

Towards Preventing a Recurrence of Corruption Related to Official Development Assistance (ODA)

September 2009

Study Panel for Preventing a Recurrence of ODA-Related Corruption

Study Panel for Preventing a Recurrence of ODA-Related Corruption

Chairperson

Toshio WATANABE, President, Takushoku University

Vice-Chairperson

Akira KOTERA, Professor, The University of Tokyo

Members

Eiji AKIFUJI, Member of the Economic Cooperation Committee, Japan Foreign Trade Council, Inc.

Teruo KAWAKAMI, Certified public accountant

Shunji KUSAYANAGI, Professor, Kochi University of Technology

Katsuya NATORI, Director, General Counsel, IBM Japan

Yasuhiko NATORI, Lawyer

Meetings

1st Meeting	June 30	How to proceed with the panel
2nd Meeting	July 15	Preventive measures by major donor countries
3rd Meeting	July 31	Findings of the interview survey of industrial associations
4th Meeting	August 26	Compilation of a report

1. Introduction

This study panel has studied measures to be taken to prevent the recurrence of corruption practices similar to the corruption case that involved Pacific Consultants International Co., Ltd. in connection with a Japanese ODA project in Vietnam (“the PCI case”). The panel met four times.

As Japan’s Official Development Assistance Charter (endorsed by the Cabinet in August 2003) states, the objectives of Japan’s ODA are to contribute to the peace and development of the international community, and thereby to help ensure Japan’s own security and prosperity.

The objectives of ODA will be achieved most effectively only when ODA to recipient countries, be it grant aid or loan aid, is used properly. Improper use of ODA, that is, corruption involving ODA, is unacceptable not only because ODA is funded by taxpayers’ money and therefore requires achieving its objectives most effectively, but also because unfair use of ODA has a negative impact on recipient countries. Unfair use of ODA may help widen economic disparities, incite a sense of social inequality, and undermine the governance capacity of recipient countries. It also unfairly benefits only a small portion of people and thus hampers the establishment of a fair competitive environment, thereby impeding sound socioeconomic development of recipient countries. By extension, improper use of ODA has, directly or indirectly, a negative impact on peace and the development of the international community.

The Ministry of Foreign Affairs (MOFA) and the Japan International Cooperation Agency (JICA) need to redouble their efforts to prevent the recurrence of corruption practices. Yet this will not suffice. In addition to working with other bilateral and multilateral donors, it is also important to ensure that businesses and recipient country governments discipline themselves to stave off corruption. Exchanging information with NGOs, as necessary, may also help. On the other hand, effective implementation of ODA should not be undermined by excessively stringent regulations on the provision of ODA. They need to consider preventive measures that are equally applied to foreign firms so that Japanese firms will not be put in an unfavorable position. Finally, attention should be paid to ensure that preventive measures do not hinder ongoing efforts to speed up the ODA implementation process.

Based on the above-mentioned fundamental recognition, this paper reports on the results of the panel’s discussions.

2. Measures that have been taken following the PCI case

The panel highly praised the measures taken by MOFA and JICA, following the PCI case that was exposed when PCI officials were arrested and indicted on corruption charges, as a major step to prevent unfair use of ODA (for the measures, see the policy document MOFA released in April 2009, “Introducing Anti-Corruption Measures Related to Japanese ODA Loan Projects”). The panel also agreed that more preventive measures should be considered.

The panel considers it appropriate to ensure that the Quality- and Cost-Based Selection (QCBS) method will take root as described in the MOFA document. The document states that QCBS has been adopted as one of the measures to help prevent corruption by introducing aspects of cost-based evaluation in the process of selecting consultancies. It also says that quality-based evaluation should remain the core of the selection process in order to give

enough consideration to the quality and safety of Japanese ODA loan projects. Attention should be paid to ensure that too much emphasis will not be placed on cost-based evaluation.

The panel considers it necessary to make JICA more involved in the process of selecting consultancies for recipient countries that need such involvement, while respecting their ownership. In view of the case of PCI, the policy document states that as far as large consultancy contracts are concerned, JICA will send external experts for technical guidance to recipient countries to speed up the process of hiring consultants as well as ensuring fairness and transparency of the process. For the time being, it is important to ensure that this policy is put into practice.

3. Findings of the interview survey of industrial associations

In compiling a set of preventive measures, this panel conducted an interview survey of two industrial associations: the Engineering and Consulting Firms Association, Japan; and the Overseas Construction Association of Japan, Inc.

The survey shows that these two associations have already taken steps to ensure compliance. The associations have set up a study group on compliance and called the attention of their member consultancies to the importance of compliance. Many of these consultancies, for their part, have organized seminars on compliance. Some member consultancies do not have compliance regulations. This suggests that there is still a need to promote corporate compliance.

A questionnaire survey of member consultancies conducted as part of this interview survey shows that some members experienced unreasonable demands from government officials of recipient countries over, inter alia, taxes and customs. According to the survey, few of these firms asked Japanese embassies/consulates or JICA for help, although they informed them of the situations as necessary. The survey also shows their expectations for more involvement by JICA. In addition, the questionnaire survey reveals some cases where firms are having a hard time because the blurred distinction between facilitation payments and bribery forces them to make difficult decisions on their own. The survey also finds that there are calls for more opportunities for consultation regarding unreasonable demands.

