



FOREIGN CORRUPT PRACTICES ACT:

A BRIEF OVERVIEW

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This paper explores the US Foreign Corrupt Practices Act (FCPA). To that end, this paper will discuss the origins of the law, its provisions, its enforcement mechanisms, its impact, its philosophy, and its future impact.

1. THE FACTS: WHAT IS THE LAW AND WHY DID IT COME INTO FORCE?

The FCPA had its origins in the disclosures of the early 1970s that the payment of bribes to foreign government officials was a widespread practice among United States companies (400 companies had admitted paying over \$300 million to foreign officials), eroding public confidence in the integrity of the free market system.^[1] Thus, in the wake of the excesses of the Nixon administration, it was determined that the loss of some contracts was a fair price to pay for US commercial integrity.^[2]

The FCPA prohibits American companies and individuals from making corrupt payments to foreign officials. The act empowers the Justice Department (DOJ) to bring criminal charges and the Securities and Exchange Commission (SEC) to impose fines and injunctions against corporations and their agents who violate the law. Individuals can be fined up to \$250,000, imprisoned for up to five years, or both for making an improper payment to an official in violation of the FCPA. A company may be fined up to \$2 million per violation.^[3] As foreign firms tap US capital markets, a US listing for example, directors and executives are exposed to sanctions if poor internal controls are deemed to have contributed to fraud in their overseas operations.^[4]

The FCPA also prohibits indirect corrupt payments or bribes. The law obligates U.S. corporations to investigate a foreign agent's background and business practices and take whatever actions are necessary to prevent those agents or consultants from making corrupt payments without company authorization or knowledge. The FCPA also requires companies to keep accurate records that reflect the company's transactions and dispositions. Companies must maintain a system of internal accounting controls, such as periodic audits of financial statements, that will help auditors and compliance officers catch suspicious payments.^[5]

Particular attention is paid to commission arrangements. Commissions split between different countries and those paid to introducing agents are generally the most suspicious, as these can be used to conceal bribery.^[6] However, FCPA regulations do make certain concessions to reality. They allow "facilitating" payments, for example, having a visa processed or getting mail service or other routine

[1] Worenklein, Jacob J.; Gellman, Gilla E. "The realities of the Foreign Corrupt Practices Act." *Directorship*, Sep94, Vol. 19 Issue 8, p6.

[2] Kaltenheuser, Skip. "A little dab will do you?" *World Trade*, Jan99, Vol. 12 Issue 1, p58.

[3] Savage Jr., Joseph F. and McElroy, Lisa T. "Keeping business above board." *Security Management*, Feb98, Vol. 42 Issue 2, p48.

[4] ---. "Corporate fraud in Asia: A lack of vigilance." *Business Asia. The Economist Intelligence Unit*. 21 Feb 2000. Page 7.

[5] Savage Jr., Joseph F. and McElroy, Lisa T. "Keeping business above board." *Security Management*, Feb98, Vol. 42 Issue 2, p48.

[6] ---. "SEC to boost bribery surveillance of overseas firms." *Global Compliance Reporter*, 10/06/97, Vol. 2 Issue 20, p1.

government services.^[7] Thus, in addition to so-called “grease payments”, payments that are legal in the country in which they are made are also permitted under the FCPA.^[8] The problem is there are no clear-cut criteria for firms to draw on. If a broker-dealer were to take a government official to lunch to discuss a deal, that could be acceptable. However, sending a public official and his family to Disney World for two weeks when business necessitates only three days is not acceptable.^[9]

2. DOES IT WORK? WHY DOES IT WORK? WHAT ARE THE ENFORCEMENT MECHANISMS AND WHAT IMPACTS DOES THE LAW HAVE ON INTERNATIONAL BUSINESS OPERATIONS.

Some would claim the FCPA does not work because overseas competitors did not face the same obstacle as US companies. Bribing a government employee is a crime almost everywhere, but the US is virtually alone in prohibiting bribery of another country’s officials.^[10] The US Commerce Department estimates that graft costs American businesses \$40 to \$50 billion in foreign contracts each year.^[11] Many US companies operating in West Africa complain that they are disadvantaged compared with European companies.^[12]

The Commerce Department reported in 1996 that since 1994 the US government had learned of significant allegations of bribery of foreign governments by foreign firms in 139 international contracts, valued at \$64 billion. The Commerce Department also estimated that US firms lost 36 of these contracts, worth \$11 billion. US companies have increasingly encountered such situations in Russia and Eastern Europe, where bureaucrats have realized that their power to decide or influence the fate of lucrative deals provides them with substantial money-making opportunities at a time when counterbalancing legal and political institutions are weak or non-existent.^[13]

However, the FCPA has also bestowed benefits. Not being able to rely on bribery has forced US firms to be tougher competitors, improving productivity and

[7] Baumgartner, Edward. “Graft Dodgers: Washington Plays Policeman Until Russia Enforces Its Anti-Corruption Laws.” *Business Russia*. The Economist Intelligence Unit: 10 May 2001. Page 4.

