

State-Owned Enterprises and Corruption: An International Perspective

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Petróleo Brasileiro S.A. of Brazil, popularly known as Petrobras, has been caught in a storm of corruption charges dragging with it the internationally popular President Dilma Rouseff, who was suspended on 12 May 2016 by the Senate and impeached by the same body at the end of August. Along with her, several Ministers and the former iconic President Lula da Silva have also been indicted. Over 117 senior executives face charges. The Government of Brazil together with its financial entities own 64% of Petrobras. According to many indicators that now seem facile, the company is an unlikely candidate to be caught in corruption charges. It was lately ranked 28 among the Fortune Global 500. It is the largest company by market capitalization north of the equator; a true state-controlled multi-national with assets in several countries in South America, North America, Africa, Europe and Asia; a signatory to the UN Global Compact and a recipient of prestigious awards for sustainability initiatives.

Petrobras also embraced outstanding corporate governance standards such as international listings, separation of CEO and Chairman, non-executive directors, board committees, regular financial and non-financial reporting, impressive disclosures, engagement of big four auditor and a dedicated Corporate Governance Officer. But years of cronyism and cleverly packaged kick-back schemes ensured about 16 companies received inflated contracts, eventually passing the benefits to some individuals, the political party in power and its associates/nominees. While the kick-backs are estimated by the

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company sources at about US\$3-4 billion, the Audit Court put the figure at US\$7.6 billion. Ironically, the Workers Party, the chief beneficiary in this scandal nicknamed “car wash”, came to power on the back of socialism and fight against corruption.

In another part of the world, there has been a globally cited strong drive against corruption in State-owned Enterprises with President Xi Jinping reportedly promising to clean up not only the “tigers” (the giants among them) but also the low flying “flies” in China. Since the beginning of 2014 over 115 C-Suite officials were reportedly named publicly for investigation, from giants including Petrochina, China Southern Airlines and Sinopec. As per one report even two years ago, 10,300 officials have been investigated for graft involving mostly engineering projects, purchasing and sales, real estate and international dealings. According to an official of the Supreme Peoples’ Procuratorate, the fundamental issue is the relationship between political power and proper allocation of resources. Not surprisingly, surveys in other countries also show public procurement as being at the center of such corruption. Other studies such as those of the Organisation for Economic Co-operation and Development (OECD) indicate low standards of disclosures, conflicts of interest, weak internal control environments as exacerbating corruption at State-owned Enterprises in some regions.

The issue of corruption in State-owned enterprises (SOE or public enterprises or Government Linked Companies or Parastatals as they are called in some countries) is not limited to the countries in the current limelight. Corruption is widespread, admittedly more noticeable in the BRICs (Brazil, Russian, India, China), where massive scandals have been reported in the energy, technology, banking and defence segments.

Given the size and economic significance of SOEs in the global economy, there are intuitively appealing estimates as to how much can be saved by arresting corruption; how that can help mitigate fiscal pressures on stressed economies and how savings can contribute to eradication of poverty and improvements in nutrition, health, and education for children, women and the extremely vulnerable and ultimately to meeting the Sustainable Development Goals (SDG).

According to the Paris based, The SOE Forum (www.thesoeforum.org) SOEs represent over 25% of GDP in many important emerging economies. More than 10% of the world’s 2000 largest companies and 25% of the top 100 multinationals are SOEs. The market capitalizations of listed SOEs could be

over 20% of the total. These numbers may be understated as they often exclude much of the financial sector, sub-national entities, as well as those in which the State may have significant shareholding and indirect control. Further, not all state-owned commercial enterprises are corporatized and are hence, excluded from these estimates.

An OECD study in 2009 estimated the value of 2050 SOEs in 25 member countries at US\$1.2 trillion accounting for about 15% of GDP. Another study estimated the sales of 204 SOEs among the world's largest 1000 companies at about US\$3.6 trillion – more than the GDP of the UK or France. In some countries in the Middle-East & North Africa, Latin America and Central Asia they may represent more than 50% of GDP. Many SOEs, including from China and India, have become global players with assets and investments in several countries and, at times, partnering with other firms. They seem to be concentrated in infrastructure, banking and financial services, and oil & gas.

