies at the other end of the range. In all parts of the former Soviet Union, whether there has been planned privatization or spontaneous privatization, the process has been riddled with corruption. Privatization has been the prime vehicle for maintaining the power of the corrupt Soviet era elite. It has allowed them to substitute personal property and monopolies for the power of the Communist Party.

The corruption surrounding privatization has affected the course of economic development and will determine the economic evolution of all the NIS states in the coming decades. This process has distributed few state resources to the mass of the citizenry. Many are poorer than they were in the former Soviet period and a small elite has acquired unimaginable wealth. Just a few years ago, most believed the privatization process was not fundamentally corrupt and that it had not set the stage for the theft and criminalization of the Russian economy. Today a consensus is emerging that just the opposite is true. Unfortunately, as we learn more about what happened (insider deals), who benefitted (a small group of oligarchs) and who was left out (the public), we see this pattern being replicated in other OSCE countries, such as Kazakhstan and Ukraine, as well.

The west is complicit in this problem because through our assistance programs in AID, World Bank and others, we promoted privatization plans without adequate safeguards to prevent their

hijacking by government officials and organized crime figures. In Congressional testimony several years ago, I warned of the consequences of failing to address the criminalization and corruption of the privatization process. At that time, particularly in Russia, many here heralded the irreversibility of Communism because of this privatization.

The privatization policies we pursued may have made Communism irreversible but they did not make authoritarianism irreversible. Lack of free elections, independent media and a concentration of economic and political power are consequences of the corrupted privatization process.

6) *THE FAILURE OF THE WEST TO RECOGNIZE THE CENTRALITY OF CORRUPTION IN THE EARLY 1990S*

Western aid and diplomatic policies failed to recognize that corruption would be a major impediment to the creation of democracy and free markets. Our focus was on deconstructing the Soviet system. We did not understand that the Soviet Union collapsed, in part, because of pervasive corruption. The perpetuation of this corruption in the post-Soviet era means that the new countries are not starting off in a new direction but are merely perpetuating the corruption which contributed to the collapse of the Soviet Union.

The continued failure in the west to acknowledge of the costs of corruption means that we fail to do adequate due diligence on assets received from the former Soviet Union. This is not only a problem in the U.S. but in many of the OSCE member states and their territories. American companies engage in bribery in violation of the Foreign Corrupt Practices Act or turn a blind eye or turn a blind eye to inflated costs (inflated because of the costs of bribes and other pay-offs) presented by their business partners. The inflated costs of doing business place our investments at risk and contribute to the pervasive corruption.

7) *COMPLACENCY IN GOVERNMENT*

Russian analysts have documented the decline in prosecutions of officials engaged in a variety of corrupt acts over the last decade. The impunity that they have known in this period of the critical redistribution of property has meant that officials can literally get away with almost anything. Those who have been prosecuted, as recent research in a special Russian labor camp for former law enforcement and government officials reveals that they were at the low end of the spectrum. Furthermore, 90% reported that they had to share bribes they received with those higher up in the chain of command. This is part of the Soviet system that has been perpetuated in the post-Soviet era. There is institutionalized corruption with almost no high level official forced to pay the costs. Only in the brief period of Primakov's premiership were there over 20 convictions of generals on corruption charges. But even in this period, the oligarchs stayed out of reach.

Corruption charges are often used as a political weapon in NIS states rather than means to address problems of high level corruption. Furthermore, systemic problems make sustained anti-corruption efforts difficult. In Georgia where the anti-corruption committee in parliament forced the removal of high level ministers from particularly lucrative posts in privatization and energy, they have not had success in forcing prosecutions, confiscating ill-gotten gain or ensuring greater integrity among the replacements of ousted officials.

### 8) *CITIZEN REACTION TO THE CORRUPTION*

Citizens of the NIS states are disillusioned by the corruption. Recent survey research indicates that Georgians seek democratic solutions to the corruption problem but in some Slavic states citizens are ready to accept authoritarian solutions to the problem or believe they are likely. The helplessness of the ordinary citizen, the entrepreneur and the NGO community in the face of this corruption should not be underestimated. The endemic corruption has a corrosive impact on the development of democracy and business. It may destroy the new societies before they have a chance to be created.

#### WHAT CAN BE DONE?

##### 1) *LIMITED OPTIONS*

Our leverage is limited both in our foreign and our economic policy. The ideal window of opportunity to address these issues has passed. We can require more compliance and oversight in World Bank and IMF policy in the region. President Wolfensohn has made corruption a central part of his leadership of the World Bank but adequate safeguards have not been placed in the past on World Bank structural loans or IMF tranches. This has been done since the debacle of August 1998 but this is already late. U.S. policy has been important in World Bank and IMF decision making on these loans.

##### 2) *CORRUPTION CAN NOT BE ADDRESSED ONLY THROUGH ANTI-CORRUPTION PROGRAMS*

With the recent recognition of the significance of corruption, the U.S. has established large anti-corruption assistance programs in Ukraine and Georgia. Corruption cannot be addressed only through targeted programs but anti-corruption measures must be incorporated in all our assistance programs. We need holistic and comprehensive strategies.

We should not be making the problems worse as we did with our earlier privatization assistance. Consideration should be given to re-doing privatization to foster fairer redistribution of assets. Today some say that it is too risky to go through this process again because it would upset the markets and result in financial chaos. The Center view is that if the Russians don't undertake this important task at least in certain sectors, the Russian people will totally discredit their government and that Russia will be in the same situation, or worse, that Italy found itself in for half of century. Indeed, we believe it is too risky not to take this course of action.

##### 3) *POLITICAL SUPPORT FOR CORRUPT LEADERS*

During the Cold War, we accepted corrupt leaders because they were a bastion against Communism. We now accept corrupt leaders in the NIS because they are protecting us from the return of Communism. We need to understand that corruption undermines democracy and makes citizens lose faith in their governments. We need to avoid repetition of our mistakes of the past. Long term stability cannot be guaranteed if there is a very corrupt leader in place. The lessons of Indonesia do not apply just to Southeast Asia but are important in the NIS as well.