[8] Worenklein, Jacob J.; Gellman, Gilla E. “The realities of the Foreign Corrupt Practices Act.” *Directorship*, Sep94, Vol. 19 Issue 8, p6.

[9] ---. “SEC to boost bribery surveillance of overseas firms.” *Global Compliance Reporter*, 10/06/97, Vol. 2 Issue 20, p1.

[10] Worenklein, Jacob J.; Gellman, Gilla E. “The realities of the Foreign Corrupt Practices Act.” *Directorship*, Sep94, Vol. 19 Issue 8, p6.

[11] ---. “Combating Corruption.” *Business Africa*. The Economist Intelligence Unit: 16 Feb 1997. Page 6.

[12] ---. *Country Report Gabon*. The Economist Intelligence Unit: 4 June 1997. Page 15.

[13] Froot, Steven. “US anti-corruption philosophy gains ground.” *China Business Review*, Jan/Feb98, Vol. 25 Issue 1, p26.

product quality. Conversely, relying on bribery has weakened foreign competitors to the point where many lack confidence that they can compete against US firms without payoffs.^[14]

Thus, in a significant sense the FCPA does work by to enabling U.S. companies to do business in the “right” way. Ultimately, this has been one of the attractions of American companies in the developing world. To the extent that other countries pass statutes similar to the FCPA, the ability of American businesses to act honestly and with integrity will be strengthened.^[15]

The functioning of the FCPA is problematic at best. Bribery and corruption remain among the most unpredictable elements of business. Detecting and prosecuting bribery that takes place overseas is difficult, if not impossible.^[16] Many companies may be paying lip-service to the FCPA by imposing contractual obligations on foreign joint-venture partners to comply with the law while knowing that violations may be taking place.^[17] Wrestling control of the vast oil and gas in countries of the former Soviet Union raised questions about whether the Clinton administration ignored rampant corruption in the former Soviet Union in order not to disrupt its political agenda in the region.^[18] No company, US or otherwise, has ever been prosecuted under the FCPA for corruption in Russia. Indeed, in nearly a quarter of a century, there have only been a few dozen prosecutions worldwide.^[19] A case settled in 1998 is the only instance where the FCPA has been used against a non-resident foreign national (the Dutch president of an American subsidiary of Dutch company had bribed an official in a bar in Panama). Prosecutions under the FCPA average only 1.5 per year, which is just a drop in the bucket of the likely corrupt practices occurring under FCPA jurisdiction.^[20]

The SEC discovered bribery in an American oil-and-gas technology company. However, since the company reported it, the SEC did not impose any civil penalty at all. It is, however, pursuing the Indonesian accounting firm, KPMG Siddharta Siddharta & Harsono, alleged to have been the conduit through which a \$75,000 payment was funneled to an Indonesian tax official.^[21] Companies that discover bribery payments or other questionable actions taken by their employees and agents after the fact may also informally consult with the DOJ.^[22]

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- [14] Kaltenheuser, Skip. “Schmiergeld.” *Across the Board*, Nov/Dec98, Vol. 35 Issue 10, p36.
 [15] Worenklein, Jacob J.; Gellman, Gilla E. “The realities of the Foreign Corrupt Practices Act.” *Directorship*, Sep94, Vol. 19 Issue 8, p6.
 [16] Fink, Ronald et al. “Bribery And Corruption.” *CFO*, Jun2002, Vol. 18 Issue 6, p49, 2/7p,
 [17] Worenklein, Jacob J.; Gellman, Gilla E. “The realities of the Foreign Corrupt Practices Act.” *Directorship*, Sep94, Vol. 19 Issue 8, p6.
 [18] LeVine, Steve and Powell, Bill. “A President and His Counselor.” *Newsweek*, 07/10/2000, Vol. 136 Issue 2, p40.
 [19] Baumgartner, Edward. “Graft Dodgers: Washington Plays Policeman Until Russia EnforcesIts Anti-Corruption Laws.” *Business Russia*. The Economist Intelligence Unit: 10 May 2001. Page 4.
 [20] ---. “The short arm of the law.” *Economist*, 3/2/2002, Vol. 362 Issue 8262, p63.
 [21] *Ibid.*
 [22] Baumgartner, Edward. “Graft Dodgers: Washington Plays Policeman Until Russia EnforcesIts

Thus, increasingly, compliance seems to be voluntary. IBM reported on the practices of its wholly-owned Argentine subsidiary when the sub paid some \$4.5 million in bribes in order to win a contract.^[23] On the one hand it could be said that the FCPA is not functioning because IBM was only fined \$300,000. However, it could be argued that this self-reporting is a positive move.

