

4 Corporate money

Lessons from the South African arms scandal and the Elf affair shed light on the need to clean up the corrupt dealings between business and politics. Joe Roeber examines how politicians involved in the arms trade abuse a secrecy they justify on the grounds of national defence; Nicholas Shaxson explores political corruption in the oil industry and considers the pros and cons of initiatives such as the Publish What You Pay campaign.

Juanita Olaya shows that because government contracting involves competing interests and policy demands, anything less than a transparent selection process lays the government open to claims of unfairness or even corruption. Duff Conacher homes in on the narrow divide between legitimate and illegitimate influence in the world of corporate lobbying. Larry Noble and Steven Weiss illustrate how civil society groups can monitor this division by exposing the flow of corporate money into politics.

The politics of corruption in the arms trade: South Africa's arms scandal and the Elf affair

*Joe Roeber*¹

The official arms trade is among the most corrupt of all legal international trades and one in which governments are inextricably entangled.² Since governments make the decision to buy and sell, it is inevitable that corruption in the trade is very often political. Moreover, governments are often at the root of the problem. While it is difficult enough to monitor deals in such an opaque market, the government-sanctioned secrecy surrounding critical aspects of the business actually provides the conditions that allow corruption to flourish.

Politicians on both sides of an arms deal may be on the take, either as individuals or recipients of illicit party funding. While importer governments play the role of customer and paymaster, exporter governments are more involved as promoters of their industries. Exporter governments have been central players in scandals involving Germany's Thyssen, Sweden's Bofors, France's Thomson-CSF (now Thales) and Britain's BAE Systems. These companies and their supporters prefer to describe as 'commissions' what others call bribes. Bribe taking is almost universally proscribed but, until recently and with the single exception of the United States, bribes were effectively legal in the countries where the payment originated, provided they were made abroad.³

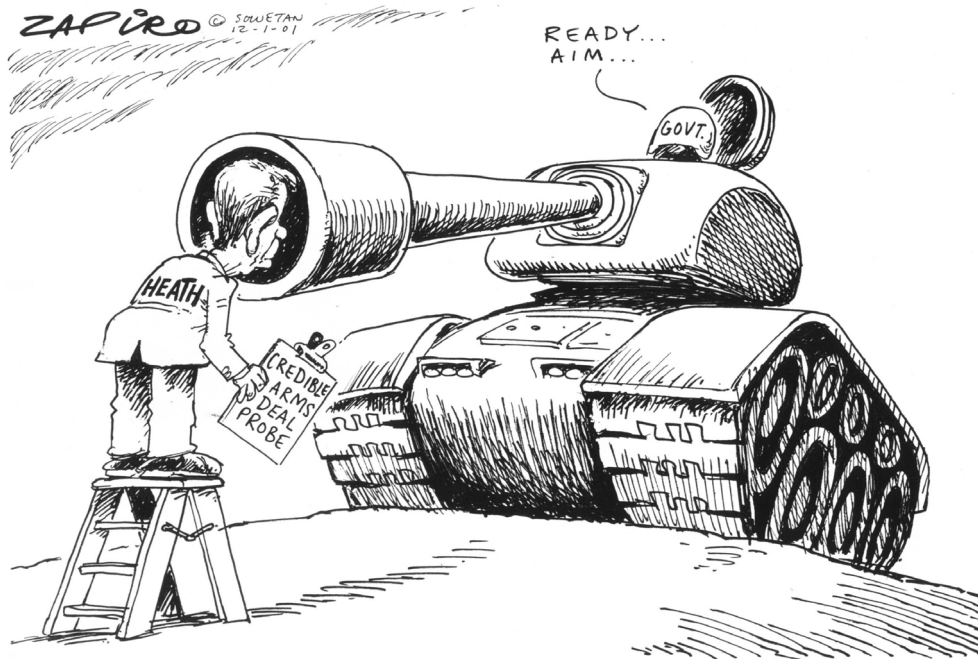
The post-cold war arms market is still plagued with overcapacity and the negotiating position of some manufacturers is weak. European companies, the largest of which are in Britain and France, struggle in a market dominated by US manufacturers. Companies of all nationalities use the inducements of bribes, which weaker players see as 'levelling the playing field'. They also use 'offsets', complex arrangements that help buyers generate the foreign exchange needed for the transaction. Offsets are opaque, difficult to monitor and hence an efficient route for corrupt payments.

In the main exporting countries, political corruption tends to be more complicated and opaque because public intolerance and an independent press add to pressures for concealment, but also because of the complexity of governments' reasons for supporting their arms industries. Governments see such industries as an integral part of their defence capability, an adjunct to foreign policy, a provider of employment and a technological research base for the national economy. As a result, exporter governments curtail public debate, invariably on grounds involving national security. The same reasons are used to justify government-sanctioned secrecy and the involvement of intelligence services. But no matter what the initial justification, someone will always find a way to use it to enrich himself. Britain's 1996 Scott Report, investigating government complicity in an embargo-busting scandal that involved the sale of dual-use equipment to Iraq, was as much as anything else a demonstration of how secrecy can be abused.⁴

Political elites and their associates in developing countries can expect to receive life-changing sums for approving arms purchases, together with those in the military and civil service who are involved. The payments come in many forms and through many routes, of which the brown envelope slipped to the man at the top (or, more likely, payment into an offshore account) is the least likely to emerge into the open. Companies have taken the techniques of making illegal payments to a high level of sophistication and politicians have efficient means of self-protection, such as the ability to influence the bodies that should be investigating them. The recent South African arms deal is representative.