#### 4) *LONG TERM POLICIES*

Endemic corruption is one of the most pernicious legacies of the Soviet period and we cannot expect a quick fix to the problem. We cannot expect to phase out anti-corruption programs in 3-5 years. We need a long term policy of engagement with countries of Eastern Europe and the NIS on these issues.

#### 5) *MUTUAL PROBLEM*

Within the OSCE and OECD context, we must acknowledge that we face a mutual problem. I spoke at the Paris meeting in July 1998 on anti-corruption. A divide developed on the corruption issue between the west and the former socialist countries. They had a corruption problem and we did not. Yet so much of the NIS resources would not lie abroad, if this were not facilitated by corruption of lack of diligence in western banking institutions. The corruption issue must not become a new way to foster the divide between East and West.

#### 6) *INTERNATIONAL MEASURES*

The OECD Anti-Bribery Treaty monitoring process needs to be done in a more expeditious manner. At present, only a few countries per year have to report on their progress. More creative and timely ways of reporting need to be created, and civil society needs to be more a part of this process. The Treaty also needs to be extended to the entire OSCE region. OSCE could create its own monitoring mechanism, or one done in collaboration with OECD and the business/NGO community.

OSCE countries need to adopt internationally accepted standards of corporate governance as part of any solution (protection of shareholder rights, financial disclosure, Board responsibilities and ownership, etc).

#### **STATEMENT BY KEITH HENDERSON, CO-DIRECTOR TRANSNATIONAL CRIME AND CORRUPTION CENTER (TRACCC)**

The following plan was developed as an aid for a trade and investment and civil society anti-corruption strategy for Russia, and an eight point cross-cutting action plan, designed to enable Russia to become part of the global economic and political community.

On the government reform side of the equation, the action plan is grounded on Russia adopting and implementing international "best practices" in a number of strategic economic and legal areas, such as public procurement, auditing and accounting, finance and banking, judicial and regulatory reform. On the civil society side, emphasis is placed on promoting the development of more advocacy associations, including those representing the business community, passing and enforcing a number of laws and policies guaranteeing the public "access to government information" and the establishment of broad-based reform-oriented public/private coalitions. Over time, such a two-pronged approach, coupled with a complementary law enforcement program, are the fundamental stepping stones needed to pave the way for a rule of law society.

The holistic strategy and multi-faceted program is largely focused on addressing the underlying historical, cultural, economic and legal causes of corruption. This perspective places primary emphasis on enhancing support for more power-sharing and for key, fragile government institutions, such as the judiciary and the Supreme Audit Institution—both of which are critical to resolving property disputes fairly and effectively and providing independent oversight over government revenues and expenditures.

A major part of the problem to-date relates to the lack of serious support for anti-corruption reforms at the highest levels of the Russian government. Initially, high-level Russian policy makers and many in the international community, including the U.S., viewed the corruption problem as an inevitable, temporary “transitional” problem. The World Bank and others did not even raise the issue or utter the word during high-level policy and/or loan discussions. Literally hundreds of millions of dollars in technical assistance was provided, by both the U.S. and the Europeans, without raising the topic or insisting upon some degree of conditionality. Little attention was given to this problem by policy makers during the peak reform years of the early to mid 1990’s. In hindsight, most Russia-specialists and Russian reformers themselves now concede that this was a fundamental mistake that must be corrected in order to promote further and sustain current economic and political reforms.

Today the situation is quite different. The international donor community, and the World Bank, have offered to provide anti-corruption assistance to the Russians; however, the Russian government has chosen not to respond in a serious manner. For the last several years the main problem has been that no person with real overarching interagency authority has been designated to undertake the complex, unpleasant task of addressing corruption, including exposing and prosecuting high-level officials and businessmen engaged in it. A number of examples can be cited to support this fact, such as:

1. very little attention and resources has been devoted to building an independent judiciary so there is very little executive/parliamentary judicial oversight and virtually no official way to resolve governmental or private property disputes (an August 1997 USIA Russian four city survey revealed that 77% believed the Russian judicial system did not provide equal justice under the law and 50% believed that the government was maintaining law and order “very badly”.);
2. no criminal procedure code has been passed so corrupt activities can not be prosecuted fairly and effectively within a democratic rule of law context;
3. investigative journalists are still being killed and/or threatened B the state is providing them insufficient protection and is not adequately prosecuting those involved;
4. the public continues to be denied access to public information even though this right is enshrined in the Russian Constitution (implementation legislation is not enforced);
5. public surveys show that public confidence in governmental institutions is at an all-time low partly because almost no high level officials or well known corrupt businessmen have been prosecuted for well publicized economic crimes;
6. new reform-oriented laws, such as those relating to public procurement and income and asset disclosure laws, are proving to be meaningless because they are not being implemented in practice;

7. several anti-corruption campaigns have been announced over the years but they have produced little results and are seen by the public as largely political.

The upcoming post-Presidential election period may provide Russia and the international community a window of opportunity to address some of these issues. Thus, it is important for the international community to provide solid support to many within the academic, business and NGO communities on a long-term anti-corruption strategy. Toward that end, our Center is supporting the Academy of Sciences and Institute of State and Law's upcoming all-Russia anti-corruption conference in September 1999. This will be the first serious effort in Russia to bring together a mix of Russian scholars and practitioners, as well as representatives from the international community, from various disciplines to develop their own strategy and action plan.

Even if the elections do not provide much of an opportunity to work with reformers within the new government, it now should be clear to all that leadership on this issue, and the demand for reform, is going to have to come from reformers within civil society—not those benefitting from the current corrupt system. There is finally movement in this direction and we can not afford to continue our fruitless efforts to work with those who do not want to change the status quo.