Major corporations, including US defense contractors, have been fined and managers imprisoned for violating the act. However, charges do more than hurt the company financially since they can damage a firm's reputation and possibly affect its ability to conduct business in the future. Understanding the FCPA and ensuring compliance is, therefore, becoming increasingly important for U.S. companies.^[24]

Perhaps the most important action that businesses can take to avoid violating the FCPA is to have a corporate compliance program as is contemplated by the federal corporate sentencing guidelines. A corporation with an effective compliance program in place can significantly reduce any fines that might be imposed in the event of an FCPA violation.^[25] Compliance programs, including regular training programs, "hot-lines" to allow employee reporting of corrupt activities, and having corporate security personnel whose job it is to monitor compliance, are valuable in helping eliminate corrupt practices and to comply with the FCPA.^[26] Therefore, by firms implementing these programs, the FCPA has had a significant impact on world business.

3. WHAT IS THE PHILOSOPHICAL BASE FOR THE LAW? IS IT UNIVERSALISTIC OR IMPERIALISTIC?

Philosophically, the moral dimension in international business transactions was at the core of the FCPA.^[27] However, during the original debate on the FCPA, some economists argued that bribery benefited development by lubricating economic engines, a theory embraced by "free rider" businessmen who claimed to merely adhere to local traditions.^[28] These theories were countered with the argument that corrupt systems are not only unjust but also inherently unstable. Because bribes must be paid in secret, normal systems of checks and balances do not function.

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- Anti-Corruption Laws." Business Russia. The Economist Intelligence Unit: 10 May 2001. Page 4.
- [23] ---. "The short arm of the law." *Economist*, 3/2/2002, Vol. 362 Issue 8262, p63.
- [24] Savage Jr., Joseph F. and McElroy, Lisa T. "Keeping business above board." *Security Management*, Feb98, Vol. 42 Issue 2, p48.
- [25] Worenklein, Jacob J.; Gellman, Gilla E. "The realities of the Foreign Corrupt Practices Act." *Directorship*, Sep94, Vol. 19 Issue 8, p6.
- [26] Savage Jr., Joseph F. and McElroy, Lisa T. "Keeping business above board." *Security Management*, Feb98, Vol. 42 Issue 2, p48.
- [27] Salimbene, Franklyn P. "The OAS and the OECD move against transnational bribery: Implications for U.S. businesses and the FCPA." *Business & Society Review* (1974), Spring99, Vol. 104 Issue 1, p91.
- [28] Kaltenheuser, Skip. "A little dab will do you?" *World Trade*, Jan99, Vol. 12 Issue 1, p58.

Without them, corruption spins out of control. For example, in Italy payoffs to political parties started at 5 percent of the price of government contracts, then escalated to 8, 10, and finally 15 percent. Then a pattern of deception involving off-the-books transactions and secret bank accounts inevitably develops.^[29]

Corrupt practices are usually inefficient and provide, at best, short-term benefit. As such, some of the largest and most successful companies in the world have strict codes of conduct.^[30] Therefore, since bribery drives up prices for products and services, reduces corporate profits, and is bad for the economic health of countries (strong evidence suggests that higher levels of corruption are associated with lower growth and lower levels of per capita income), foreign investors and international aid agencies are increasingly taking the level of bribery and corruption into account in their investment and lending.^[31]

Bribery scandals in half a dozen countries led the US to hope that other countries would follow suit after passage of the FCPA. But the act was derided as misguided American moralism. The United States also promoted a UN treaty to ban bribery, but that effort fizzled.^[32] In an era of Cold War mistrust, other nations suspected a hidden US trade agenda and resented what they viewed as a unilateral policy pushed by the US. Thus, despite ample scandals in other nations, no other country followed the US lead. Instead, many continued to allow tax deductibility of bribes which helped to encourage them.^[33]

Putting it into a current perspective, Sen. John McCain noted, “During the Cold War, banks and governments often looked the other way when pro-western leaders in developing countries treated national treasuries as personal treasure troves. Today, we cannot afford to look the other way. Corruption undermines our goals of promoting democracy and fostering economic growth and trade liberalization. We want a level playing field throughout the world for American business.”^[34]

It appears that the law was created based on a naïve universalist approach that bribes are bad.^[35] It is universal in the sense that local customs could breach U.S. law.^[36] What might be considered a bribe under one legal code could easily be

[29] Brademas, John and Heimann, Fritz. “Tackling international corruption.” *Foreign Affairs*, Sep/Oct98, Vol. 77 Issue 5, p17.

