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# The Organization of Anticorruption – Getting Incentives Right!

Johann Graf Lambsdorff

**Abstract**

Governments and private firms try to contain corruption among their staff mostly in a top-down, rules-based approach. They limit discretion, increase monitoring or impose harsher penalties. Principles-based, bottom-up approaches to anticorruption, instead, emphasize the importance of value systems and employee's intrinsic motivation. This embraces the invigorating of social control systems, encouraging whistle-blowing, coding of good practice and alerting to red flags. This paper investigates how some top-down measures run counter to bottom-up contributions. Examples range from penalties imposed with zero-tolerance, debarment or the nullity of contracts. While top-down elements are indispensable for containing corruption they must be designed well in order to avoid discouraging the bottom-up endeavors.

*JEL Classification:* D73, K42

*Keywords:* Corruption, whistle-blowing, contract penalties, debarment, nullity

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## 1 Introduction

Corruption confronts both governments and private firms with similar problems. Contracts are awarded to the wrong bidders, to those paying bribes rather than delivering quality. Public policies as well as corporate strategies are distorted by side payments and resources are embezzled for private use. This paper investigates how to organize anticorruption. Due to the aforementioned similarities, most of the ideas developed here are equally applicable to public and private organizations.

Anticorruption can either relate to rules or to principles and it can be done either top-down or bottom-up, (Lange 2008). A rules-based, top-down variant is currently given emphasis by law enforcement and regulators. This paper seeks to highlight some of the shortcomings of such an approach. It argues that that many in society, in government, commerce and civil society, can contribute to bottom-up endeavors. Their support is utterly needed for successful anticorruption. We need methods to ameliorate top-down and bottom-up, systems that embrace clear rules but do not dampen principles. This paper provides some specific advice on how to avoid the discouraging effect of selected top-down measures.

The paper starts by reviewing a variety of widely discussed approaches to anticorruption, noting whether they are more rules-based or more principles-based and whether they are rather top-down or bottom-up (sections 2 and 3). This review allows putting the subsequent findings into perspective. Sections 4 and 5 emphasize the need for bottom-up methods to complement top-down approaches. They introduce into the concept of the invisible foot and how it can help in containing corruption. Section 6 seeks to reconcile top-down and bottom-up and provides practical guidance to some specific reform proposals.

## 2 Rules-based approaches to anticorruption

Many methods for anticorruption refer to rules. These rules have two dimensions. The first one is **repression**: draconic penalties and higher probabilities of detecting malfeasance. Since the seminal work of Becker (1968) it is standard to see criminal behavior as being driven by rational calculus. A fully rational, risk-neutral actor opts for criminal behavior if the expected benefit exceeds the sanction multiplied by the probability of being convicted. Even if rationality is imperfect, this calculus promises to capture a good deal of the incentives faced by human beings. This argument is further supported by the fact that bribery, fraud and embezzlement are less emotional types of misconduct. They are usually not carried out in the heat of a moment. Rather, they require sophistication, skills and long-term planning. This puts sufficient emphasis on the sober balancing of pros and cons. The 2003 United Nations Convention Against Corruption requests all signatory countries to implement criminal codes for countering corruption. Currently, this approach is the most important rules-based approach to increase repression.

Repression appears to be an indispensable element in the fight against corruption. But judiciaries perform quite differently across countries. Data on prosecutions and court convictions related to fraud, bribery and embezzlement reveal that they are common in countries such as Canada, Finland, Germany, and New Zealand, reaching up to 100 annual cases per 100,000 inhabitants. But in many less developed countries these figures are seriously lower; often less than one single case per 100,000 inhabitants is counted, (United

Nations Office on Drugs and Crime 2008). What might cause these huge discrepancies? First, law enforcement is costly and, second, requires an honest judiciary. Both these issues may be scarce in supply, particularly in the second group of countries mentioned above.

But increasing repression certainly has also detrimental effects. Threats of penalties and enhanced monitoring may adversely affect the intrinsic motivation of public and private employees. They may thus not complement civic engagement against corruption but substitute it. There is empirical evidence providing reason to cast doubt on approaches that focus on formal, rules-based, anticorruption endeavors. For example, Voigt, Feld and van Aaken (2008) investigate the impact of prosecutorial independence in containing corruption and find that de facto independence decreases corruption. However, de jure independence does not exert the same impact. A similar finding related to the strictness of campaign financing rules is reported by Stratmann (2003). Looking only at formal rules may thus easily mislead.