The questionnaire survey indicates that MOFA's points of contact for information on corruption are not yet fully known, pointing to the need for more public relations.

4. Recommendations

In light of the situation mentioned above, this panel recommends the following measures:

(1) For MOFA and JICA

(i) Strengthening rules on punitive measures for businesses

PCI's earlier irregularities in connection with development studies they conducted in Costa Rica have prompted MOFA and JICA (and the former JBIC) to take a number of preventive measures. Nevertheless, the modus operandi used in PCI's corruption case in Vietnam was so methodical and sophisticated that meticulous examination of relevant documents could not have discovered irregularities. While the indictment of PCI officials must have had a major deterrent effect, it is essential to provide disincentives for businesses to indulge in irregularities. One such disincentive worth considering may be imposing tougher sanctions

on businesses that have committed irregularities a second time (keeping them away from the market for a certain period).

At present, MOFA and JICA can disqualify firms to tender bids or receive orders in accordance with three sets of rules: (i) guidelines for imposing measures against firms that have engaged in fraudulent practices in Japan's grant aid projects/programs; (ii) rules on measures against entities that have engaged in fraudulent practices in JICA's financial assistance; and (iii) rules on measures to suspend the qualification to participate in competitive bidding for contracts with JICA. These rules allow for doubling the period of disqualification in the case of highly malicious intent or critical consequences. The panel recommends amending the rules so as to allow for more than doubling the disqualification period for firms that have repeated corruption practices. However, at the same time, MOFA and JICA should consider defining "the length of time between such repeated cases."

These measures should be imposed only when procedural fairness is maintained by, for example, providing opportunities for explanation.

The panel also recommends extending the disqualification period for bribery, which is up to two years under the current rules. The possibility of extending the period to up to three years should also be explored in light of the fact that the disqualification period for violating the Antimonopoly Law and bid rigging is up to three years under the current rules.

It is important not to put Japanese firms in a disadvantageous position. Arrangements should be made so that firms based in recipient or third countries will be subject to equal discipline. This requires MOFA and JICA to call on these firms and recipient country governments to take necessary measures.

(ii) Making good use of points of contact for information on corruption

The interview survey has shown that many firms do not know that points of contact for information on corruption are available for them. The system of these points of contact is aimed at the central management of information on corruption. Under the system, the central contact point is placed at MOFA headquarters (the Aid Policy and Management Division of the International Cooperation Bureau), and branch contact points at JICA Headquarters, Japanese embassies, and JICA overseas offices. Information received at these branch points is reported to the central contact point to manage the information in an integrated manner. MOFA and JICA should mount a fresh information campaign, reminding Japanese firms that branch contact points as well as the central contact point at MOFA headquarters are available to them.

The panel has learned that the information that these contact points have received over the period of half a year since this system was launched in March 2009 is varied in accuracy and reliability. This suggests the need to improve the accuracy of such information in order to use the system more effectively. To that end, the panel recommends that essential items for entry be established so that informers will be able to know what kind of information to offer. A reasonable approach may be to compile these items - including the name and contact information of the informer as well as a description of the corruption practices in question - into a fixed form and post it on the contact point for information on corruption located on the website of Japan's ODA. It is important to ensure that information that might help identify the firms concerned will not be disclosed.

It is also necessary to ensure that the interest of informers will not be undermined; concerns about the possibility of reprisal from the entities on which information is provided have been raised in the interview survey described earlier. Firms are concerned that providing such information would undermine, in some way or other, business opportunities for them in the future. Their concern is that the source of information might be readily identified if they report to one of the contact points that they have received unreasonable demands, for example, and MOFA or Japanese embassies call on the entities concerned in recipient countries for corrective action based on that report. Regarding such concern, stipulations that informers must not be subject to unfair treatment have already been incorporated into Exchange of Notes (E/N) and ODA Loan Agreements (General Terms and Conditions or GTC). Additional steps should be taken, however, if the report system is to be fully utilized. They include explaining anew these measures to industrial associations concerned in order to obtain their understanding and support. Also, the Government of Japan should take resolute action if the recipient country gives unfair treatment.

(iii) More involvement of JICA in the selection and contract processes

In light of the PCI case, JICA has recently introduced a measure whereby JICA will send external experts to recipient countries for technical guidance in the case of a large consultancy contract. It is desirable to reinforce this measure so that JICA will increase its involvement in the selection and contract processes. JICA should decide the specifics while taking into account the situation of each recipient country.

(iv) More involvement of Japanese embassies and JICA overseas offices

Japanese embassies and JICA overseas offices should better respond to the consultation requests from Japanese firms involved in ODA projects. It is important to organize regular discussion meetings with Japanese firms doing business in the recipient country for exchanging views (or for consultation), although the situations vary from country to country. The ambassador, deputy heads of missions, and officers in charge of economic affairs or economic cooperation should play a central role in consulting such support system. Adequate attention should be paid to the confidentiality of information in order to encourage firms to speak candidly.