[30] Baumgartner, Edward. “Graft Dodgers: Washington Plays Policeman Until Russia Enforces Its Anti-Corruption Laws.” *Business Russia. The Economist Intelligence Unit*: 10 May 2001. Page 4.

[31] ---. “The short arm of the law.” *Economist*, 3/2/2002, Vol. 362 Issue 8262, p63.

[32] Brademas, John and Heimann, Fritz. “Tackling international corruption.” *Foreign Affairs*, Sep/Oct98, Vol. 77 Issue 5, p17.

[33] Kaltenheuser, Skip. “A little dab will do you?” *World Trade*, Jan99, Vol. 12 Issue 1, p58.

[34] Srodes, James. “Curbs On Foreign Bribery—And Foreign Aid.” *World Trade*, Feb2000, Vol. 13 Issue 2, p12.

[35] Hotchkiss, Carolyn and Petty, Ross D. “The sleeping dog stirs: New signs of life in efforts to end Corruption in International Business.” *Journal of Public Policy & Marketing*, Spring98, Vol. 17 Issue 1, p108.

[36] ---. “SEC to boost bribery surveillance of overseas firms.” *Global Compliance Reporter*, 10/06/97, Vol. 2 Issue 20, p1.

just a routine business transaction under another. People around the world have a wide variety of opinions on this subject, for example, the custom of gift giving in many Asian nations. The FCPA, however, does take such cultural expectations into consideration. The distinction between what is and what is not a bribe can be very gray at times. Even in Japan where gifts are part of the normal business process, sometimes that is considered corruption and sometimes it is not.^[37]

Other advanced economic powers not only overlooked, but also even encouraged, via tax deductions, the bribery which the FCPA aims to stop. Unlike US companies, European and Japanese firms did not face criminal prosecution for paying bribes. Nine Western European countries, as well as Australia and New Zealand, allowed corporations to deduct such “business expenses” from their taxable income.^[38] In Germany there was the word “schmiergelt” on the income tax form which means “grease money”.^[39]

Thus, the implementation of the FCPA can seem quite imperialistic; success in the Indonesian case discussed above appears to be pushing American extraterritorial ambitions even further.^[40] Extra-territorial laws are increasingly coming into play.^[41] However, improving the operational environment for Western firms ultimately depends on domestic reforms.^[42]

4. FINALLY, WHAT ARE THE IMPLICATIONS OF THE LAW? WHY ARE BRIBERY AND CORRUPTION ISSUES GROWING IN IMPORTANCE THROUGHOUT THE INTERNATIONAL BUSINESS COMMUNITY?

The spirit of the FCPA has spread around the world through a new convention.^[43] Trends giving a new sense of urgency to efforts to combat corruption include the end of the Cold War, the arrival of the information revolution, and the global acceptance of the ideology of free trade.^[44] International investors will rapidly move their capital out of the economy when the corruption is exposed. Examples of this are found in the flight of capital from eastern Asia and Russia in 1997

[37] Morphy, Erika. “Grease Busting.” *Export Today’s Global Business*, Jan2001, Vol. 17 Issue 1, p48.

[38] Froot, Steven. “US anti-corruption philosophy gains ground.” *China Business Review*, Jan/Feb98, Vol. 25 Issue 1, p26.

[39] Kaltenheuser, Skip. “A little dab will do you?” *World Trade*, Jan99, Vol. 12 Issue 1, p58.

[40] ---. “The short arm of the law.” *Economist*, 3/2/2002, Vol. 362 Issue 8262, p63.

[41] ---. “Corporate fraud in Asia: A lack of vigilance.” *Business Asia*. The Economist Intelligence Unit. 21 Feb 2000. Page 7.

[42] Baumgartner, Edward. “Graft Dodgers: Washington Plays Policeman Until Russia Enforces Its Anti-Corruption Laws.” *Business Russia*. The Economist Intelligence Unit: 10 May 2001. Page 4.

[43] Anderson, Teresa. “Legal reporter.” *Security Management*, Dec98, Vol. 42 Issue 12, p90.