**BRIBERY AND CORRUPTION IN RUSSIA: TRENDS IN 1998-1999  
STATEMENT BY VLADIMIR BROVKIN, PROJECT DIRECTOR  
TRANSNATIONAL CRIME AND CORRUPTION CENTER  
(TRACCC)**

**EXECUTIVE SUMMARY:**

The adoption of the criminal code in Russia in 1996 and the launching of presidential campaigns against corruption had generated a widely held expectation that the free for all chaos of the period of privatization of state assets of 1995-96 which had been accompanied by corruption, loans for shares scandal and marred privatization of Sviazinvest were over and a period of building the rule of law state was going to commence. Unfortunately the record of 1998 and especially 1999 has not moved Russia anywhere closer toward that goal. In fact corruption has become worse. It has permeated major branches of government. It has become a political issue number one in national politics. It is threatening the political stability and the peaceful transition from one administration to another if elections as required by law do take place at the end of 1999 and early 2000.

**1. 1997 SVIAZINVEST AUCTION AS LAUNCHING OF THE WAR OF THE OLIGARCHS**

In August 1997 an auction for a 25% stake of the State communications company Sviazinvest took place in Russia. Foreign bidders were admitted for the first time and one consortium of investors competed against another. As the date of the bidding approached the accusations of wrong doing mounted. Kokh the director of the privatization committee had to resign amid allegations that the auction was fixed in favor of Oneximbank, a bank a led by Mr. Potanin. It was alleged

that the so-called "Privatization Tsar" Chubais played into the hands of Potanin and the group of financiers standing behind it. George Soros the well-known international financier participated in the auction which he later called the worst investment of his career.

The side that lost Berezovsky, Most bank group and others launched a vigorous campaign against the side that won the bid. It is known in Russian politics as the first salvos in the War of the Oligarchs, the echoes of which are still rocking Russian political Olympus.

The Sviazinvest auction was merely the most noticeable example of a practice well established in 1994, 95 and 96 a practice of insider dealing, abuse of office for personal gain, fixed privatization auctions and other questionable practices. The reason that this particular incident got so much publicity was that foreign investors participated and were appalled by the degree of corruption.

## 2. TOWARD THE AUGUST 1998 CRASH

The fall of 1997 and the spring of 1998 were marked by the succession of crises, the firing of Chubais, the firing of Prime Minister Chernomyrdin, the GKO crisis, and finally the default and the crash of the financial system.

These political events were merely a manifestation of the deeper problem a problem of unhealthy speculative capitalism based on financial schemes, pyramids and massive flight of capital to safe heavens abroad and speculation of the GKO market.

The main point is that Russian rulers tried to create an impression for IMF that Russian had a stable currency, a viable monetary policy and thriving securities market. All that was supposed and did attract infusions of Western capital that bought Russian securities backed by favorable ratings of international agencies. High GKO rates of return encouraged Western buyers, which in turn stimulated higher rates and speculative drive which had to end up in a bursting of the bubble.

The government of Kirienko was a government of financial tycoons who used the treasury and the knowledge of the financial policy to their advantage. It was a government where corruption manifested itself in leaking privileged information to banker-friends to the detriment of the system as a whole and the collapse of the entire system on 17 August 1998.

## 3 PRIMAKOV AND THE ATTEMPTS AT REFORM.

The appointment of Primakov as Prime Minister should be understood as admission in the Russian political context that the so-called reformers were bankrupt both politically and economically. The banks were bankrupt having defaulted on western loans and having wasted millions and millions of Western depositors' money. It was an admission that the system of so called reformers type capitalism backed by the IMF in Russia did not work. It generated corruption, speculation, a Potemkin capitalism that looked good but turned out to be rotten.

Primakov's government was in fact a government that attempted reform at least as far as corruption is concerned. After stabilizing the financial markets, Primakov moved against some of the oligarchs as they are known in Russia, the powerful financial tycoons and their financial industrial empires. In a spectacular collaboration with the Prosecutor General; Skuratov raids were made on the offices of Sibneft, Aeroflot accounts were checked and several investigation on the pro-

priety of privatization was launched. January and February 1999 were the two months when it appeared that the Russian government was doing something against corruption, not by repression, or arbitrary arrests but by judicial investigation.

This short period ended in the ouster of Prosecutor General Skuratov in February. As is well know the Federation Council voted twice against the President's decision to fire the Prosecutor General and yet Yeltsin is continuing to impede Skuratov's work. Now some charges were brought against him to impede his investigations into the wrong doing of Berezovsky, Borovoi and other friends of the family of President Yeltsin. Strictly speaking Yeltsin's harassment of Skuratov is a gross violation of the separation of powers of the Russian constitution.

#### 4. THE OUSTER OF PRIMAKOV AND THE NEW GOVERNMENT OF CORRUPT OFFICIALS.

Prime Minister Primakov was the next to be ousted. In the context of a campaign against Skuratov the firing of Primakov has to be understood as a roll back to inquiries into the corruption of Yeltsin's administration. It was a blow to independent judiciary and a blow to a accountable government. As is well know the Duma was intimidated by the threat of dissolution to approve of the new cabinet. The new appointments were a disillusionment to those who had hoped that the struggle against corruption started under Primakov would continue. In fact exactly the opposite is the case. The people who are playing key roles in the government are people with tarnished reputations, people who had worked in ministries and agencies known to be notoriously corrupt which had siphoned off state revenue on a consistent basis over the years.

Moreover, the task of these appointments as the Russian media attests was to make the financial flows of the budget less transparent, so that money could be siphoned off ostensibly for the election campaigns of 1999 and possibly 2000.

## PREPARED STATEMENT OF LUCINDA A. LOW

JULY 21, 1999

Mr. Chairman, Mr. Co-Chairman, Members of the Commission, thank you for the opportunity to testify before you today concerning the extent and impact of corruption in the OSCE countries and strategies for dealing with it.

For more than 20 years, I have been involved in counseling U.S. companies and others subject to U.S. laws on compliance with the Foreign Corrupt Practices Act, or FCPA. I am also a member of the Board of Directors of Transparency International USA. Transparency International, the parent organization to the U.S. chapter, is the leading non-governmental organization in the anticorruption movement. I have also been involved with anti-corruption law reform issues during my Chairmanship of the Section of International Law and Practice of the American Bar Association (ABA) in 1996-97, and in other professional organizations. I will speak to you both from my counseling experience, which has been worldwide, including many OSCE countries, and from my experience with TI and other organizations.

