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Discussion Paper: Questionable Foreign Payments

Introduction:

The Administration urgently needs to establish its general policy on the issue of questionable foreign payments and its specific program to implement that policy. Decisions are needed as to (1) what new domestic legislation, if any, the Administration will propose or support, (2) the substance of an international agreement on illicit payments that the United States can accept and how much political effort will be made to achieve such agreement, and (3) the steps the Department should take to enlist the cooperation of foreign governments in dealing with the illicit payments problem.

Senator Proxmire has scheduled hearings for March 16 on S. 305, the "Foreign Corrupt Practices Act of 1977" and he reportedly expects to report the bill to the Senate in early April. Secretary Blumenthal will testify. The Administration needs to have a position on that bill by that date.

The ECOSOC Working Group on the Problem of Corrupt Practices meets March 28 to elaborate an international agreement on illicit payments and/or alternative recommendations. By that date -- and preferably by

March 16 -- the Administration should take a position on this exercise.

Background:

SEC and Congressional investigations over the last two years have disclosed questionable foreign payments by more than 200 U.S. enterprises. These disclosures have shocked international public opinion, caused serious political problems for a number of friendly foreign governments, and damaged public confidence in free enterprise and established institutions.

In response, Congress enacted new legislation which (a) made foreign bribes taxable as U.S. income, and (b) required the reporting of fees, commissions and political contributions made in connection with the sale of defense articles and services for foreign armed forces. The State Department issued regulations implementing these provisions of the Arms Export Control Act. Other bills providing for criminalization of foreign bribes, disclosure of questionable foreign payments, and improved corporate management and accounting procedures were proposed by Senator Proxmire, President Ford, and the SEC, respectively. None were enacted into law, but the Proxmire criminalization bill passed the Senate 86-0.

The SEC now requires issuers to disclose a broad range of foreign payments that are deemed "material" under very general guidelines. Under proposed, new regulations proxy statements will have to disclose the involvement of directors and executive officers in "material" political contributions and payments to foreign officials, direct or indirect, other than to satisfy lawful obligations.

The Senate also adopted unanimously a resolution (S. Res. 265) calling upon the Executive Branch to negotiate in the MTN and other international fora a binding international agreement with sanctions to control illicit payments in international trade. Subsequently, the United States persuaded the UN Economic and Social Council (ECOSOC) to establish an Ad Hoc Intergovernmental Working Group on Corrupt Practices to elaborate the possible scope and contents of an agreement to combat illicit payments. The Working Group is to report to ECOSOC this July.

The U.S. has proposed an international agreement based on (1) enforcement of host country criminal laws; (2) uniform provisions for disclosure of payments to foreign officials and agents' fees made in connection with Government procurement in international trade or to influence other official acts of foreign officials of commercial interest to foreign investors; and (3) international cooperation by exchange of information and judicial assistance in the enforcement of the above laws.

Progress towards agreement has been slow as the developing countries have not been ready to begin substantive negotiations. The developed countries appear open to an international agreement but have strong objections to adopting new national legislation such as the U.S. proposals for uniform disclosure laws. The next, and critical, meeting of the ECOSOC Working Group is scheduled for March 28-April 8. There may be one additional meeting before the Working Group makes its final report to ECOSOC this July but none is presently scheduled. At this point, it is unrealistic to expect to conclude a treaty in 1977, but we must begin sub-

stantive work at the March 28 meeting and make enough progress to persuade ECOSOC to continue the Working Group or to recommend convening a diplomatic conference.

There are clear linkages between our position on domestic legislation and our position on an international agreement, and the decisions on both are best made together. Accordingly, the options discussed below include both domestic legislation and an international agreement.

