

How to root out Russian corruption

A group of business leaders has been given a tough task to fulfill by President Vladimir Putin

By Matthew H. Murray and Elena A. Panfilova
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At a Kremlin meeting on Feb. 19, President Vladimir Putin publicly challenged the leaders of the Union of Industrialists and Entrepreneurs (RSPP) to help "destroy the breeding ground for corruption."

RSPP is a business association that includes the financial-industrial groups that secured control of a majority of Russia's wealth during the past decade of privatization. The association responded by creating a working group that will recommend administrative reform measures to the president within three months.

Many analysts dismissed the exchange between Putin and RSPP as one staged to help the Kremlin manage public debate over corruption, leading toward the election season.

Ironically, the Feb. 19 meeting skirted scrutiny of the business practices of RSPP members. It is tempting to view it as a post-Perestroika production of Gogol's "Inspector General."

Instead, consider the ways that the president's vocal position can spur the public debate and advance civil society's objective to reduce corruption. The public tends to blame the demand side of the corruption equation — that is, civil servants at all levels and bureaucrats of all stripes.

Who to blame?

Such blame, in turn, leads to a focus on administrative reform — particularly reducing obstacles to business that provide civil servants the opportunity and incentive to demand bribes and engage in other forms of rent-seeking.

Russia, however, must attack the breeding ground from both the demand and supply sides. To succeed, the supply side, or private sector, must accept a significant degree of responsibility.

Perhaps this is why, on Feb. 19, the Russian president directed his challenge for "concrete suggestions" to RSPP.

Russia's leading financial-industrial groups have been and remain in a position to mold government decrees and regulations, licensing and tendering procedures to secure ownership of state assets — also known as "state capture." World Bank and European Bank for Reconstruction and Development studies show that countries with a high incidence of "state capture" tend to be weakened by poor governance of economic development. Licenses or tenders granted without competition create conditions under which a few companies monopolize public resources and tax-paying, efficient businesses subsidize inefficient enterprises. State capture by large enterprises creates barriers to market entry by small-to-medium-size enterprises ("SMEs") and foreign investors.



IGOR YURGENS, the vice president of RSPP, which has been asked by Putin to help 'destroy the breeding ground for corruption.'

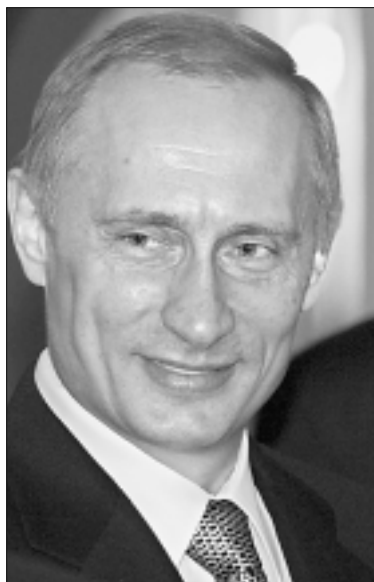
It impedes the rule of law and undermines confidence in government institutions.

Russia's market development has also been hindered by a related phenomenon — "business capture." A business group seeking to take control of assets owned by a private company turns to government officials for assistance.

Officials use their positions to manipulate courts, laws and administrative and law-enforcement agencies to help the group secure the company's property. This trend also severely undermines the credibility of institutions required to govern a market economy. Perhaps this is why, in a speech before the

Interior Ministry on Feb. 6, Putin warned law enforcement authorities to cease becoming involved in private commercial disputes.

Notwithstanding the fact that civil servants play a role in both state and business capture, these practices are bred in the private sector. The breeding ground can be attacked only if private sector leaders take initiative.



VLADIMIR PUTIN

There are numerous market incentives for RSPP and other business leaders to adopt anti-corruption practices. They include enhancing reputation and good will as business assets, reducing the risk and costs associated with capture, strengthening competitive position, increasing shareholder value, and gaining access to capital and credit on better terms. In the long-term, RSPP requires institutions that can govern a market economy built on true competition.

To meet Putin's challenge, RSPP should take concrete initiatives that can be implemented largely by the supply side. In particular, RSPP members should form "integrity pacts" with other large businesses, SMEs and non-governmental organizations (NGOs) at the national and regional level designed to institute conditions for transparent and fair business competition.

The most concrete form of an integrity pact is a "no-bribery pledge," under which companies entering a government tender or privatization bid and the officials responsible for choosing the winner commit to a transparent procedure. In particular, they pledge not to offer, pay, accept or seek bribes of any kind during the tender.

To show their good faith, they may place funds in escrow that they would relinquish if they did engage in bribery. If a business does not abide by the guidelines, they lose the bid and other participants in the pledge can stop doing business with or blacklist them.

Such pacts have been implemented to one degree or another throughout the world, including in Ecuador (tender for oil refinery rehabilitation), Panama (privatization of telecommunications), Indonesia (Technology Ministry), Argentina (subway and bridge construction), Nepal (municipal

contracts) and Benin (highway construction).

In order to maximize impact on economic growth, RSPP should form integrity pacts that help both large enterprises and SMEs. Disproportionately injured by the extortion practices of officials at all levels, SMEs are already taking local initiatives throughout Russia.

Clubbing together

For example, in St. Petersburg, a highly regarded economics professor, Lev Kaplan, and the General Director of the U.S. subsidiary of Otis Elevator, Vladimir Marov, have led the formation of an "Honest Builders' Club."

The coalition dedicated to fair business practices now includes 30 of the largest local construction companies, various NGOs and the city's Vice-Governor for Construction.

RSPP can find ample know-how for combating corruption in the

ground-breaking research being performed by Russian NGOs. According to a recent study by the Center for Anti-corruption Research and Initiative of Transparency International-Russia and INDEM, Russian citizens pay more than \$30 billion a year in bribes, not only to conduct business but also to secure access to health, education and housing. A Transparency International-Russia survey shows how corruption continues to breed at a rapid pace in regional and local governments.

Targeting the regions

RSPP leaders should also take initiative in the regions in which they operate their factories. They are in the best position to help institute local programs to monitor government agencies and budget processes, increase access to information regarding allocation of public resources, and foster independent oversight of public procurement.

Business has a direct incentive to address such issues at a regional level. The human resources of any company are more productive and efficient in an environment where employees feel secure about bribe-free health care, education, and housing services.

To galvanize Russia's public debate over corruption, it is vital to remove the sole responsibility for reform from government. By focusing on the supply-side, debate can lead to more direct, immediate and measurable action.

In turn, by taking the initiative, the private sector assumes a position to demand government steps to guarantee that regulatory processes are fair, open, competitive and informed.

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