Although virtually every country has laws criminalizing the bribery of *domestic* public officials, the FCPA was the first law to criminalize bribery of *foreign* public officials. It was the only law of its kind for approximately 20 years. Consequently, U.S. companies competing for business abroad with foreign companies have found themselves subject to restrictions that their foreign competitors did not have. Not only did foreign companies have no FCPA counterpart, but their tax laws often allowed them to deduct bribes as a business expense, something that U.S. tax laws have disallowed since the late 1950s, and their accounting standards did not mandate transparency or adequate internal controls on corporate expenditures.

U.S. companies seeking to do business in the OSCE region have encountered, and continue to encounter today, significant corruption.<sup>1</sup> It arises in the privatization of state enterprises, in restrictions imposed on trade, in government procurement, and in other business operations which are subject to regulation. It appears to arise at all levels of government. It cuts across industries, including telecommunications, oil and gas, construction, tourism, and manufacturing. I am personally aware of business opportunities in the region that have been lost to U.S. companies because of bribes paid by foreign competitors.

Though corruption is prevalent, the extent of the problem varies widely among OSCE countries. In the 1998 Corruption Perceptions Index published by Transparency International, which ranks countries from least to most corrupt (from 1 to 85) according to perceptions of business people and others active there, the OSCE countries ranked as follows:

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<sup>1</sup> Corruption in the economic arena will be treated here as distinct from corrupt activity relating to organized crime, a huge problem in certain countries of the region.

Denmark – 1	Estonia – 26
Finland – 2	Belgium – 28
Sweden – 3	Hungary – 33
Iceland – 5	Greece – 36
Canada – 6	Czech Republic – 37
Netherlands – 8	Italy – 39
Norway – 8	Poland – 39
Switzerland – 10	Belarus – 47
Luxembourg – 11	Slovak Republic – 47
United Kingdom – 11	Turkey – 54
Ireland – 14	Romania – 61
Germany – 15	Yugoslavia – 61
Austria – 17	Bulgaria – 66
United States – 17	Ukraine – 69
France – 21	Latvia – 71
Portugal – 22	Russia – 76
Spain – 23	

(See Attachment A for the full 1998 Index.) Although it is impossible to determine from this survey why these disparities in corruption levels exist, it is clear that emerging democracies and transitional economies as a group fare worse than countries with more established political and economic systems. The variation may also depend on the form of government and the amount of government regulation—countries with a greater degree of liberalization tend to have fewer opportunities for corruption. Because of the wide variation in levels of corruption in the region, some countries will require greater efforts to combat corruption, and the specific priorities may well differ.

Not atypically, the problem of corruption in the region takes many forms. A few months ago, I counseled a client on a situation in which a local partner, apparently in order to get a needed permit, had promised part of the equity in a project to a company that, upon investigation, appeared to be controlled by a key government official. Concerned about the vicarious liability provisions of the FCPA, my client had to assess whether it could continue to pursue the project and do business with its local partner. And just a few weeks ago, I counseled a client who, on the verge of being announced the winner of a publicly-bid project, was approached to make a payment “on the side” to match what its foreign competitors had offered to take the project away from it.

In both cases these clients refused to engage in corrupt activity, and in both cases they were able ultimately to retain the business. Their success was due in one case to an intense lobbying campaign against the corrupt activity and in the other case to a variety of measures to educate the foreign partner and force changes to the transaction. In both cases the client had to devote significant time and resources to overcoming the problem. It is not always possible to overcome such requests, however. Sometimes the opportunity is lost without any advance warning of improper activity.

In addition to lost business opportunities for individual firms, empirical evidence indicates that corruption leads to a reduction of foreign investment, which is particularly crucial for transitional economies, and a retardation of economic growth. Corruption may also

reduce government revenue, alter the composition of government expenditure, and decrease or misallocate investment in infrastructure and public services.

Yet, the attitude that bribery is simply part of the international business game remains strongly-entrenched in many parts of the region. Earlier this year, I traveled to Eastern Europe for FCPA compliance training for personnel in our client's field offices in the region. The client was concerned by the extent to which its local personnel were being routinely asked to make payments, large and small, in connection with its projects there. I encountered a kind of "everybody does it" cynicism about the ability of companies to resist corruption. I was even told that under the former Communist regime in one country, bribes were legal as long as one obtained a permit from the state to pay them! I do not know if this story is apocryphal or not, but it reflects a still quite common perception that corruption is an inevitable part of business.

What can be done to combat corruption in this region? Laws are certainly a part of the solution, although by no means the only part.

In the last five years, as other countries besides the United States have begun to recognize the tremendous costs of corruption, the legal landscape has begun to change dramatically. Three international organizations—the OECD, the OAS, and the Council of Europe—have developed treaties aimed at combating corruption. The international financial institutions have also begun to attack corruption in both their procurement and their lending. Likewise, in the private sector, organizations such as Transparency International and the American Bar Association have initiated programs to assist in the battle against corruption.

These measures—unthinkable only a few years ago—are significant, but represent only a beginning. Some of them—such as the OECD Convention—are quite narrow, basically only attacking the problem from the "supply" side, through criminalization and closely related measures.<sup>2</sup> But corruption is both a supply and a demand problem, which is why the OECD Convention—although extremely important to the competitive posture of U.S. companies in international business—is only a part of the answer for the developing world.

Particularly for transitional economies, combating corruption effectively implies a series of measures to establish the rule of law. It implies the professionalization of the civil service, and the payment of living wages for government workers. It implies the development of ethics-in-government standards, and in many cases mechanisms, for insuring that government officials are not able to enrich themselves improperly through government service. It implies transparent tax, customs, and procurement systems and other types of law reforms. It likewise implies transparency in privatizations of state-owned enterprises and in regulatory processes. Last but by no means least, it implies an ability to enforce the laws, and the strengthening of the judicial sector.

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<sup>2</sup> For an overview of the OECD Convention and a brief comparison to the FCPA, see Attachment B, Lucinda A. Low and Timothy P. Trenkle, "U.S. Antibribery Law Goes Global: Standards Tightening Up," *Bus. L. Today*, July/Aug. 1999, at 14.