[44] Hotchkiss, Carolyn and Petty, Ross D. “The sleeping dog stirs: New signs of life in efforts to end Corruption in International Business.” *Journal of Public Policy & Marketing*, Spring98, Vol. 17 Issue 1, p108.

and 1998.^[45] One study indicates that the effect of corruption on foreign direct investment has the same negative effect on inward FDI as raising the tax rate by fifty percentage points.^[46]

Under increasing pressure from the US, several multilateral organizations have taken steps to address public corruption in the world marketplace. Thus, the competitive terms in foreign markets may soon become more equal and additional tools will be available to address issues of potential corruption in international transactions.^[47] Now, the World Bank requires strict anti-bribery procurement. The IMF has required countries to adopt anti-bribery laws to be eligible for assistance and suspended loans to Kenya and Cambodia because of corrupt practices.^[48]

Other multilateral organizations are also espousing the FCPA philosophy. The Organization of American States adopted the first anticorruption treaty in the world which criminalizes transnational bribery in the Western Hemisphere and provides for extradition of corrupt officials. Transparency International, a non-profit organization devoted to fighting corruption and funded by multinational corporations, foundations, and Western government development agencies, now boasts chapters in over 60 countries.^[49] Transparency International's major strength lies in the fact that it does not simply preach a message of honesty and probity in the developing world, but actively presses industrial democracies to legislate and enforce anti-bribery statutes modeled on the FCPA.^[50]

Although the US unsuccessfully raised the issue of bribery before the WTO in 1996 as an unfair trade practice, Transparency International has pressured the EU on the issue of corruption. Government procurement agreements in the WTO, North American Free Trade Association, and the EU offer additional measures to combat bribery by making the procurement process more transparent. Even the United Nations has resolved through the Economic and Social Council, to support actions against corruption. Taken together, the activities of the governmental and nongovernmental organizations would indicate that momentum against corruption is building. NGOs, professional standards, and public pressure from governments and the public are starting to have an impact on the debate on corruption.^[51]

[45] McCubbins, Tipton F. "Somebody Kicked the Sleeping Dog—New Bite in the Foreign Corrupt Practices Act." *Business Horizons*, Jan2001/Feb2001, Vol. 44 Issue 1, p27.

[46] Wei, Shang-Jin. "How Taxing Is Corruption on International Investors?" *Review of Economics & Statistics*, Feb2000, Vol. 82 Issue 1, p1.

[47] Moyer, Homer E.; McGlone, William M. "Foreign Corrupt Practices Act: The next generation of issues." *Corporate Legal Times*, Mar97, Vol. 7 Issue 64, p46.

[48] Froot, Steven. "US anti-corruption philosophy gains ground." *China Business Review*, Jan/Feb98, Vol. 25 Issue 1, p26.

[49] *Ibid.*

[50] ---. "Combating Corruption." *Business Africa*. The Economist Intelligence Unit: 16 Feb 1997. Page 6.

[51] Hotchkiss, Carolyn and Petty, Ross D. "The sleeping dog stirs: New signs of life in efforts to end Corruption in International Business." *Journal of Public Policy & Marketing*, Spring98, Vol. 17 Issue 1, p108.

As the fight against corruption gains further steam do to its political correctness, the advanced nations compete to claim they have powerful anti-corruption laws.^[52] Some developing countries, too, have moved unilaterally to clean up their business environments.^[53] Other countries appear to be following the lead of the FCPA due corruption scandals in countries in Eastern Europe and elsewhere, including Asia and South America.^[54] In this era of anti-corruption, countries trying to pass watered-down versions of the FCPA can appear to be soft on corruption.^[55]

As the threat of exposure of corrupt practices threatens a country's or company's public standing, there is less of a willingness to allow corruption to continue. Companies are proving more active in whistle-blowing and governments in applying diplomatic pressures.^[56]

Therefore, in most respects it seems that the FCPA is functioning even though perhaps more through self-regulation or the threat of indictment. Moreover, its ideals are spreading around the world due to both US pressure and a growing need for countries and companies to be transparent in order to draw investment and public trust.

[52] ---. "The short arm of the law." *Economist*, 3/2/2002, Vol. 362 Issue 8262, p63, 3p.

[53] Froot, Steven. "US anti-corruption philosophy gains ground." *China Business Review*, Jan/Feb98, Vol. 25 Issue 1, p26.

[54] Worenklein, Jacob J.; Gellman, Gilla E. "The realities of the Foreign Corrupt Practices Act." *Directorship*, Sep94, Vol. 19 Issue 8, p6.

[55] ---. Country Report Canada. *The Economist Intelligence Unit*: 10 Nov 1997. Page 13, which discusses a plan by Canada to enact a voluntary code of conduct without compliance requirements.

[56] Kaltenheuser, Skip. "Schmiergeld." *Across the Board*, Nov/Dec98, Vol. 35 Issue 10, p36.