South Africa's arms scandal

It is a tribute to the openness of post-apartheid South Africa that concerns about corruption in the US \$4.8 billion arms deal signed in 1999 remained vividly alive in spite of robust attempts by the government to crush them. Activists raised the issue in parliament, experienced the full force of attempts to suppress discussion and were swatted away in 2001 with a report that was widely dismissed as a whitewash – not least because the only body with a credible claim to independence, the Heath Special Investigation Unit, was excluded from inquiry by a dubious constitutional manoeuvre.⁵ Nevertheless, two challenges are making their way through the courts. One, brought by Economists Allied for Arms Reduction, is being mounted against the financing of the deal. The other, brought by Richard Young, a South African defence contractor, is seeking compensation for having lost out to a Thomson subsidiary in a tender.



Zapiro, South Africa

In addition, South Africa's deputy president Jacob Zuma came under investigation for allegations that he attempted to solicit a bribe from Thomson's South African head in return for protecting the company from investigation and giving it his 'permanent support'.⁶ The case was brought to an end when the director of prosecutions, Bulelani Ngcuka, announced in August 2003 that Zuma would not be charged because, though there is a strong prima facie case against him, the government could not be sure to win the case in court. The charges against Schabir Shaikh, a businessman closely involved with Zuma, spell out in considerable detail just what the evidence is – the money and other benefits Zuma allegedly received.⁷ Closely linked to Zuma's case is that of former chief whip of the ruling African National Congress, Tony Yengeni. In March 2003, he was sentenced to four years in prison for fraud related to the tender process involving an affiliate of the German shareholder in the European Aeronautic Defence and Space Company. Yengeni appealed.⁸

Other questions remain unanswered. BAE Systems won a contract for jet trainers with their venerable Hawk in competition with the cheaper Aermacchi MB339, preferred by the South African air force, raising questions about the tender process. (Performance parameters were modified and, when this manipulation did not produce the answer, the ministers' committee instructed evaluators to ignore price in the approved value system.⁹) The offset arrangements, touted as the crowning triumph of the financing process and ultimate justification for the deal, have been widely questioned. Sweetheart deals abound as part of the offset programme, allegedly giving friends of senior politicians

– and even President Thabo Mbeki’s brother, Moeletsi – a share of the defence pie under the rubric of ‘black empowerment’.¹⁰

One example among many concerns the then minister of defence, the late Joe Modise, who bought an interest in a company, Conlog, with money lent from Germany while he was still minister. The company was expected to benefit from the defence package through black empowerment and the loan was channelled through an account belonging to the sister-in-law of Chippy Shaikh, the head of procurement in the defence ministry and brother of the head of the Thomson subsidiary mentioned above. Modise’s last act as defence minister was to sign the contract to buy submarines from German shipbuilder HRW before the money had been approved.¹¹

Underlying South African arms procurement are fundamental questions about the strategic rationale for buying expensive and technically complex systems – specifically Anglo-Swedish Gripen fighters, British Hawk trainers and state-of-the-art German frigates for deep-sea operations – to defend South Africa against neighbours that are no military threat.¹² A thorough review process came up with four alternative defence options costing 4–6 billion rand (US \$0.7 billion) but, after many trips to Europe, a hi-tech package costing 29 billion rand (then US \$4.8 billion) finally emerged. With the cost of financing and a weaker rand, the deal now runs to 66 billion rand (US \$9.1 billion) – and it doesn’t end there.¹³ The defence ministry is now seeking increased funding from the treasury to bring the equipment up to operational status.¹⁴ In the light of South Africa’s desperate need for social investment, this would be a major scandal even without the garnish of corruption. At this late stage, the least we can do is ask what part corruption played in arriving at this overgrown defence package.

Box 4.1: Political corruption and the politics of procurement

The awarding of contracts after the latest Iraq war brought the interface between politics and government contracting into sharp focus. Under a recent headline, reading ‘Iraq deals: secrecy vs. disclosure’, the *New York Times* observed that ‘executives of publicly traded companies are wary of complying with regulations to fully disclose significant business developments for fear of alienating agencies awarding Iraqi contracts’.¹

Discussions about political corruption often focus on political party finance and electoral systems. But there is also ample scope for political corruption in public contracting, especially when secrecy reigns. One clear case is when political parties and politicians use government assets (among them public policy, contracts, jobs, state property and immunity) for their own private benefit. A recent illustration was the arrest in Japan of politician Suzuki Muneo, who allegedly took bribes from logging companies in exchange for contracts and tried to influence Japan’s foreign and aid policy to benefit a construction firm locked in a dispute in Russia.² Power may also be used to pay back political supporters or to secure future support. This was an allegation made in relation to the privatisation auction for Slavneft, Russia’s eighth-largest oil company. One of President Vladimir Putin’s main financiers and long-time supporters allegedly benefited in the sale.³

Government contracting is often used as a public policy tool. Around 68 per cent of a national spending budget is given over to contracts⁴ and governments are usually

concerned not only with the works on offer, but also with the impact they may have on local industries, employment or overall expenditure. The fact that various interests are in play need not be a problem so long as the public interest is paramount and the government adjudicates between competing claims fairly and transparently. When the contracting process is not transparent, governments expose themselves to accusations of corruption.

The political dimension of procurement looks starkest in the context of war and post-war reconstruction. In relation to the first phase of post-war reconstruction in Iraq in 2003, for instance, when talk of the reconstruction preceded the war itself, can one talk about how transparent and clean the contracting is for the reconstruction process without referring to the political context and the use of force that created the reconstruction need? Much has been said about the fact that contracts were awarded to companies that had made significant contributions to the US Republican Party campaign in a bidding process that was not open. If there had been fair and open competition for the contracts, questions about process – and related doubts over their timing, quality and price – would not now be raised. Good politics and good procurement go hand in hand, with transparency underpinning both.