As I noted earlier, virtually all countries have laws prohibiting the bribery of domestic public officials. Some countries with the most elaborate laws are regarded as among the most corrupt, however. In these countries, the laws exist, but are not enforced, or are enforced selectively. Thus, the strengthening of enforcement capacity, which implies not just the judiciary, but police, prosecutors, and other parts of the system, needs to become a priority. Non-governmental organizations are a key participant in establishing systems to monitor and report on compliance with these laws. The press also plays an important informal role in enforcement, by publicizing potential wrongdoing. Many U.S. companies fear adverse publicity—the unfavorable article in the *Wall Street Journal*, or the *Washington Post*—as much as an actual enforcement action.

My recommendation to the Commission would therefore be that a broad governmental and law reform agenda be pursued in the OSCE countries. An educational initiative and efforts to strengthen civil society should accompany this reform agenda. Experience has shown that success in the fight against corruption ultimately depends on a combination of legal, economic, societal, and cultural factors. FCPA compliance programs, for example, are most successful in those companies that have a culture that emphasizes both ethics and respect for law. Simply having a program—a set of rules—without an accompanying compliance culture results in compliance being given lip service only, and being ignored when more pressing business needs arise.

The agenda I have outlined is not an agenda that could be accomplished overnight. Our U.S. experience with the FCPA has shown that it took at least a decade for many companies to develop more than superficial compliance programs and for business attitudes to change. But that does not mean that efforts to address the issue in the OSCE countries cannot begin today.

To deal with the supply side problem, efforts should be redoubled to promote ratification and implementation of the OECD Convention by those European signatory countries (such as France, Italy, the Netherlands, and Belgium) that are actively engaged in international trade and investment but have not yet ratified. Efforts should also continue to eliminate the tax deductibility of bribes, and to strengthen accounting standards, particularly for large enterprises.

The Council of Europe Anticorruption Convention represents a more ambitious “supply side” effort than the OECD Convention. In my view, while there are many important features of this Convention, it does not do enough to address the demand side issues in the region, which, as indicated above, implicate the rule of law in a much broader way. However, because the Council of Europe Convention, like the OECD Convention, requires cooperation among participating countries in investigations and enforcement, it offers important tools to deal with a problem that frequently crosses national boundaries.<sup>3</sup> Also like the OECD Convention, it contains a monitoring mechanism (GRECO), an important tool for ensuring that full implementation and enforcement take place. Ratification and implementation of this Convention

<sup>3</sup> For a comparison of the cooperation provisions of the OECD and Council of Europe Conventions, see Attachment C, Lucinda A. Low and Michael L. Burton, “Emerging Global Anticorruption Standards: New Prosecutorial Tools for Transnational Investigations and Enforcement,” prepared for The 13th Annual National Institute on White Collar Crime, San Francisco, CA, Mar. 1999.

by states in the region should therefore be supported, and consideration should be given to developing “bridging” mechanisms between the OECD and Council of Europe Conventions to maximize the cooperation available between the two groups of participants.

In addition, on the demand side, there should be a coordinated effort among donor organizations and international financial institutions, as well as politico-military institutions, to ensure that there is an agreed-upon agenda, a set of priorities, and efforts to address those priority governmental, law reform, civil society strengthening, and education measures.

Finally, for countries such as Yugoslavia which will be experiencing major capital inflows for reconstruction or other purposes, it is essential that monitoring mechanisms be developed to ensure that corruption in externally-financed projects is minimized. Aid donors and lenders alike need to develop a much stronger capacity in this area than they have had historically. Aid should also be carefully targeted to specific areas, projects or recipients to hinder the diversion of funds for corrupt uses. Borrowers and fund recipients should be required to demonstrate that they have internal compliance programs in effect, including policies, procedures, and training, in order to qualify to participate in these projects.

Thank you for the opportunity to present this testimony. I would be happy to answer any questions you may have.

**TRANSPARENCY INTERNATIONAL (TI) 1998 CORRUPTION  
PERCEPTIONS INDEX**

The first table given below provides the actual score along with the number of surveys used and the standard deviation. In a second table the individual sources are listed that have contributed to the assessment of each individual country.

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
1	Denmark	10.0	0.7	9
2	Finland	9.6	0.5	9
3	Sweden	9.5	0.5	9
4	New Zealand	9.4		8
5	Iceland	9.3		6
6	Canada	9.2	0.5	9
7	Singapore	9.1	1.0	10
8	Netherlands	9.0	0.7	9
9	Norway	9.0	0.7	9
10	Switzerland	8.9	0.6	10
11	Australia	8.7	0.7	8

**CPI—NOTES**

**1998 CPI Score**—relates to perceptions of the degree of corruption as seen by businesspeople, risk analysts and the general public and ranges between 10 (highly clean) and 0 (highly corrupt).

**Surveys Used**—refers to the number of surveys that assessed a country's performance. 12 surveys were used and at least 3 surveys were required for a country to be included into the 1998 CPI.

**Standard Deviation**—indicates differences in the values of the sources: the greater the standard deviation, the greater the differences of perceptions of a country among the sources.

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
12	Luxembourg	8.7	0.9	7
13	United Kingdom	8.7	0.5	10
14	Ireland	8.2	1.4	10
15	Germany	7.9	0.4	10
16	Hong Kong	7.8	1.1	12
17	Austria	7.5	0.8	9
18	United States	7.5	0.9	8
19	Israel	7.1	1.4	9
20	Chile	6.8	0.9	9
21	France	6.7	0.6	9
22	Portugal	6.5	1.0	10
23	Botswana	6.1	2.2	3
24	Spain	6.1	1.3	10
25	Japan	5.8	1.6	11
26	Estonia	5.7	0.5	3

