

THE ROLE OF THE PRIVATE SECTOR IN PROMOTING ECONOMIC GROWTH AND REDUCING POVERTY IN THE INDO-PACIFIC REGION

Over the last two decades the private sector has become a significantly important partner in development throughout the Asia Pacific Region. Market liberalisation policies of India and China in early 1990s and the increasingly open economic policies of other emerging markets in the region have dramatically changed the relationship between the private sector and governments and, in turn, public policies towards companies. These shifts have aimed at increasing investment opportunities that leverage the region's infrastructure, build-out, and young educated labour force and low cost of labour as part of national development strategies.

The changing role of the private sector over the last few years poses two fundamental questions:

- How can the private sector engage in sustainable and inclusive business in the different jurisdictions they operate in to promote economic growth?
- How can the private sector be an effective partner in promoting development and poverty reduction?

Transparency International (TI) believes that governance and anti-corruption measures play a critical role in setting out the relationship between companies and governments to respond to both these questions in the Indo-Pacific region, as well as elsewhere.

CONTEXT

In their report to the United Nations, the High-level Panel on the Post-2015 Development Agenda agreed that every effort should be made to achieve the Millennium Development Goals (MDG) by 2015. Nonetheless, in order to frame a single and cohesive post 2015 development agenda involving economic growth and social inclusion, the global community will need to pursue economic and social transformations in order to achieve sustained and inclusive economic growth. Amongst the top requirements for such structural transformations, the High-level Panel placed on the global development agenda the need to promote good governance and fight corruption. Creating wealth through sustainable and transparent management resources was also crucial to the promotion of sustainable development. Finally, they put forward the need for partnerships between governments, the private sector and civil society in order to align their efforts towards sustainable development¹

¹ See http://www.un.org/sg/management/pdf/Monrovia_Communique_1_Feb_2013.pdf

At the G20 Ministers of Finance Governors of Central Banks meeting, the Australian government identified two guiding priorities for the G20 in 2014: to promote stronger economic growth and to enhance resilience of the global economy to destabilising shocks. Tackling corruption and increasing transparency is crucial to enhancing economic growth and to establishing a cleaner, safer, more sustainable economic framework.

The Bribe Payers Index (BPI) is a tool developed by TI and ranks the likelihood of companies from 28 leading economies to win business abroad by paying bribes. It focusses on private companies in 28 countries and shows the most vulnerable sectors and home countries of companies which pay such bribes. In the same way, TI released the Global Corruption Barometer Report in 2013 which indicated that people from the poorest countries are likely to pay bribes to access the basic services to which they are entitled.² TI stresses the necessity to fight corruption in both public and private sectors as both of these TI tools show indicate a clear relationship between both sectors and the need for anti-corruption measures.

The G20 Anti-Corruption Working Group has identified a number of sectors vulnerable to corruption, including the natural resource sector. Half of the world population lives in oil, gas and mineral-rich countries. Such resources could generate large revenues and contribute to development and poverty reduction. It has been recognised that, when governance is weak, the extraction of such resources can result in poverty, corruption and conflict. The EITI (Extractive Industries Transparency Initiative) aims to strengthen governance by improving transparency and accountability in the extractives sector. Each implementing country creates its own EITI process, which is overseen by a multi-stakeholder group with representatives from government, companies and national civil society. The international EITI Board and the International Secretariat, based in Norway, are the guardians of the EITI methodology internationally.³

Similarly, corruption in public procurement does not just mean citizens' money wasted. It means that the public's needs are not fairly and properly considered when projects are designed and implemented; it undermines the quality of works and services, which in turn can damage the environment and even cost lives. Effective monitoring plays an important role in preventing corruption and helping ensure that corrupt conduct is exposed and properly sanctioned. Commitments to adhere to high standards of integrity by bidders and government authorities ensure a level playing field for those involved in the procurement process.⁴ Procurement touches all dimensions of people's lives and represents substantial amounts of public resources mobilised for the public good. Around the world, municipal and national governments use public procurement processes to build roads, provide school textbooks, stock medical clinics and construct drinking water systems. These different activities account for a public contracting market that is estimated globally at US\$ 2 trillion.⁵ With these significant funds at stake, there is a need to ensure that taxpayer money is well spent to deliver high quality goods at a fair cost. However, practice has