The above examples have clear policy implications. First, political party finance laws must also consider the related issues of conflict of interest and statutes of limitations for both contractors and government officials. This can help to halt the abuse of privileged information and power that emerges from the 'revolving door' that allows former office holders to pass directly into senior corporate positions and vice versa. Secondly, corruption is not a spot market: today's favour need not be repaid tomorrow, but often several electoral terms in the future. Therefore, information requirements and control systems must be fashioned so that they apply over the long term.

Juanita Olaya (Transparency International)

Notes

1. *New York Times* (US), 12 April 2003.
2. *Asia Times* (Japan), 5 August 2003; BBC News (Britain), *Asia-Pacific*, 16 July 2002.
3. *Washington Post* (US), 25 January 2003.
4. UNPAN Statistical Database, central government expenditures by type and function, as percentage of all central government expenditure as of 1997 (calculations by author). Resulting figure excludes expenditure on wages and interest payments from the world average. Differences according to country development level may arise.

The arms dimension of the Elf case

Arms corruption scandals and near-scandals are not new to Europe, whose most recent affair centres on the Elf investigations in France. In January 2003, Roland Dumas, foreign minister under François Mitterrand, was declared innocent of enjoying the fruits of corruption from Elf (*'recel et abus de biens sociaux'*) passed on to him through his mistress, Christine Deviers-Joncour, an offence of which he had been found guilty two years before.¹⁵ The appeal court decided that, although Joncour was hired specifically to open the back door to his office, Dumas had not known that the 17 million franc (US \$3 million) flat where they met – or the thousands of dollars lavished on him from her unlimited credit card – had been corruptly supplied by Elf.¹⁶ Nor was it even suggested that he had received any of the 65 million francs (US \$12 million) she was

allegedly paid to induce him to change government policy to permit the sale of frigates to Taiwan for 14.6 billion francs (US \$2.6 billion). Policy was indeed changed and, according to Dumas himself, the shipbuilder, Thomson-CSE, paid US \$500 million in 'commissions' to people known to himself and President Mitterrand. In effect, the court appears to have judged that Dumas, a lawyer to the rich and famous, close friend of the president, government minister and president of the highest court in France, had simply been naive.

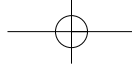
Investigation of the Taiwan deal has since disappeared from sight, sucked into arbitration. Meanwhile, some of Dumas' co-defendants went back to court along with others, mostly Elf managers, charged with bribing African politicians and helping themselves on the way.¹⁷ Evidence of payments to French politicians was declared a 'defence secret' by the government and not allowed into court.

The ramifications of the Elf case wind across the border to Germany, where they helped to destroy the reputation of ex-chancellor Helmut Kohl. At the heart of the matter are the 'commissions' allegedly paid by Elf to 'facilitate' the purchase of the moribund Leuna refinery in East Germany. According to Loïk Le Floch-Prigent, Elf's director general, the company bought the refinery at Mitterrand's insistence to help his friend Helmut, whose modus operandi allegedly included buying the allegiance of the Christian Democratic Union's (CDU) regional agents with money from a party slush fund. The process that led to the end of Kohl's long career began with the suggestion that bribes may have been paid to facilitate the sale of tanks to Saudi Arabia by Thyssen.

South Africa ordered 36 tanks after the 1990 Gulf War in a non-competitive tender at a cost of 446 million marks (US \$223 million), of which half was commissions. It is reasonable to assume that most of the commission flowed to the princely sponsors of the deal, as is traditional. But a chunk stayed with middleman Karl-Heinz Schreiber; some flowed back to Thyssen managers (which is when the German tax authorities became interested); and a small piece went to the CDU, which is when journalists perked up and Kohl's career started to unravel.¹⁸

Under German rules, only half the tanks qualified for export licences. On 20 February 1991, Schreiber, a Bavarian fixer whose thumbprint is to be found on many deals, contacted the CDU's treasurer, Walther Leisler Kiep, for help.¹⁹ It seems the CDU was paid for a change of government policy: a week later, the federal security council overrode the foreign ministry and approved the export of the tanks. On 2 August Thyssen paid the first instalment of Schreiber's commissions, 11 million marks (US \$5.7 million), and just over three weeks later Schreiber gave a briefcase containing 1 million marks (US \$500,000) in cash to the CDU's accountant in the presence of Kiep. The subsequent history of the money tells us about how slush funds are sometimes used: 422,800 marks (US \$211,400) went to the accountancy firm, 370,000 marks (US \$185,000) to a CDU trusty and the rest stayed with Kiep.

In May 1999, the Augsburg tax office arrested two Thyssen managers for tax fraud, claiming they omitted to declare 12.5 million marks (US \$6.25 million) received from Schreiber. A warrant was also issued for the arrest of Ludwig-Holger Pfahls, the former secretary of state in the ministry of defence and later president of the German consti-



tutional court, on the grounds that he had not declared a 3.8 million mark (US \$1.9 million) bribe. He has remained out of the country.

Deductions and recommendations

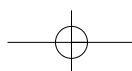
What do these details tell us about political corruption in the arms trade? They tell us that it happens, although they cannot tell us how often. They seem to suggest the problem is endemic, given that such deals are few in number, large and discontinuous. Industry apologists will claim they demonstrate how rare such occurrences are. Critics say they show how rarely they are discovered. To decide which explanation is the most likely, we must look at the nature of the industry, at the circumstances in which corruption flourishes and at the role of politics.