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
27	Costa Rica	5.6	1.6	5
28	Belgium	5.4	1.4	9
29	Malaysia	5.3	0.4	11
30	Namibia	5.3	1.0	3
31	Taiwan	5.3	0.7	11
32	South Africa	5.2	0.8	10
33	Hungary	5.0	1.2	9
34	Mauritius	5.0	0.8	3
35	Tunisia	5.0	2.1	3
36	Greece	4.9	1.7	9
37	Czech Republic	4.8	0.8	9
38	Jordan	4.7	1.1	6
39	Italy	4.6	0.8	10
40	Poland	4.6	1.6	8
41	Peru	4.5	0.8	6

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
42	Uruguay	4.3	0.9	3
43	South Korea	4.2	1.2	12
44	Zimbabwe	4.2	2.2	6
45	Malawi	4.1	0.6	4
46	Brazil	4.0	0.4	9
47	Belarus	3.9	1.9	3
48	Slovak Republic	3.9	1.6	5
49	Jamaica	3.8	0.4	3
50	Morocco	3.7	1.8	3
51	El Salvador	3.6	2.3	3
52	China	3.5	0.7	10
53	Zambia	3.5	1.6	4
54	Turkey	3.4	1.0	10
55	Ghana	3.3	1.0	4
56	Mexico	3.3	0.6	9

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
57	Philippines	3.3	1.1	10
58	Senegal	3.3	0.8	3
59	Cote d'Ivoire	3.1	1.7	4
60	Guatemala	3.1	2.5	3
61	Argentina	3.0	0.6	9
62	Nicaragua	3.0	2.5	3
63	Romania	3.0	1.5	3
64	Thailand	3.0	0.7	11
65	Yugoslavia	3.0	1.5	3
66	Bulgaria	2.9	2.3	4
67	Egypt	2.9	0.6	3
68	India	2.9	0.6	12
69	Bolivia	2.8	1.2	4
70	Ukraine	2.8	1.6	6
71	Latvia	2.7	1.9	3

<b>Country Rank</b>	<b>Country</b>	<b>1998 CPI Score</b>	<b>Standard Deviation</b>	<b>Surveys Used</b>
72	Pakistan	2.7	1.4	3
73	Uganda	2.6	0.8	4
74	Kenya	2.5	0.6	4
75	Vietnam	2.5	0.5	6
76	Russia	2.4	0.9	10
77	Ecuador	2.3	1.5	3
78	Venezuela	2.3	0.8	9
79	Colombia	2.2	0.8	9
80	Indonesia	2.0	0.9	10
81	Nigeria	1.9	0.5	5
82	Tanzania	1.9	1.1	4
83	Honduras	1.7	0.5	3
84	Paraguay	1.5	0.5	3
85	Cameroon	1.4	0.5	4

**PREPARED STATEMENT OF PETER GRINENKO****JULY 21, 1999**

Mr. Chairman, thank you for the opportunity to address the Helsinki Commission today on the issue of corruption in the countries of the Organization for Security and Cooperation in Europe (OSCE). This is a subject with which I have been closely associated in three ways: through my experience as police investigator in New York City, as a businessman in the OSCE region, and as an American with ethnic ties going back to Russia and Ukraine.

A little about myself. My mother's grandfather was a general in the Czar's army, and all the male members of her family were killed by the Bolsheviks. My mother was born in 1917, and married my father, a Ukrainian, in the 1930s. After WWII, they managed to escape to Germany, where I was born. I grew up in the United States, in an extended family that spoke Russian, French and English.

In my early years, I spent several years in the company of my great grandmother and her daughters. They taught me about Russia, the value placed on culture and the morality that existed there before communism. Even then I sensed that their values were different from my mother's, but at the time I didn't understand the reason for the difference. Then I went to Russia.

In 1987, after over 18 years with the New York City police department, I was thinking about retirement. Most of my career in the police department involved property crimes, with over 10 years in the auto crime division. By 1980, because of my ability to speak Russian and the Soviet emigration in the mid 1970s, I had experience dealing with Soviet criminals in the United States. As a result, I was recruited by the FBI for a small task force that dealt exclusively with criminals from that part of the world. Not only were we very successful in our investigation and prosecution of these criminals, but this experience greatly enhanced my understanding of the Soviet mentality. At the same time policies instituted by Gorbachev were opening up the Soviet Union. I already had a number of businesses in the United States and I thought that this was the perfect opportunity to use all my experience to get involved in a new and interesting venture in the land of my ancestors.

I visited the Soviet Union for the first time in 1987. By mid 1988 I had set up my first joint venture. I still travel to that part of the world 4 or 5 times a year, for about a month at a time and I continue to conduct business there today—in a very limited way. The main reason that I have limited my exposure is the topic of this hearing. Based upon my experience, bribery and corruption in the former Soviet Union are not the exception, they are the norm. While corruption existed before the dissolution of the Soviet Union, the collapse of political controls, and the influx of hard currency has produced post-Soviet business practices that are even more corrupt. The purported advent of "capitalism" and "democracy" in this part of the world has not only made matters much worse, it has also had a much greater effect on the public in general. In 1991, I shut down my largest enterprise, which included operations in Latvia, Russia and Ukraine, because I realized that there was no way for me to conduct business in these emerging economies without taking part in the corruption. Combine

this with the substantial loss of product due to pilferage by factory workers, among various other obstacles, and you begin to realize, as I did, that it was next to impossible for me to make a go of it.

However, I keep trying. Some call this wishful thinking on my part. More times than not, I run into the same problems. For example, an enterprise in Russia requested that I sell them equipment for a small meat processing plant. I offered to set up a “turnkey” operation for 1.2 million dollars. However, the Russian business people with whom I was negotiating on this project chose to accept an offer by an Italian company who set up a much smaller operation, but for \$800,000 dollars more than I had proposed. Why? As I found out later, the Italian company had paid off the director and his assistants. Even though I didn’t consider myself naive at the time, I was still flabbergasted by how blatantly open the corruption was.