² See <http://www.transparency.org/gcb2013>

³ See <http://transparency.org.au/index.php/our-work/preventing-corruption-in-australia/eiti/>

⁴ See http://www.transparency.org/whatwedo/activity/curbing_corruption_in_public_procurement

⁵ OECD, 'The size of Government Procurement Markets' (Paris, France: OECD, 2002). www.oecd.org/dataoecd/34/14/1845927.pdf. This amount corresponds to potentially contestable government procurement markets, i.e. markets where "competitive pricing exists, where there is actual and effective competition, or there is potential competition due to the existence of low barriers to entry to the market".

shown that where transparency and accountability are low in public procurement, corruption can arise at a rate of between 10 and 25 per cent — and in the worst cases, up to 50 per cent — of the total contract's value.⁶ Moreover, companies in the public works contracts and construction sector are seen as the most prone to bribery.⁷ Similarly, collusion between companies in the public contracting sector is a problem and warrants increased attention⁸.

To counteract this reality, procurement and public financial management standards must be enacted that promote the transparent and accountable oversight of funds destined for the public's benefit as well as which are consistent with international agreements. Efforts being led by the Construction Sector Transparency Initiative (CoST), the Global Initiative on Fiscal Transparency (GIFT), the Open Contracting Initiative and the Open Government Partnership (OGP) represent important multilateral processes that are setting a new and common bar for what is transparent and accountable procurement, including the full range of documents that should be publicly disclosed.

BENEFITS OF ENGAGING IN SUSTAINABLE AND INCLUSIVE BUSINESS

Estimates show that the cost of corruption equals more than 5% of global GDP (US \$2.6 trillion), with over US \$1 trillion paid in bribes each year. Corruption adds up to 10% to the total cost of doing business globally, and up to 25% to the cost of procurement contracts in developing countries. Moving business from a country with a low level of corruption to a country with medium or high levels of corruption is found to be equivalent to a 20% tax on foreign business.⁹ Companies are confronting increased corruption challenges, as part of entering new markets, consolidating their business and working in public-private partnerships. Companies have a responsibility and interest in promoting good business practices —these benefit their bottom line. Ethics — built upon transparency, accountability and integrity —help to set the tone at the top for all company staff to act in conformity with the principle of good corporate practices. The following paragraphs put into perspective the benefits of engaging in anti-corruption for countries and companies.

BENEFITS FOR COUNTRIES

Economic Growth and Productivity

⁶ Transparency International, 'Handbook for Curbing Corruption in Public Procurement' (Berlin, Germany: TI, 2006). www.transparency.org/whatwedo/pub/handbook_for_curbing_corruption_in_public_procurement.

⁷ Based on 19 sectors and the views of over 3,000 business executives who were surveyed about the extent to which companies from 28 of the world's leading economies engage in bribery. See: Transparency International, 'Bribe Payers Report 2011' (Berlin, Germany: Transparency International, 2011). <http://bpi.transparency.org/bpi2011/results/>.

⁹ Clean Business is Good Business, the Business Case against Corruption, Joint Publication by the International Chamber of Commerce, Transparency International, the United Nations Global Compact and the World Economic Forum Partnering against Corruption Initiative

Good governance, characterized by the absence of corruption, provides the fundamental basis for economic development and income growth.¹⁰ Research shows that countries with high levels of corruption tend to collect less tax revenues,¹¹ have higher public spending and larger fiscal deficits.¹² In addition, ten per cent reduction in corruption is found to raise productivity by 4 per cent of GDP and increase net annual capital inflows by 0.5 per cent of GDP.¹³

Evidence also shows that better governance – and hence more transparency and less corruption – causes higher economic growth.¹⁴

High levels of corruption are strongly linked to large shadow economies, causing losses to government revenues, lowering GDP and weakening institutions.¹⁵ Although the exact size of the shadow economy is difficult to ascertain, some estimates put it at about €2.2 trillion in Europe.¹⁶ Greece loses €15 billion a year¹⁷ to tax evasion and has a shadow economy twice the size of its budget deficit.¹⁸

Countries that invest resources in fighting illicit practices are also economically more competitive.¹⁹