Despite the lack of sufficient and validated data, it is obvious the economic dimensions and implications of SOEs are significant for the global economy and for the new aspirations of sustainable development. They are a sector whose efficiencies are often in debate but also one that hosts significant corruption. According to an IMF Staff Discussion Note released in May, 2016, the cost of bribery – excluding overall corruption of all kinds and their economic and social costs – appears to be between US\$1.5 - US\$2 trillion per annum or about 2% of global GDP. SOEs account for a significant part of this “abuse of public office for private gain”, as the definition of corruption goes. The SOE Forum states that fighting corruption in SOEs can improve their competitiveness significantly, reduce dependence on the State exchequer, improve internal accruals for investments and protect jobs in the long run.

Corruption among public officials has been studied, categorized and described over the millennia but it is only in recent decades that it has been mainstreamed into global dialogue and attention. Consequently, there are now many protocols, task forces, agreements and alliances addressing the issue. There are several recommendations ranging from strong immediate punitive actions to long-drawn institution building and culture change. However, these are general in nature and not specific to SOEs and hence, an area that needs specific empirical study.

In the case of SOEs, corruption perhaps is mostly collusive rather than facilitative or extractive (going by one typology). The facilitative type is often experienced in public service provision – some euphemistically call it speed money or grease. In many developing countries, low ranking government

officials interacting with the public are the face of this type of corruption. In many societies that have not focused on rights over the decades, this facilitative corruption has been so institutionalized as to become a social norm – a custom reflexively performed.

There is the extractive type of corruption too – that often is the cause of leakages in transmission of material benefits such as pensions, employment guarantee and the like. They also extend to systematic rents such as those demanded by Police, Municipal officials, Transportation authorities or those in-charge of recruiting temporary labor or providing small-time contracts. The Transparency International studies these common corruption practices in many countries and provides great insights.

Collusive corruption, the bane of SOEs, occurs primarily when the insiders (management and/or the Directors) join with outsiders (mainly politicians, government officials, powerful intermediaries or clients themselves) to abuse official power for private gains directly or indirectly. This is strikingly evident in award of contracts (civil works, purchase of capital equipment, maintenance contracts, procurement of bulk materials etc.) in the case of the manufacturing sector. In the banking and development finance sectors, advancing of credit for non-bankable projects/proposals and write-offs of non-performing loans, in part or full, are common results of such collusive actions.

There are several suggestions and illustrative case studies for reducing the scope for corruption. Most prominent among these are (a) transparent e-procurement supported by a legislative framework (b) actively operating whistleblower mechanisms at the organizational as well as civil society levels (c) improved attention to internal control environment using modern systems and processes (d) empowering the stakeholders/civil society to obtain information (e) setting standards for more detailed financial and non-financial disclosures and (f) invoking/building an ethical culture.

The power balance for implementing these is surely vested with the shareholding/administrative/responsible Ministries or where applicable, the Shareholding entities (designated national wealth funds, coordinating agencies, Special Purpose Vehicles etc.). The question arises, as to how these powers should be motivated to restrain themselves from unethical conduct in dealing with the SOE. They should be directed and controlled to provide the critical leadership for ethical conduct and give the strategic support to SOE they help govern, *i.e.*, provide meta-good-governance. There is no silver-bullets to deal with this problem, each country must devise a compelling action-framework with political will, which in the end is creative action

against odds! Making space where none seems to exist and acting strategically on it!

Even as the powers in many countries may be loathe to move rapidly in that direction, they must note, among other known considerations, the increasing issue of “extraterritoriality” that includes aspects of corruption. Consequent to global and regional cooperation under the aegis and with the active support of multi-lateral and bilateral bodies, corruption is no longer a private transaction or domestic, national issue. Other countries are indeed interested parties especially if there are trans-national transactions and bribery. Most countries have specific laws now that gives them wide-powers and makes the bribe-giver equally liable as bribe takers whether they are located within the country or elsewhere. Authorities can even dispute tailor-made contracts or the granting of special dispensations that may indeed be deemed as corruption. There are also attempts to link corruption with abuse of human rights and social responsibility in some contexts to gain extraterritoriality jurisdiction. SOEs must beware of this emerging gray area that, at its worst, may even see corruption in preferential treatments, monopolistic actions, lack of transparency and poor disclosures.

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