It really bothers me to see what has become of the country my great grandmother used to speak of with such pride, and it has become important to me personally to try and understand what has led to the current state of affairs. In over 12 years of exposure to the Soviet and post-Soviet system, I have learned that there were many contributing factors, but almost all of them can be tied to the effects of 70 years of communism. The socialist ideal that everyone is equal did not stop people from wanting nice things, but it fostered an environment in which people could not get the nice things they wanted legally, so they resorted to illegal methods. People went to work not just for their salaries, but for what they could steal. They then used what they stole to barter for the luxuries, or sometimes just basic necessities that were in short supply. By making the absolutely normal human desire “to have” a criminal activity, communism produced two generations of people for whom corruption became a way of life. Furthermore, there were the legal and sub-legal limitations on religious practices. To be a success in the Communist system, you could not be known as a religious person. You could lie, cheat, steal, but as long as you could quote the latest Party line and had the right friends, that was the ticket to success. If you understand the morality of that time, then today’s situation is even easier to understand. The people who were responsible for all this are still in control now, but today they wear the “jacket of democracy”.

When I found out several months ago that I might be asked to speak before this commission, I started questioning people about their personal experiences with corruption. This was not an easy task since most people don’t appreciate it when you ask them things like “When did you first become a thief?” On one occasion I had a discussion with a woman in Russia. I told her about a case that I had worked on as a detective in New York. We had recovered a quarter of million dollars. I explained to her how we went about handling the money. As we spoke it became abundantly clear to me, and to her, that she (and everyone that she knows) would have “handled” the money very differently than we did. After our discussion, she realized how ingrained her corrupt attitude was and conceded that her attitude was probably indicative of the society in general. When I asked another woman, a health care worker in Latvia, about her first experience with corruption, she tearfully related a story about her childhood on the “kolhoz” (collective farm) in Belarus. She was about 5 years old and her father used her as a lookout while he stole grain from the ware-

house. She said her father excused what he did by saying that the grain belonged to the state and “the people are the state”. In addition he claimed that it really wasn’t stealing because the director of the “kolhoz” would also be taking some.

Corruption in this part of the world does not just occur in government. It is not just a problem when trying to conduct business. It is part of the society and is perceived as a means of survival. Indeed, this situation even exists within the immigrant community in the United States. For example, immigrants from Russia who have organizational or managerial positions in the home health care field “help” more recent immigrants in obtaining the training and certification required for employment. They also “help” find positions for these immigrants once they are trained. At each step of the process, bribes are expected by the manager. If the immigrant does not have status (i.e., “illegal immigrants”), the situation is even worse. Typically those without status are required to pay additional monthly bribes to the managers in order to keep their jobs.

Mr. Chairman, I hope that my testimony has helped to personalize your knowledge of the problem that our businesspersons and law-enforcement personnel face in dealing with corruption in the countries of the OSCE. I also know that Commission and the Congress would like to hear proposals on combating this problem. I don’t think there are any realistic short-term solutions to this problem. Hopefully, some of the legal approaches initiated by the international community to combat bribery will have some effect. I am also aware of cooperative efforts between our law enforcement officials and their counterparts in the countries under discussion.

But any long-term solution must address society as a whole. In my opinion, the only methods that have any real chance of working are those aimed at the younger generation in these countries. It is unfortunate, but in my experience, most of the older generation has absolutely no confidence in their government or in their own future. They are just concerned with having as much as they can now, and in order to get it, they’ll do whatever they have to.

Just teaching students from the former Soviet Union about democracy and capitalism won’t work. However, it is my understanding that there are currently programs through which high school and college students come to the United States for about a year, go to American schools and live with American families. I think this is a good idea. Young people from these countries need to be exposed to our way of life — yes, even with its negative characteristics — so that they can learn about capitalism and democracy first hand, and so that they will get a historical perspective of our freedom and prosperity. They need to understand that delayed gratification, and even sacrifice, may be necessary before they “make their first million.” They also need to see how basic morality and rule of law works to protect property and lawfully acquired wealth.... that armed guards are the exception rather than the norm. Their experiences here will allow them to see how destructive corruption and bribery are to the moral fiber of their society. Some of them may not be especially moved by these lessons, but I believe that many of them will return home and share what they’ve learned. With a large number of students and over a number of years, I am convinced that slowly, changes will occur. When we send teachers and set up various training programs

over there now, they are ineffective because the Russians laugh at our efforts. They look at us as naive or cynical Westerners getting paid to come to address a culture that we know nothing about. I don't think they'll be as quick to laugh at their own family members or fellow citizens. These opportunities should be available to a large number of students on a continuing basis. I don't know how the system works for selecting participants, but insofar as the United States government is a sponsor, I trust that there are necessary safeguards are in place to assure that the selection process is equitable. Otherwise, only those children of the controlling elite might end up being included. We currently send millions in aid, but those in power only use it for their own purposes. They've had 70 years of communistic teachings and have lived the reality of corruption. The next generation of Russians (Ukrainians, Latvians, etc) needs to see another type of reality and I don't think they'll "see it" or understand it unless they live it.

Mr. Chairman, our own security and economic interests are enhanced when crime and corruption are reduced in countries that we need to deal with. I hope this hearing will assist the Commission and the Congress in this endeavor, and I would be glad to answer any questions that you or other members of the Commission might have. Thank you.

**RESPONSE OF LUCINDA A. LOW TO QUESTIONS SUBMITTED  
BY COMMISSIONER PATRICK A. MULLOY**

On behalf of Transparency International-USA and myself, this is in response to the two follow-up questions asked of me by Commissioner and Assistant Secretary Mulloy in relation to the CSCE hearing July 21, 1999 on Bribery and Corruption in the OSCE Region. In effect, the two questions called for my priority recommendations concerning both the “supply side” and the “demand side” measures the Commission should support to combat corruption in the region.

Given the size and diversity of the OSCE region in terms of levels of development of its constituent members and the nature and extent of the corruption problem among countries, formulating such recommendations is a challenge. Without attempting a country-by-country review, the following are the general recommendations we would make on both the supply and the demand sides of the issue.