Catalysing investment

Strong anti-corruption practices create a stable and reliable investment climate. In a survey of more than 390 senior business executives, almost 45 per cent said corruption risks led them to not enter a market or pursue a business opportunity.²⁰ More than 35 per cent of companies polled in another survey said they opted out of attractive investments due to corruption in the host country.²¹ According to a 2013 survey, the majority (58 per cent) of corporate lawyers consider demands for bribes from customs, police officers or tax inspectors as their main cause for concern.²² In India this concern is shared by three quarters (76 per cent) of the respondents. Corruption reduces or distorts the role of the government in enforcement of contracts and protection of property rights.²³

¹⁰ Aron, Janine (2000): Growth and Institutions: A Review of the Evidence, World Bank Research Observer, Vol. 15, No. 1, pp. 99-135; Kaufmann, "Myths and Realities of Governance and Corruption."

¹¹ Friedman, Eric, Simon Johnson, Daniel Kaufmann, and Pablo Zoido-Lobaton. "Dodging the grabbing hand: the determinants of unofficial activity in 69 countries." *Journal of public economics* 76, no. 3 (2000): 459-493.

¹² Tanzi, Vito. "Corruption around the world: Causes, consequences, scope, and cures." *Staff Papers-International Monetary Fund* (1998): 559-594

¹³ Lambsdorff, Johann Graf. "How corruption affects productivity." *Kyklos* 56, no. 4 (2003): 457-474.

¹⁴ Kaufmann, "Myths and Realities of Governance and Corruption;" Mauro, Paolo. "Corruption and Growth," *The Quarterly Journal of Economics*. 110 no. 3 (1995): 681-712.

¹⁵ U4 Helpdesk, "Literature review on the linkages between illicit economy and corruption," November 2013; Eugenia-Ramona Mara, "Causes and consequences of underground economy". *Annals. Economic Science Series*, Vol. XVII, (2011): 1109-1117; Friedrich Schneider and Dominik H. Enste. "Shadow Economies: Size, Causes, and Consequences." *Journal of Economic Literature*, 38 n. 1 (2000): 77-114.

¹⁶ <http://www.econ.jku.at/members/Schneider/files/publications/2012/ShadEcEurope31.pdf>

¹⁷ Economist, 'Dues and Don'ts: Southern Europe will have trouble increasing its tax take', 12 August 2010. www.economist.com/node/16792848.

¹⁸ <http://www.transparency.org.uk/corruption/statistics-and-quotes/stolen-assets-a-tax-evasion>.

¹⁹ Kaufmann, "Myths and Realities of Governance and Corruption."

²⁰ PricewaterhouseCoopers, *Confronting Corruption: The Business Case for an Effective Anti-corruption Programme*. London: PricewaterhouseCoopers, 2008.

²¹ International business attitudes to corruption survey 2006, in Control Risks and Simmons & Simmons. *Facing up to Corruption 2007*.

²² Control Risks, *International Business Attitudes to Corruption*. 2013

²³ Tanzi. "Corruption around the world: Causes, consequences, scope, and cures."

A country's control of corruption affects the size, quality and productivity of public and private investment.²⁴ Countries with good anti-corruption records see more domestic and international investment as well as other business transactions.²⁵ They receive, on average, more foreign direct investment (FDI) per capita.²⁶ Corruption in the business sector is detrimental to competitors, smaller scale companies²⁷ and the interest of society.²⁸ An increase in the corruption level from that of Singapore to Mexico impacts foreign investment as much as a tax increase of 20 percentage points would.²⁹

Promoting Trade

The quality of institutions is a fundamental prerequisite for trade liberalization. In developing countries, it is seen as conditioning a country's export performance.³⁰ Bribery-free custom officers eliminate a barrier to trade and international competition by preventing illegal payments³¹ and the evasion of tariffs destined for state coffers.³²

BENEFITS FOR COMPANIES

A survey of international business managers estimates that corruption inflates project costs by at least 10 per cent – in some cases more than a quarter.³³ Where there is low corruption, operational costs are kept low, business is better and greater value is created for company stakeholders. Companies want to be able to operate in stable environments in which corruption is limited to non-existent.