Table 1: Ordinary Least Squares Regressions
Perceived Corruption, Anticorruption Rules and their Implementation [a)]

| Dependent Variable | TI Corruption Perceptions Index 2007 | | WEF Perceived Effectiveness of Anticorruption, 2007 [b)] | |
|---|---|---|---|---|
| Independent Variable | 1. | 2. | 3. | 4. |
| Constant | 1.81 | 2.34 | 4.72 | 5.27 |
| | (2.2) | (3.2) | (4.3) | (4.7) |
| Anticorruption: Legal Framework [c)] | -0.042 | -0.018 | -0.033 | -0.026 |
| | (-3.1) | (-1.3) | (-2.0) | (-1.4) |
| Anticorruption: Practical Implementation [d)] | 0.098 | 0.032 | 0.030 | -0.001 |
| | (5.7) | (2.4) | (2.6) | (-0.1) |
| GDP per capita[e)] | | 0.12 | | 0.056 |
| | | (6.0) | | (3.6) |
| Obs. | 48 | 48 | 44 | 44 |
| $R^2$ | 0.55 | 0.82 | 0.14 | 0.33 |
| Jarque-Bera[f)] | 15.4 | 1.5 | 0.9 | 1.9 |

[a)] White corrected t-statistics are in parenthesis.
[b)] In the World Economic Forum's Executive Opinion Survey 2007 Businesspeople are asked "In your country, has the government put in place effective measures to successfully combat corruption and bribery?" The data range between 2.0 (for Argentina) and 5.9 (for Canada).
[c)] Data by Global Integrity 2007. The data range between 51 (for Lebanon) and 96 (for Romania).
[d)] Data by Global Integrity 2007. The data range between 30 (for Algeria) and 81 (for the USA).
[e)] Source of data: World Development Indicators. The data relates to 2005. It is purchasing power adjusted in current international 1000 $.
[f)] The Jarque-Bera measures whether the residuals are normally distributed by considering its skewness and kurtosis. The assumption of a normal distribution can be clearly rejected for levels above 6

Global Integrity (2007) produces a dataset that assesses various key issues on governance and anticorruption. These data reveal in how far rules, in their context called "legal framework", are effective in reducing corruption. They investigate issues such as elections, civil society and the media, accountability, administration, oversight and the rule of law (for example, whether there exists an anticorruption agency). Table 1 reveals how the "legal framework" and its "practical implementation" relating to these issues impact on perceived levels of corruption in a cross-country investigation. It is interesting to see that the data on

practical implementation correlate with the TI Corruption Perceptions Index (even when controlling for GDP per capita), but not those on the legal framework, where the wrong sign is obtained. In the 2007 Global Competitiveness Survey of the World Economic Forum (WEF) businesspeople are asked about the effectiveness of anticorruption measures. Again it is only Global Integrity's data on practical implementation that correlates with this assessment by WEF (although this impact does not survive the inclusion of GDP per capita as a control variable). A good performance with respect to the "legal framework", instead, even decreases businesspeople's rating of successful anticorruption. Rules-based approaches to anticorruption are important, but they neither improve a country's rating in the TI Corruption Perceptions Index nor do businesspeople perceive them to be effective. This, certainly, does not mean that rules-based approaches are futile. It may indicate that they are sometimes badly communicated to the business community or insufficient to be approved by businesspeople. Certainly, it may also imply that more time is needed to see an impact on perceived levels of corruption.[1]

A second dimension of rules for anticorruption relates to **limits on discretion**. Corruption is seen to take place where office holders and corporate employees have leeway in carrying out their tasks and can base their decision on monetary inducements instead of the pertinent factors. Suggestions on how to limit discretion relate to staff rotation, separation of functions, standardization of rules and procedures, internal and external audits as well as the four-eyes principle.