The arms trade shares the properties of other corruptible trades, but it is set apart by two features: the lack of price transparency – the prerequisite of a functioning market – and officially sanctioned secrecy. It is this combination that hard-wires the trade for corruption. The close involvement of government in its activities merely makes things worse. It is not surprising that the political system, from time to time, should be up for sale to potential beneficiaries. The resulting positive feedback loop of corruption inflates the business and adds to the supply of arms into unstable regions.

Can anything be done? There are many possible actions, of which we shall mention three – with two preconditions: first, the only measures worth taking must have a good chance of success and be multilateral. The second condition is that a campaign for action should not be captured by the much wider campaign against the arms trade per se. In that context, it is paradoxical that the thrust of an anti-corruption effort would be not to ban the arms trade, but to improve it by preventing distortions in defence procurement.

- The first and most important action would be to **make the OECD Anti-Bribery Convention effective** – starting with a rigorous and independent monitoring system with a secure hotline for whistleblowers (see ‘Will the OECD Convention stop foreign bribery?’, Chapter 7, page 128).
- Second, given that exporter governments have the power to issue, or withhold, export licences within certain legal and political parameters, the **approval of export licences** should be made conditional on companies having pre-qualified themselves with annual undertakings from the companies’ top management and lodged with export control departments. These undertakings, akin to the ‘annual sign-off letters’ now routine in large oil companies, would certify that, to the managers’ knowledge, no bribery was involved in getting the business.
- Borrowing from the ‘Publish What You Pay’ initiative in the extractive industries, the third action would be to change accounting rules to require the **reporting of all payments** on a national basis.

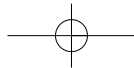
If these proposals are not acceptable to governments, voters should be encouraged to ask their governments to justify the practice of bribing the political elites in some of



the poorest countries in the world to buy arms they may not need with money they probably cannot afford.

Notes

1. Joe Roeber is a freelance journalist and member of TI UK.
2. The official arms trade is the legal, open market trade that usually involves governments as buyers or sellers. This report does not consider arms and systems traded in the black or grey markets or smuggled to embargoed destinations.
3. The practice of bribing foreign officials is banned in countries that have ratified the 1997 OECD Anti-Bribery Convention.
4. Sir Richard Scott published his five-volume report of the *Inquiry into the Export of Defence Equipment and Dual-Use Goods to Iraq and Related Prosecutions* in February 1996. See www.ombudsman.org.uk/pca/document/hc804/a30-95.htm
5. See www.idasact.org.za/pims/arms/review.htm
6. See 'Zuma Denies Bribery Allegations', SABC News (South Africa), 29 November 2002; 'Bank Record Raises New Questions on "Bribe"', *Business Day* (South Africa), 7 July 2003; and 'Zuma Investigation Stirs Dormant Party and Empowerment Tensions', *Financial Mail* (South Africa), 8 August 2003.
7. 'Zuma off the Hook', *Sunday Times* (South Africa), 24 August 2003; 'Shaikh Case Puts Zuma back in the Spotlight', *Business Day* (South Africa), 26 August 2003.
8. 'Yengeni out on Bail Pending Appeal against Sentence', SAPA (South Africa), 19 March 2003.
9. Report to Parliament of the Joint Investigation into Strategic Procurement Packages, 14 November 2001, Chapter 4. A series of reports in the *Guardian* (Britain), 13, 14 and 16 June 2003, looks at the trade, focusing on the South African deal, and suggests that the then minister of defence, Joe Modise, was handsomely paid for his help; see 'BAE "Paid Millions" to Win Hawk Jet Contracts', *Guardian* (Britain), 30 June 2003.
10. See 'President's Brother Buys into Arms Deal', Paul Kirk, *Mail and Guardian* (South Africa), 27 July 2001 and 'More Arms Deal Revelations', Raenette Taljaard MP, Democratic Alliance website, 26 March 2002.
11. The story of Modise's involvement is told in 'Soldiers of Fortune', Peter Honey, *Financial Mail* (South Africa), 26 March 2002.
12. See 'The New Defence Equipment' page of the South Africa Government Online website, www.gov.za/projects/procurement/background/new_equipment.htm
13. 'South Africa's Multi-billion Arms Programme Revisited', *Defence Systems Daily*, 19 November 2001, www.defence-data.com/features/fpage47.htm
14. See vote 22 in the Budget 2003 document, available on the National Treasury website, www.treasury.gov.za
15. The background to the 2001 trial (sketching in the German connection) is to be found in David Ignatius, 'True Crime: The Scent of French Scandal', *Legal Affairs* (US), June 2002.
16. 'Court Overturns Dumas Conviction for Corruption', *Independent* (Britain), 30 January 2003.
17. For background, see 'The Elf Affair: Who's Who', *Financial Times* (Britain), 15 April 2003. The court process finished in July 2003, with the verdict expected in November.
18. The beginning of the Thyssen story is found in 'Schreiber muss mit Auslieferung rechnen' (Schreiber faces extradition) *Süddeutsche Zeitung* (Germany), 8 May 1999; and 'BND prüft Verstrickung in Waffengeschäfte' (Federal Intelligence Service checks involvement in



arms deals), *Süddeutsche Zeitung* (Germany), 1 October 1999. An extensive account is to be found in 'Goldgräber in Kriegszeiten' (Gold-diggers in times of war), *Der Spiegel* (Germany), no. 46, 1999.

19. For Schreiber's modus operandi see Stevie Cameron and Harvey Cashore, *The Last Amigo: Karl-Heinz Schreiber and the Anatomy of a Scandal* (Toronto: Macfarlane Walter & Ross, 2001).