Ensuring the ease of doing business:

Improvements in rule of law and control of corruption are positively and robustly correlated with greater ease of doing business.³⁴ Companies with anti-corruption programmes and sustainable and inclusive guidelines are found to suffer up to 50 % fewer incidents of corruption, and to be less likely to lose business opportunities than companies without such programmes.”³⁵ Where bribe payments

²⁴ Mauro, "Corruption and Growth," Lambsdorff, Johann Graf, "The Impact of Corruption on Capital Accumulation", Unpublished Manuscript, Göttingen University (1999); Hodge, Andrew, Sriram Shankar, D. S. Rao, and Alan Duhs.

²⁵ CSIS. The Cost of Corruption. Strategies for Ending a Tax on Private-sector-led Growth, Rowman&Littlefield. 2014.

²⁶ Mauro, "Corruption and Growth."; Podobnik, Boris, Jia Shao, Djuro Njavro, Plamen Ch Ivanov, and H. Eugene Stanley. "Influence of corruption on economic growth rate and foreign investment." The European physical journal B 63, no. 4 (2008): 547-550.

²⁷ Tanzi. "Corruption around the world: Causes, consequences, scope, and cures."

²⁸ Transparency International, Bribe Payers Index 2011.

²⁹ Wei. "How taxing is corruption on international investors?"

³⁰ See: Jütting, Johannes (2003): Institutions and Development: A Critical Review, OECD Development Centre, Working; Levine, Ross (2005): Law, Endowments and Property Rights, Journal of Economic Perspectives, Vol. 19, No. 3, pp. 61-88. Paper No. 210; and World Bank (2001): World Development Report 2002: Building Institutions for Markets, Washington, DC and New York: World Bank and Oxford University Press.

³¹ Alberto Ades and Rafael Di Tella, "Rents, Competition, and Corruption." *The American Economic Review* 89, no. 4 (1999): 982-993; Dutt, Pushan, and Daniel Traca. "Corruption and bilateral trade flows: extortion or evasion?." *The Review of Economics and Statistics* 92.4 (2010): 843-860.

³² Dutt and Traca. "Corruption and bilateral trade flows."

³³ Control Risk and Simmons & Simmons, Facing up to Corruption 2007

³⁴ World Bank, Doing Business 2014, 15.

³⁵ Transparency International, Global Corruption Report 2009 - Corruption and the Private Sector

flourish, firms on average waste more time with government officials over bureaucratic negotiations and experience higher, not lower, costs of capital (e.g. credit).³⁶ Corruption prevents the development of a fair and efficient private sector and also reduces the quality of products and services.³⁷

Generating business:

Anti-corruption practices help to set a level playing field to compete on merits, not bribes. 45% of companies surveyed believe understanding corruption will help them compete more effectively and enter new markets.³⁸ Executive surveys conducted by the World Economic Forum show that bureaucracy and corruption represent the top constraints for firms in emerging economies.³⁹ Where deals are agreed due to corruption, there is no guarantee that the counterpart will deliver or a legal remedy to enforce the illicit deal.⁴⁰ Corruption leads to firms charging a higher price than the going market rate,⁴¹ altering production decisions not based on demand but corruption.⁴²

Companies that are open by making timely and accurate disclosures are rewarded by shareholders, markets and the public's confidence and trust.⁴³

Protecting business

Companies with anti-corruption programmes and sustainable and inclusive guidelines, compared to those without, experience half the cases of corruption and do better at keeping business.⁴⁴

Anti-corruption practices set a high bar on behaviours and policies that benefit business. Setting a positive example by promoting a corrupt-free environment increases public trust. These engagements reinforce each other and ensure that business plays a pivotal and expanding role in improving the well-being of societies, communities and individuals. Maintaining sustainability, inclusiveness and integrity standards minimise the risks posed by corrupt practices to brand, staff morale and business -government relations.⁴⁵ 86 per cent of respondents to a survey of top companies said having and publicizing an anti-corruption programme is valuable or very valuable to a company's brand.⁴⁶ There is clear evidence that managing corruption risk is part of good governance and adds to the value of the corporate brand.⁴⁷

36 Kaufmann, Daniel and Shang-Jin Wei. "Does 'grease money' speed up the wheels of commerce?" MPRA Paper No. 8209, 1999.

37 Transparency International, Bribe Payers Index 2011.

38 PwC, *Confronting Corruption*, 2008.

39 Kaufmann, "Myths and Realities of Governance and Corruption."

40 Brunetti, Kisunko and Weder, "Credibility of Rules and Economic Growth - Evidence from a World Wide Private Sector Survey". Lash. "Corruption and Economic Development."