The Proxmire bill's Title I, which deals with illicit payments abroad, has two parts. First, it would require firms regulated by the SEC to establish improved accounting procedures and management controls, and would prohibit falsification of accounting records and false statements to auditors. Second -- and of much greater concern to the Department -- it would make it a criminal offense to use the mails or other instrumentalities of U.S. commerce to bribe a foreign official in order to obtain business or to influence legislation or regulations of the official's government. Title II of the bill would provide for notification of ownership of certain levels of equity shares registered with the SEC.

The Department should have no problem supporting the accounting rules in Title I. The options discussed

below relate to the more difficult problem of criminalization or disclosure of foreign payments.

Options:

1. Concentrate on international action and vigorous enforcement of existing legislation and regulatory programs. Support the SEC proposals included in the Proxmire bill requiring corporate management controls and prohibiting false statements to auditors. Oppose criminalization at this time.

Pros

-- No new legislation is necessary at this time since vigorous SEC and IRS enforcement programs under existing law and the new tax legislation, and the reporting requirements of the Arms Export Control Act, have had a significant deterrent effect.

-- The proposed new SEC regulations, if adopted, will further deter questionable foreign payments by U.S. firms.

-- The U.S. could continue to seek international agreement on broader disclosure while preserving flexibility to negotiate a compromise which might fall short of public disclosure or criminalization by home countries.

-- Would minimize damage to U.S. trade and foreign relations which might result from further unilateral measures.

Cons

-- Further steps are urgently needed to restore public confidence in U.S. business and other institutions.

-- Prospects for an early conclusion of an effective international agreement are uncertain.

-- Such a position would meet with strong opposition in Congress.

-- The Carter Administration could be accused of being weaker than the Ford Administration on this issue.

2. Support the Proxmire bill as modified to clarify and narrow the criminal provisions. The U.S. would add home country criminalization to its present proposals for an international agreement on illicit payments.

Pros

-- Represents a direct and forceful statement by the Administration on corporate corruption.

-- Would satisfy Proxmire and many -- but not all -- proponents of unilateral action.

-- Would satisfy LDC demands for the home countries to take action against MNCs.

-- Would avoid the administrative burdens of disclosure for business and government.

-- Would avoid competitive disadvantages of unilateral disclosure of agents' fees.

-- Mutual assistance would enhance the enforceability of criminal legislation.

Cons

-- Would be more difficult than disclosure to enforce.

-- U.S. criminal investigation of bribery of foreign officials could lead to serious diplomatic problems.

-- Criminalization is strongly opposed by influential bar and business groups.

-- Internationally, developed countries would be opposed to such a move (although it is not clear whether their opposition would be any greater than exists toward disclosure).

-- Would require a fundamental shift in our ECOSOC negotiation strategy.

Possible variation on Option 2:

2. The U.S. might adopt a criminal approach but make it effective only with respect to countries with which it has entered into an agreement on mutual enforcement assistance and/or home country criminalization.

Pros

-- This would ensure that the law is applicable only where it can be enforced and where diplomatic problems will be minimized.

Cons

-- The concept of contingent criminal jurisdiction is novel, could be difficult to sell to Congress, and may be seen as inappropriate.

3. Legislation requiring disclosure of certain foreign payments.

Pros

-- Disclosure is a more effective deterrent than criminalization.

-- Easier to enforce by criminal penalties since it would not be necessary to prove the purpose of a payment which is not reported.

-- Would extend SEC-type disclosure to firms not regulated by the SEC, and would establish disclosure requirements which are more specific than those of the SEC.

-- Appears to be more acceptable than criminalization to large segments of the business and legal communities.

-- If we could reach international agreement on this approach, it would afford the greatest protection for U.S. interests since it would be easier to monitor performance of treaty obligations to compel disclosure than to verify enforcement of criminal laws.

Cons

-- Found little support in Congress last year.

-- Both developed countries and LDCs oppose the public disclosure approach we have pressed internationally.

-- Would represent a major reporting burden and could not be administered without a major bureaucratic structure.

-- Makes more difficult any fallback from the public disclosure position we have taken internationally in order to obtain an agreement.