The Elf trial: political corruption and the oil industry

Nicholas Shaxson¹

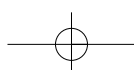
Less than 30 per cent of the world's oil, according to BP, comes from OECD countries.² Much of the rest comes from poor countries whose governance problems, according to emerging research, are often exacerbated by oil dependence.³ Since colonial times poor governments have taken significant control over their oil and gas industries: they can now more easily dictate the terms on which their oil is extracted. The result, when Western oil firms accept corrupt leaders' demands, can be the export of corruption into the rich world, via oil firms and banks that use tax havens in deregulated financial markets to deal secretly with corrupt leaders. Flows of oil money are so huge they can distort decision-making not just in poor producer countries, but in the rich world too.

Political corruption in the oil business takes many forms. One is simply the payment of bribes to national leaders in pursuit of oil deals, often covered by the smokescreen of intermediaries or layers of secret bank accounts in tax havens. Such bribes can run into tens, even hundreds of millions of dollars. Companies deny bribery but weak national laws in producing countries allow them to negotiate official contracts containing payments that flow to elites, bypassing national treasuries. Firms can then say the problem is not one of bribery, but of flawed national accounting, or just bad revenue management.

The Elf trial and beyond

French magistrates investigating former state oil firm Elf Aquitaine (now renamed Total) since 1994 have opened a window on some of the oil industry's secrets. The investigations, which Britain's *Guardian* newspaper called 'perhaps the biggest financial scandal in a western democracy since the end of the Second World War',⁴ illustrate the problems of political corruption that have characterised the oil industry for decades. Elf had no monopoly on political corruption but it makes an excellent case study, because it 'got caught'.

Elf was state-owned until 1994. Graduates of elite French institutions regularly rotate between political and diplomatic posts, state firms like Elf, big private companies and the secret services. Matters are complicated, especially in Africa, by elaborate 'réseaux': solidarity networks, masonic structures, secret services, overseen by men like the shadowy Jacques Foccart, an agent of French presidents for whom Elf was his most powerful tool and perhaps his most important consideration.⁵



Elf used French political influence in oil-rich Gabon to sign favourable contracts generating large super-normal profits as it built itself into General de Gaulle's vision of a French national champion able to rival 'Anglo-Saxon' competitors. Gabon and Elf Gabon were also giant piggy banks that allowed Elf and France to conceal bribery and wield other tools such as mercenary and arms-dealing services, either in pursuit of oil deals or towards more overtly geopolitical ends. The Elf trials have uncovered payments to politicians in Africa, Central Asia, China, France, Germany, Russia, Spain, Taiwan, the United States and Venezuela. Details of Elf's payments, the court has heard, were even sent for approval to French budgetary authorities, the presidency and customs.

The Elf 'system', in place since the 1960s, had two other purposes, essential for its survival. One was the covert financing of France's main political parties and secret services. The second, also essential in preserving silence, was personal enrichment.

After 1989, when the late French president François Mitterrand appointed Loik Le Floch-Prigent head of Elf, corruption escalated. President Mitterrand, just re-elected, was unhappy that the Elf system mostly benefited rival right-wing or 'Gaullist' political groups and said his Socialist Party should get a bigger cut.⁶ This was a go-ahead to expand the Elf system.

'Originally, everything was more or less Gaullist-controlled', said François-Xavier Verschave, head of Survie, a Paris-based campaigning group.⁷ 'Then Le Floch-Prigent came along. The system became less classical, more heterodox, more baroque. So it became vulnerable.'

New rivalries in French politics and the secret services created leaks, counter-leaks and denunciations. French laws gave the magistrates wide powers (in contrast to some 'Anglo-Saxon' jurisdictions where plea bargaining and other features can allow deals to prevent dirty secrets from being aired) and the case took on a life of its own. Pulling each thread produced others, and the complexity multiplied.

Magistrates like Eva Joly, who launched the investigations in 1994, received death threats and needed bodyguards at times.⁸ Obstruction in France was worsened by poor cooperation from Britain, Liechtenstein and Monaco, though Swiss judges have been more helpful. French laws make it hard to prove bribery of officials, so magistrates tend to focus on personal enrichment or kickbacks. Even so, the investigations have brought the wider Elf system to light.

The effects of the Elf trials are ambiguous. They have exposed corruption but recent legislation has curbed the investigating magistrates' powers, and more restrictions are likely to come. 'It is as if [Eva] Joly had netted a load of fish, which are now left to rot in the sun while the French public politely holds its nose', wrote commentator David Ignatius. 'She prised open a door, at great personal risk, but the political class refused to follow her through it into a new era of accountability ... for a moment at least, the system was weak, exposed and, perhaps, even ready to topple, but it survived because of the code of silence of the French elite.'⁹ Senior French politicians like Charles Pasqua and even President Jacques Chirac have been named, or alluded to, in the trials, but have so far escaped legal punishment. Chirac has presidential immunity.

The trials have identified many corrupt or questionable mechanisms: overpayment for assets generating hidden subsidies, payments through chains of offshore accounts,

the use of Gabon as an offshore financial turntable for generating hidden payments, and the use of secrecy and commercial intelligence as keys to financial success. There are 'revolving door' problems; the use of politically networked intermediaries to win deals; specialised trading companies that confuse revenue flows; persistent links between oil and the covert arms trade; and the assumption by oil firms of diplomatic functions.

As revealed in the Elf trials, political corruption in oil is tied up with banking. One example was the renegotiation of Angola's US \$5 billion debt to Russia in 1996: after a debt reduction deal to US \$1.5 billion, the debt was purchased by Russian oligarchs who used political connections in Moscow to obtain the debt privately. Then two intermediaries who featured in the Elf trials helped persuade Angola to repay the debt in oil through a murky loan arrangement led by French banks.