41 CSIS. *The Cost of Corruption*.

42 Eicher, Sharon, ed. *Corruption in international business: the challenge of cultural and legal diversity*. Gower Publishing, Ltd., 2009.

43 <http://www.oecd.org/daf/ca/corporategovernanceprinciples/43653645.pdf>

44 PricewaterhouseCoopers, *Economic Crime: People, Culture and Controls: The Fourth Biennial Global Economic Crime Survey*. London: PricewaterhouseCoopers, 2007.

45 Transparency International, *Global Corruption Report 2009*; U4 Helpdesk, "Incentives for the private sector to refrain from corruption."

46 PwC, *Confronting Corruption*, 2008.

47 PwC, *Confronting Corruption*, 2008.

Corruption undercuts business. In a 2011 worldwide business survey conducted by TI, nearly 30% of the respondents declared to have lost business to bribery by a competitor in the last year.⁴⁸ In a 2013 survey, nearly one third of the corporate lawyers consider the risks associated with demands for bribes to secure contracts as their main concern.⁴⁹ In the same survey, 43% of the respondents believe that customs bribery is a major concern for their business.⁵⁰

WHAT CAN BE DONE TO PROMOTE SUSTAINABLE AND INCLUSIVE BUSINESSES?

In the long term, corruption has a corrosive effect on economic growth, equality and the quality of a country's governance and institutional environment. Evidence indicates that corruption is likely to adversely affect long-term economic growth through its impact on investment, taxation, public expenditures and human development. Corruption is also likely to undermine the regulatory environment and the efficiency of state institutions as rent-seeking distorts incentives and decision-making processes. Not only does corruption affect economic development in terms of economic efficiency and growth, it also affects equitable distribution of resources across the population, increasing income inequalities, undermining the effectiveness of social welfare programmes and ultimately resulting in lower levels of human development. This, in turn, may undermine long-term sustainable development, economic growth and equality.⁵¹

For a country's equitable and sustainable development, governance mechanisms are needed across the board: from a nation's education and health systems to its financial system and companies. Governance is needed to mitigate climate change and to effectively manage land and natural resources. Governance is also needed for the global system that is tasked with deciding on and monitoring the development commitments that are made beyond 2015⁵².

Transparency, accountability, integrity and participation also create the foundation to fight public and private sector corruption at the local, national and global level. They are the essential ingredients for ensuring acts of corruption do not go unpunished and that impunity and violence are eliminated. They are the forces that create well-governed, peaceful and just societies.

As a new development agenda is being formulated, it is essential to position governance at its centre. At the international level, collective efforts are needed to support fiscal transparency and domestic resource mobilisation by combatting illicit flows — from capital flight to money laundering and tax evasion — that funnel an estimated US\$ 1.6 trillion per year away from the public purse. This money is sorely needed for health care, education, infrastructure and other national public works

⁴⁸ Transparency International, *Putting Corruption out of Business*, 2012. <http://www.transparency.org/research/bps2011/>

⁴⁹ Control Risks, *International Business Attitudes to Corruption*. 2013

⁵⁰ Control Risks, *International Business Attitudes to Corruption*. 2013

⁵¹ http://www.transparency.org/files/content/corruptionqas/Impact_of_corruption_on_growth_and_inequality_2014.pdf

⁵² UN, "Communiqué Meeting of the High Level Panel of Eminent Persons on the Post-2015 Development Agenda" in Monrovia, Liberia, 1 February 2013.

www.post2015hlp.org/wp-content/uploads/2013/02/Monrovia-Communique-1-February-2013.pdf.

projects. These are funds that can be used to strengthen social stability and prevent internal conflicts. International cooperation is urgently needed to promote financial integrity and transparency of the international financial system.⁵³ This can be done by rigorously enforcing anti-money laundering obligations, including ‘Know Your Customer’ and due-diligence procedures. At the same time, global level efforts are required to ensure that national and international financial sector regulatory authorities have the necessary resources and expert training to fully perform their roles in supporting these efforts. Finally, legal frameworks are required to enable asset recovery cases to go to court, both in countries where assets were stolen and deposited.⁵⁴

It is in everyone’s interest for the Private Sector to grow beyond the traditional profit making mind-set and adhere to accountability and transparency. There is no reason why companies should not play by the same rules that are expected of governments.