1. [Supply Side] ***Support the Work of the OECD.*** As the questions you posed recognize, the work of the OECD should be a priority on the supply side. This includes, but is not limited to, the OECD Antibribery Convention. Specifically:

- Countries that have signed but not yet ratified the Convention should be encouraged to ratify promptly;
- Countries that have ratified should be encouraged to implement the Convention fully and promptly, and to enforce it;
- Expansion of membership in the Convention should focus only on exporting countries, recognizing that the Convention is highly targeted and relevant only to those countries; it will not therefore be the “solution” for many OSCE countries;
- The OECD should be encouraged to pursue the unresolved issues of payments to political parties, party officials and candidates, use of offshore financial subsidiaries, role of foreign subsidiaries, and bribery as a predicate offense to money laundering legislation;
- The OECD should continue to push for the elimination of tax deductibility of bribes by all its members; and
- The OECD should receive adequate funding from governments to support these efforts. At the same time, the OECD should be encouraged to make its processes as open and transparent as possible, including for the participation of NGOs and civil society.

2. [Supply and Demand Sides] ***Encourage Participation in the Council of Europe Convention.*** Because the OECD Convention is not relevant for all countries and, even for relevant countries, is limited in scope, other tools need to be pursued. The Council of Europe includes many OSCE members in its membership; their participation in that body’s Criminal Law Convention Against Corruption should be encouraged.

- As with the OECD Convention, “participation” implies the full package of ratification, implementation, and enforcement. This will require greater capacity-building in some countries than in others, because in some countries enforcement institutions are still weak; and
- The Council of Europe should be encouraged to take other related initiatives, for example, regarding the elimination of tax deductibility for bribes and the development of stronger corporate governance and accounting standards, as well as initiatives to strengthen its Convention. For example, it would be helpful to eliminate or reduce the number of permitted reservations to the Convention, to ensure the existence of a consistent and effective regime within the region.

3. [Supply and Demand Sides] ***Continue to Encourage Links between the OECD and the Council of Europe Efforts:***

- Ongoing dialogue between the Council of Europe and OECD participants and institutions should be encouraged, with a view towards exchange of information and experience, development of priorities, and convergence of standards; and
- Mechanisms for cooperation in enforcement between members of the two treaty regimes should be encouraged, particularly those mechanisms that would facilitate prosecution of offenders throughout Europe.

4. [Demand Side] ***Support Procurement Reform Efforts by the WTO as a Priority Issue.*** There is an opportunity this year for the conclusion of a binding, multilateral WTO Agreement on Transparency in Government Procurement at the Ministerial meetings in Seattle on November 30 to December 3. Transparency is essential to a predictable, efficient procurement regime, in the OSCE region and elsewhere. Experts estimate that where lack of transparency leads to systemic corruption, it can add 20-25% to the costs and result in inferior quality purchases. Almost 90%, or \$2.7-4 trillion a year, of government procurement occurs without agreed transparency rules. Transparency in government procurement could enhance economic growth and limit corruption, and can help pave the way for other law reform initiatives that will reduce corruption. Conclusion of the WTO Agreement is important for the OSCE region and should be a priority objective.

5. [Demand Side] ***Support Law Reform Projects of USAID, USIA, and other U.S. Government Agencies, as well as International Agencies.*** Corruption is intimately linked with rule of law. Initiatives to combat corruption should continue to receive a high priority in U.S. development assistance, and anticorruption efforts should be “mainstreamed” into all rule-of-law initiatives funded by the U.S. government (whether through bilateral or multilateral institutions) that are aimed at improving the legal infrastructure of

countries in the OSCE region. Promotion of transparency, modernization of laws, and the participation of civil society, should be elements of all law reform projects.

At the same time, additional mechanisms need to be developed to avoid corruption in the granting of development assistance to countries, particularly emergency response assistance, currently of importance in the region. This must be a priority issue with the impending reconstruction of Yugoslavia and the recent disclosures regarding funding to Bosnia.

6. [Supply and Demand Side] ***Support Conditional Lending by International Financial Institutions.*** International financial institutions should be encouraged to continue to condition country and project lending on anticorruption performance and good governance by borrowers. Companies should be required by these institutions to develop internal compliance programs as a condition for loan or grant eligibility.

7. [Demand Side] ***Refrain from Imposing Unilateral Sanctions.*** Because combating corruption on the demand side is complex and will not be accomplished overnight, the imposition of unilateral trade or investment sanctions by the U.S. is unlikely to be an appropriate or effective measure. Sanctions tend to create a hostile relationship with the sanctioned country, which is particularly problematic for anticorruption and good governance initiatives as to which, as Dr. Louise Sullivan and others have testified, a critical task is engendering a sense of ownership among transitional and developing countries.

Thank you for the opportunity to provide these additional views to the Commission. If Transparency International-USA or I can be of further assistance, please do not hesitate to contact us.

Very truly yours,

Lucinda A. Low

cc: Nancy Zucker Boswell, Transparency International—USA

**PETER GRINENKO'S RESPONSES  
TO ASSISTANT SECRETARY MULLOY'S ADDITIONAL  
QUESTIONS FROM THE JULY 21, 1999 CSCE HEARING ON  
CORRUPTION**

1. What are your recommendations (from highest to lowest priority) regarding things we should focus on the "demand side"?

- *Personal Accountability:* Presently no one is accountable for anything. Change will only occur when there are serious personal ramifications for taking bribes and participating in corruption.
- *Equitable Privatization:* All citizens of the OSCE should have the opportunity to own real property. Corruption exists because individual citizens don't have a personal stake in the economy. Currently, only the powerful and the elite own property because they have political control. As long as property control is centralized there will be corruption.
- *Buy Russia's nuclear weapons:* As I suggested several years ago when speaking at a conference sponsored by the Center for Strategic and International Studies, we should connect as much financial aid as possible to Russia's nuclear weapons. They want our money and by buying their weapons we can ensure that they don't fall into the wrong hands.

2. On the "supply side", do you have any additional recommendations other than strict and OECD agreements to get rid of tax deductibility of bribers?

- *Aid:* Except when buying nuclear weapons, all aid should be in the form of American product and the distribution of the product should be controlled by representatives of our government (who would be held accountable).
- *Bounties:* We should take an example from our Internal Revenue Service and pay a percentage of uncovered corruption to anyone who reports it.
- *Sanctions:* Sanctions should be placed against companies and countries that take part in and condone corrupt practices.



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in Europe (CSCE).**

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