A French parliamentary report in 2001 on money laundering identified London and territories linked to Britain, including Bermuda, Gibraltar, the Channel Islands, the British Virgin and Cayman Islands, and the Isle of Man, as a huge under-regulated terrain ideal for money laundering; oil money often transits these zones.¹⁰ The looting of several billion dollars in oil revenues by former Nigerian dictator Sani Abacha, with the complicity of Britain-based banks, is well documented. An American intermediary, James Giffen, was indicted in 2003 for violating the US Foreign Corrupt Practices Act by allegedly paying US \$78 million to top political officials in Kazakhstan on behalf of Mobil (now ExxonMobil) (see the country report on Kazakhstan, Chapter 8, page 202).

Cleaning up corrupt oil

In the light of this complexity – of which the above is only a taster – it is worth examining Publish What You Pay (PWYP), an NGO-led campaign that emerged out of corruption investigations by Global Witness in Angola but has since acquired international force.¹¹ PWYP wants regulators in rich countries, and possibly institutions like export credit agencies, to require natural resource companies to publish disaggregated data, country by country, to show oil firms' tax and other payments clearly. From published accounts, it is usually impossible to unpick revenue flows between companies and countries such as Angola.

PWYP faces technical and political challenges. Its approach cannot capture all contractual revenue flows: under production-sharing contracts, host governments like Angola's own the oil under the ground, and they pay oil firms for their services – not vice versa. Only some payments, like corporate taxes or signature bonuses, flow from companies to governments. So disclosure by companies of their payments to host governments would not capture, for example, a state's profits from its own share of oil production, which can be more than half of total state revenue. State oil firms can also mingle revenue flows from oil, refineries, gas, chemicals, petrol stations and state joint ventures with oil service companies, which are outside PWYP's scope. Cloudy revenue flows from downstream operations, such as refineries, are especially difficult in countries like Nigeria, which has large refining interests and where state subsidies make the issue murkier still.

The Extractive Industries Transparency Initiative (EITI), backed by the British government, aims to fill some technical gaps by focusing not just on international oil companies, but also on host governments. 'We need joint action by governments and companies, working in tandem', said British prime minister Tony Blair at an EITI meeting in June 2003. 'We need to link "Publish What You Pay" with "Publish What You Earn".' But by aiming to bring governments like Angola's on board it sets itself ambitious targets; there are fears that the countries for whom the issue is most important will be the ones most resistant to joining up: corrupt payments are often used as tools of political power. Individuals involved in PWYP argue that a purely voluntary approach (which the EITI and others advocate) is not strong enough to make companies change.

But neither PWYP nor EITI tackles forms of corruption such as revolving doors and conflicts of interest. It is also outside their scope to assess whether investment costs in, say, an oilfield (recorded under the term 'cost oil' in production-sharing contracts) reflect true market value or contain hidden subsidies that could generate bribes. The Elf trial has uncovered several examples of bribes hidden inside inflated investment costs. In 2001 Angola agreed the details of an 'oil diagnostic study' with the IMF, which explicitly recognises this problem and recommends safeguards against 'overstating unit costs of production, operating costs and field development cost; and inclusion of unauthorised costs in the cost-recovery account'.¹²

Developments like the creation by Angolan state oil firm Sonangol of more than 60 joint ventures and subsidiaries with foreign oil service firms for oil platforms, drill ships and the like, covering most areas of 'investment costs', complicate matters further. Oil firms plan to invest US \$23 billion in Angola over the next five years,¹³ so this area is potentially a vast 'black box' in which oil service companies are only supervised by host governments and oil companies. Collaboration in hiding revenue flows in this arena is highly likely.

'Neither EITI nor PWYP touch cost oil, let alone go inside the "black box"', said an oil company official. 'Neither will reveal anything about bribes; it is an illusion to think that. I do not even understand why people think corruption is the biggest revenue management problem. I think of it as a sideshow, albeit an important and particularly disgusting one.'¹⁴

PWYP and EITI are aware of the challenges – and of the hostility of some oil firms to PWYP, with its emphasis on mandatory disclosure. 'PWYP will not capture everything but it is a very important first step', said Simon Taylor of Global Witness, adding that PWYP's demands, if met, would remove a hypocrisy by which different standards are applied in the rich and poor worlds, and would still reduce the scope for corrupt payments.¹⁵ 'It is a question of enshrining new global best practice. We are at the beginning of a process.'

The two campaigns have significant political momentum: more than 160 NGOs have signed up to PWYP and, at the June 2003 EITI meeting, a group of institutions representing an astonishing US \$3 trillion in managed funds publicly supported the initiative.¹⁶

The size of the oil companies and the strategic significance of their product explain their abilities to override national laws, or to change them in their favour. This is the

source of much of the corruption. In *The Seven Sisters*, Anthony Sampson's classic 1975 history of the oil industry, oil firms 'appeared to be part of World Government ... financing whole nations, fuelling wars ... an enduring subject of suspicion and investigation; their supranational expertise was beyond the ability of national governments'.¹⁷ The scale and endurance of political corruption in oil over so many decades suggests it will never be eradicated, only tempered, in a permanent struggle between oil interests, on the one hand, and political actors in the rich world or civil society and political interests in poor countries, on the other. In general terms, the larger the oil sector relative to a country's economy and institutional strength, the greater the potential for political corruption.

Within national borders, checks and balances have developed, often through democratic processes, to curb political corruption. The problems often appear not within countries but between them, in a global terrain where multinational firms like the oil majors exploit the fact that the array of different national legal systems meshes together so poorly. This provides huge opportunities for loopholes. Tackling political corruption in the oil business is part of a wider challenge to strengthen and coordinate global governance.