For growth to be sustainable and consistently reduce poverty, it is crucial for companies to look beyond immediate profit and move towards medium and longer term development strategies. Governance and anti-corruption programmes play an imperative role in ensuring that the economy grows in a sustainable and inclusive way and that development is promoted alongside poverty reduction across the globe. This is an area which is traditionally supported by bilateral donors. Given the pervasive nature of corruption and its impact on every aspect of a society and the need of creating a level playing field for businesses, companies have a duty to engage in anti-corruption programmes as much as traditional bilateral and multi-lateral donors.

BUSINESS INTEGRITY TOOLKIT

The Business Integrity toolkit of TI Introduces six steps in combatting corruption in the sector in order for companies to become the preferred choice:

1. Commit to an anti-corruption programme ‘from the top’

Companies should adopt an anti-corruption programme as an expression of core values of integrity and responsibility as well as to effectively counter corruption; an effective programme requires oversight, leadership and support from the Board of Directors (or equivalent) and senior management; the commitment should be expressed formally through a written statement published internally and externally.

2. Assess the current status and risk environment

Before a business develops and implements its anti-corruption programme, it conducts a risk assessment; the aim of the risk assessment is to identify areas of greatest inherent risk (for example along geographic or functional lines) and evaluate the effectiveness of existing risk-mitigating

⁵³ Raymond Baker and Eva Joly, “Illicit Money: Can it be stopped?”, New York Review of Books, 3 December 2009. www.gfintegrity.org/content/view/277/72/.

⁵⁴ These measures reflect Transparency International’s recommendations listed in ‘Recommendations ahead of meeting of the Ministers of Finance and Governors of Central Banks’, Washington, DC, April 18-19 2013”. www.transparency.org/files/content/activity/8Apr2013_LetterToFinanceMinistersAndCentralBankGovernors_EN.pdf

measures; as a result, the business can prioritize and allocate resources appropriately to the areas of greatest risk.

3. Plan the anti-corruption programme

After completing its risk assessment, a business lays the foundation by developing a plan of action; policies and procedures are developed defining the scope and activities of the anti-corruption programme; the policies and procedures should be available throughout the organization and be issued in the main languages of all employees.

4. Act on the plan

After planning an anti-corruption programme, the written words need to be translated into visible actions; this is a key step in the overall framework, as it is TI's experience that while many businesses have well planned programmes they fall short on effective implementation; controls must be tempered in consideration of the trustworthiness and competence of stakeholders.

5. Monitor controls and progress

Implementing an anti-corruption programme is not a one-time event; it needs to be followed up through regular periodic evaluation (monitoring); monitoring ensures that strengths and weaknesses are identified and that the programme is continuously improved to remain effective and up-to-date (change management activities); Internal and external monitoring must be undertaken

6. Report internally and externally on the programme

Reporting on the anti-corruption programme demonstrates the sincerity of the company's commitment and demonstrates how values and policies are being translated into action; reporting not only reassures internal and external stakeholders that the business is operating properly but can also act as a deterrent to those intending to bribe or solicit bribes

Businesses face pressure from their stakeholders (e.g. customers, investors, export credit agencies) to adopt, implement and monitor good anti-corruption practice standards to avoid the risks of losing business, encountering operational constraints and falling share prices. They must also adhere to laws and regulations in order to avoid the risks of fines, civil damages, loss of license to operate, and imprisonment. Finally, businesses compete in globalized markets not only with their goods and services, but also with their reputation; corrupt practices increase the risk of negative publicity and damages reputation (e.g. through media coverage, civil society campaigns, social networking). Similarly, businesses must assess the strength and weaknesses of governance systems in countries that they are to engage in doing business. It is in countries' general interest to be interested in attracting sustainable and inclusively oriented businesses and nurture sustainable and inclusive work accordingly.