It is also important to impress on recipient country governments the fact that Japan's public and private sectors exchange information regularly and that the Government of Japan supports Japanese firms. Along these lines, Japanese embassies and JICA overseas offices should further strengthen ties with Japanese chambers of commerce in recipient countries and thus identify impediments to business activities of Japanese firms in a more timely and appropriate manner. They should also call the attention of recipient country governments to the importance of compliance at such opportunities as government-to-government negotiations so as to prevent government officials of recipient countries from making unreasonable demands on Japanese firms.

(v) Closer monitoring of ODA projects

Since 2002, MOFA and JICA have been conducting improved external audits for three ODA schemes: loan aid, grant aid, and technical cooperation.

To further improve the framework for continued monitoring of ODA projects, JICA will explore the possibility of increasing and improving human resources at its overseas offices and assigning external experts to reinforce them. External experts will be tasked with

assessing whether progress meets the expectations of lenders, including conducting on-site inspections of project sites, and supporting the project process as a whole. Ways to put this idea into practice should be studied separately; implementing the idea requires training human resources and securing necessary budget allocations.

(2) For Firms

(i) Recommendations for enhancing compliance

Firms should establish their own code of conduct for promoting ODA projects. While many Japanese firms have already taken steps to enhance compliance for the fair use of ODA, it is important that the Government of Japan uninterruptedly encourages them to raise their compliance awareness. To date, the Government of Japan has called the attention of Japanese firms to the importance of compliance at critical occasions, including when corruption practices were revealed and when the Unfair Competition Prevention Act came into force. There is no denying that this measure has not had a long-term impact because it has been taken on only a few occasions. It is necessary to constantly encourage firms to enhance compliance at such opportunities as regular informal meetings between MOFA/JICA and industrial stakeholders.

In the context of corporate compliance, coordination between the government and firms is important when the latter receive unreasonable demands. Firms should, in their code of conduct, make clear on what occasion or at what stage they will report to a contact point and seek the involvement of MOFA/JICA.

(ii) Recommendations for familiarizing firms with international competition standards

Large-scale construction works in an ODA loan project often entail a conflict between the client and the contractor over additional changes to the construction works and the terms/conditions. Such a conflict should be settled in accordance with internationally recognized terms/conditions or rules (e.g., the International Federation of Consulting Engineers (FIDIC) Conditions of Contract). It is pointed out that Japanese firms may have insufficient knowledge and experience regarding the general conditions of international construction works, although many of them are familiar with the Construction Business Law and the Code of Contract, which serves as a guideline for public works in Japan. The Government of Japan, JICA, and industrial associations need to organize seminars on FIDIC Conditions of Contract for Japanese firms to help them deepen their understanding of international contracts.

(3) For Recipient Countries

(i) ODA policy for recipient countries where a corruption case has occurred

No country in the world has a policy of terminating the provision of ODA to recipient countries altogether where a corruption case has occurred. Yet if the Government of Japan took no action against such recipient countries, that would engender doubt about its commitment to preventing corruption. The Government of Japan has already established rules on suspending the flow of funds and demanding a refund regarding the relevant portion of contract if a corruption case occurs. The point is to familiarize recipient countries with these rules. The Government of Japan needs to maintain the option of suspending the provision of ODA to such recipient countries on a case-by-base basis depending on the scale of corruption.

(ii) Recommendations for enhancing governance

The Government of Japan has long supported legal and judicial development in Vietnam,

Cambodia, Laos and other countries through technical cooperation projects as part of its efforts to help developing countries with governance enhancement.

The Basic Policy of the Assistance for Legal and Judicial System Development that the Government of Japan formulated in April 2009 sets out a number of strategic targets, including: (i) helping recipient countries to establish the rule of law by sharing universal values such as freedom and democracy; and (ii) creating an enabling environment for sustainable growth and ensuring compliance with international rules.

Governance enhancement in recipient countries will not be achieved overnight; it will require consistent efforts. Japan's assistance in legal and judicial development has so far revolved around drafting bills and implementing laws with a focus on basic laws and economic laws. The Government of Japan should also consider expanding such assistance to cover such aspects as improving the public procurement system and developing the regulatory framework for preventing corruption. It is also important that Japan promote such assistance in cooperation with other donors and under the framework of international coordination. In the case of a technical cooperation project that will take time to formulate, it is important to consider taking a prompt first step by, for example, organizing a seminar in the recipient country regarding the Unfair Competition Prevention Act of Japan or the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

(iii) Recommendations for capacity building

Given that counterparts in recipient countries often have limited knowledge or understanding of contracts, it is important to organize FIDIC Conditions of Contract seminars in order to help them deepen their understanding of international contracts, as in the recommendations for firms described earlier.

(4) Efforts towards an International Framework

Since different countries have different rules on preventing corruption, it is helpful for donor countries to discuss how to prevent ODA-related corruption. Japan should exercise its leadership in this effort.

(5) Follow-up on Recommendations

To translate all these recommendations into prompt action, MOFA and JICA should set up taskforces to follow up on the recommendation items in one year. They should also make the findings of the follow-up available on their websites.