Notes

1. Nicholas Shaxson is the author of country reports on Angola and Gabon for the Economist Intelligence Unit and a regular contributor to the *Financial Times* (Britain) and *Financial Times Energy* (Britain).
2. BP, *BP Statistical Review of World Energy* (London: BP, 2003).
3. For a good account of the problems, see Catholic Relief Services, *Bottom of the Barrel: Africa's Oil Boom and the Poor* (Baltimore: Catholic Relief Services, 2003).
4. *Guardian* (Britain), 2 June 2001.
5. See Antoine Glaser and Stephen Smith, *Ces messieurs Afrique* (Paris: Calmann-Lévy, 1994) and their later book, *Ces messieurs Afrique 2: Des réseaux aux lobbies* (Paris: Calmann-Lévy, 1997). Foccart died in 1997.
6. Le Floch-Prigent confirmed Mitterrand's request during the trials.
7. Interview with author.
8. Joly describes some of the threats and intimidation in a new book, *Est-ce dans ce monde-là que nous voulons vivre?* ('Is this the world we want to live in?') (Paris: Les Arènes, 2003).
9. David Ignatius, 'True Crime: The Scent of French Scandal', *Legal Affairs* (May-June 2002).
10. Arnaud Montebourg and Vincent Peillon, *Rapport d'information*, 10 October 2001.
11. See www.publishwhatyoupay.org
12. 'Terms of Reference: Financial Diagnosis and Monitoring of State Petroleum Reserves', published in 2001 on the state media website www.angola.org
13. Dow Jones Business News, 18 June 2003.
14. Interview with author.
15. Interview with author.
16. 'Investors' Statement on Transparency in the Extractives Sector', organised by ISIS Asset Management, June 2003.
17. Anthony Sampson, *The Seven Sisters: The Great Oil Companies and the World They Made* (New York: Viking Press, 1975).

Box 4.2: Canada's rules on lobbying: key loopholes remain

Canada's rules on lobbying are often cited as a model for the rest of the world, but after a series of scandals involving political donations and the misuse of public funds, Prime Minister Jean Chrétien proposed significant changes to the federal laws on lobbying, political finance and ethics rules in June 2002. The reforms are intended to increase the transparency of lobbying, to set limits on political donations and to reform the institutions that oversee the ethical behaviour of government ministers and parliamentarians. Unfortunately, the changes still leave large loopholes.¹ In the case of lobbying, rules on disclosure remain too limited and weak enforcement is a particular problem.

Regulating lobbyists – and ensuring transparency – is critical in the fight against political corruption because the line between legitimate and illegitimate lobbying is thin. Canadian lobbyists are governed by the Lobbyists Registration Act (LRA) and a code of conduct introduced in 1997 under the provisions of the LRA.

In principle, the LRA should ensure the registration of all lobbyists, but the law only requires them to register if they are specifically paid for the purpose of lobbying. The law specifies three categories of lobbyists: consultant lobbyists (hired, usually by corporations, to work on specific efforts); in-house lobbyists working for corporations; and in-house lobbyists working for non-profit organisations. By these definitions, a significant proportion of corporate lobbying is not disclosed: paid employees of corporations often gather the information needed to lobby, but don't have to register as lobbyists, while corporate directors and retired executives (who are not always paid, and therefore do not need to register) actually do the lobbying.

A number of interest groups and the media have consistently called on ministers and senior civil servants to disclose who lobbies them, since this would ensure that *all* lobbying efforts aimed at these key policy-makers are transparent. However, the federal government has refused to enact this measure and the provinces of Ontario, British Columbia, Nova Scotia and Québec have all enacted lobbying legislation based on the weak federal example.

The LRA requires registered lobbyists to disclose basic details about themselves (or the client, in the case of a consultant lobbyist), the departments lobbied, the aim of the lobbying and the techniques used. The recent amendments, enacted in June 2003, include one significant addition: a requirement that lobbyists disclose past work with the government. This is a step forward since it will shed light on the problem of 'revolving doors' through which former public officials cash in on their inside knowledge and access by becoming lobbyists.

But disclosure of another crucial piece of information – how much is spent on a lobbying campaign – is still not required in Canada (though it is in more than 30 US states); nor are lobbyists asked to disclose previous work with political parties or candidates.

The real flaw in Canada's lobbying system, however, is a lack of enforcement and penalties for violations of ethics. The enforcement front-line consists of the Lobbyists Registrar and the Ethics Counsellor, which both lack sufficient resources to audit the lobbying industry and ensure compliance with the Lobbyists' Code of Conduct. Furthermore, the Ethics Counsellor is appointed by and can be overruled by the prime minister, which creates a risk of bias because the Ethics Counsellor's rulings may affect the prime minister or members of his cabinet.

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Among its other stipulations, rule 8 of the lobbyists' code prohibits lobbyists from placing public officials 'in a conflict of interest by proposing, or undertaking, any activity that would constitute an improper influence' on the official. The interpretation of this rule is crucial to its enforcement. The Ottawa-based citizens' group Democracy Watch has filed a number of complaints about lobbyists breaking rule 8 by fundraising, working for or giving gifts to the prime minister, or to ministers they were lobbying. The Ethics Counsellor has dismissed several of the complaints on the basis of a narrow interpretation of the rule, and Democracy Watch is challenging the dismissals in court.²

Although the federal government refused to require lobbyists to disclose how much they spend, recent changes to the federal political finance law closed several (but not all) loopholes in the disclosure of donations. Bill C-24, which amends the Canada Elections Act and comes into force in January 2004, also sets limits on political donations for the first time. In terms of its effects on lobbying, lobbyists' donations to parties and candidates will now be more fully identified.

Bill C-34, due to become law by December 2003, is the final part of Prime Minister Chrétien's ethics package. If passed in its entirety, the bill will see the Ethics Counsellor replaced with three new ethics watchdogs. A new Ethics Commissioner with more independence will enforce rules for cabinet ministers and parliamentarians; an Ethics Officer will watch over senators; and the Registrar will enforce the Lobbyists' Code of Conduct.³

However, key loopholes remain in the bill: the ethics watchdogs will not be fully independent since the cabinet will still control appointments; the public will not be allowed to file complaints with the watchdogs; and the courts will be barred from reviewing the watchdogs' decisions. There will continue to be no independent enforcement of ethics rules for federal civil servants (nor effective whistleblower protection). A better system, which Democracy Watch continues to advocate, would be a single fully independent, fully empowered, fully accountable ethics watchdog for ministers, all parliamentarians, civil servants and lobbyists.

Nearly 140 years after achieving nationhood, Canada's federal government still lacks key anti-corruption measures to ensure that secret political donations and high-powered lobbyists cannot distort the public interest by gaining undue influence over politicians. The changes to the lobbying, political finance and ethics laws introduced in 2003 are a step in the right direction, but much more remains to be done.

Duff Conacher (Democracy Watch, Canada, www.dwatch.ca)

Notes

1. For details of the bills see: www.parl.gc.ca/LEGISINFO/index.asp?Lang=E and for details of the laws see: www.lois.justice.gc.ca/en/index.html
2. In January 2003 the Ethics Counsellor stated that a lobbyist has violated rule 8 if he did something to 'interfere with the decision, judgement or action' of a public official in a way that amounted to 'a wrongful constraint, whereby the will of the public office holder was overpowered'.
3. In addition, Bill C-34 provides further impetus to efforts to pass ethics rules for all members of the House of Commons and senators. Previous attempts to pass such rules failed when federal politicians refused to enact rules that cover themselves. In contrast, the Québec government reacted to an ethics scandal involving lobbyists and ministers in early 2002 by enacting even stronger measures by the end of the year and setting up a new watchdog, just for lobbyists.

Box 4.3: Following the Enron money trail

Rumours began in autumn 2001 that the Texas-based energy giant, Enron, was in serious financial trouble. Not only was the company about to declare bankruptcy, but it was also guilty of ethical and accounting misdeeds that would culminate in criminal charges and numerous inquiries by the US Congress.

Enron was more than just a financial scandal, of course. It was also a political bombshell, largely due to reporting by the Washington-based Center for Responsive Politics (CRP). Shortly after Enron's troubles became public, CRP released statistics showing the corporation and its employees had donated nearly US \$6 million to candidates for Congress or the president, and to the national political parties, over the previous 13 years. CRP also showed that Enron's former CEOs, Ken Lay and Jeffrey Skilling, were among the most generous givers in the company.

Enron's extensive political connections led many to wonder if Washington had turned a blind eye to the company's transgressions. A story that had begun in the business section leapt to the front page of every major publication in the United States and around the world.

CRP has tracked all political contributions at the federal and national level every day since 1989. It benefits from a robust disclosure system in the United States that places particular emphasis on pre-election disclosure. Several times a year, every candidate for high office, as well as the political parties, must file disclosure reports with the Federal Election Commission (FEC) that detail their fundraising and spending. Recipients of contributions totalling over US \$200 in a year are legally required to list the donor's name and address. The recipient is also required to ask for the donor's occupation and employer, and report that information if it is provided.

That detail is critical, for it allows CRP to examine contribution information, downloaded from the FEC, in a bid to identify political donors and the interests they represent. For every contribution CRP can fingerprint, it assigns different codes identifying the donor, their employer, their occupation and the broad industry or interest group into which they fall. A contribution from a Microsoft employee, for example, will carry one code unique to the donor, another assigned to all Microsoft employees, yet another given to all employees of computer companies, and so on.

As a result, CRP can not only gauge how much money a particular donor, company or industry has contributed overall, but also how much was given to the Democratic party or the Republican party, and incumbents versus challengers. All this information is available free on CRP's website, www.opensecrets.org. CRP's biggest audience is the media, but NGOs focused on a wide range of issues also pay close attention, as do academics, to political players themselves – and their adversaries.

CRP's mission is to make the public more aware of the role money plays in who wins elections, what interests have the most influence among politicians and which legislative proposals have the best chance of passage. CRP does the research and analysis that the government agency collecting the information cannot, or will not, do.

CRP doesn't say money buys votes. It does say that big donors get access to politicians that others do not. Donors use this access to establish relationships with elected officials, developing influence at the highest levels of power. Often, they get what they want. Enron was just one example of a corporation playing the political game to its advantage. CRP believes that public awareness of who finances whom in US elections is the best way possible to ensure against future occurrence of such abuses.

Larry Noble and Steven Weiss (Center for Responsive Politics, United States)

Box 4.4: Dora Akunyili: TI Integrity Awards winner 2003

Dora Akunyili is Director General of Nigeria's National Agency for Food and Drug Administration and Control. She has defied death threats while tackling corrupt practices in the manufacture, import and export of drugs, cosmetics and food products.



Since taking up her position in April 2001, Akunyili – a pharmacologist by training – has earned nationwide respect for her persistence in prosecuting illegal drug traders and imposing strict standards on multinational companies. She has pursued manufacturers and importers of counterfeit drugs, deemed to be a leading cause of deaths by stroke and heart failure in Nigeria.

Counterfeit drugs worth an estimated US \$16 million have been confiscated and destroyed by Akunyili and her staff, saving countless Nigerian lives in the process.

'Corruption in the health sector is murder', Akunyili said. She dedicated her award to all who have died as a result of using counterfeit drugs.