Some similar caveats exist for the second goal of anticorruption rules, the limits on discretion. Quite often, bureaucratic rules aimed at reducing discretion tend to produce frictional costs and run counter to other goals of public administration. Kelman (2003; 1990) argues that anticorruption rules imposed by the legislator aim at limiting discretion of procurement officers but in essence produce bad outcomes. Such rules aim at improving competition and anticorruption but divert officers away from the actual goals of acquiring best-value products and services for the government. For example, procurement guidelines often discourage the use of experience related to the past performance of contractors. Fears that performance evaluations might be biased or driven by bribes are responsible for such rules. The top-down distrust towards procurement officers comes at a high cost because contractors have limited interest in good performance. Another problem arises if contracts should generally be awarded to the lowest-cost bidder. Procurement officers' tasks are limited to checking whether official specifications are fulfilled. Anything below this official level (experience, reputation, maybe even red flags for misbehavior) would have to be disregarded. When contractors detect loopholes in the tender documents more details will be added to these specifications in subsequent tenders. This marks the starting point of a process where an increasing burden of specifications acts as a deterrent to bidders and suffocates competition. Anechiarico and Jacobs (1996: 123-138) argue in a similar fashion and report evidence on procurement in New York City.

Rose-Ackermann (1999: 60-63) criticizes Kelman's proposal for reform, fearing that risks of corruption and collusion are downplayed. The dismal experience with some procurement guidelines should serve to adjust them, but not to end anticorruption *in toto*. It should thus be investigated whether alternative approaches to anticorruption would prove more successful. For example, a less rules-based and less top-down approach to anticorruption may face fewer objections.

[1] In this respect it must be pointed out that lagged variables in the regressions may have better captured the underlying logic. Unfortunately, these are unavailble.

## 3 Principles-based approaches to anticorruption

Some authors have argued that instead of focusing on rules the fight against corruption should relate more to principles. Key to getting principles right is an understanding of the goals that individuals within an organization strive for. These might be influenced by **prevention**, embracing the control of incentives and the fostering of values within an organization.

There is a huge body of economic literature that reveals how corruption may result from adverse incentives, (Rose-Ackermann 1999: 9-17; Lambsdorff 2007: 2-12; 59-61). Price or quantity restrictions may produce artificial shortages where bribery serves as a market clearing device. Import quotas, for example, produce an excess supply of export goods and the limited import licenses may be handed out in exchange for a bribe.

There is consensus that anticorruption should identify such dismal rules and tend to avoid them, where possible. But apart from such prescriptions it appears difficult to use **incentives** for inducing integrity. Paying a bonus for honesty is impossible to implement. Incentives might be given in relation to effort and measurable economic surplus. There is not yardstick that might serve as a remuneration for honesty. Secondly, incentive schemes imply a variation of employee's income, lowering the security equivalent of their pay and crowding out the risk-averse (and potentially less corrupt) from obtaining the respective position. The consequence is that incentive schemes for inducing integrity fall short of economists' prescriptions. Incentive theory, at best, helps us detect the variety of inconsistencies and disincentives. Incentives will hardly ever be sufficient to outbid the briber, as is sometimes suggested by formal principal-agent modeling. Realistically, incentive schemes may highlight and acknowledge individual integrity but fall short of producing high-powered rewards....

One approach for getting incentives right is by focusing on group behavior and, rather than by focusing on narrow payoffs, trying to get values right. For example, Paine (1994) and Kapstein and Wempe (1998: 859), argue that integrity is more than following rules. Integrity should aim at establishing a **value system** that provides guidance even where rules are lacking. They propose training methods, aimed at coding desired behavior. Such trainings will certainly be an important issue for the years to come. They can help in communicating more clearly the conflicts of interest unique to specific sectors and countries. Furthermore, ethical training can help in developing an atmosphere of transparency and stewardship among a firm's and a bureaucracy's employees.

Rules and principles are both needed in anticorruption. Good principles need the rules to become embedded and to serve as a benchmark for behavior. But rules without principles may backfire badly. The clearer such rules the clearer are employees advised on how to circumvent them. For example, bribing a public official is illegal, but the US Foreign Corrupt Practices Act (FCPA) allows favors to be given to well connected private businesspeople, so called "gift-partnerships", or to engage (bribe-paying) intervening purchasers in public procurement, (Moran 2006; 2008; Lambsdorff 2007: 145-7; 167). Lacking knowledge on what local agents do with their consultancy fees and commissions may qualify as an excuse when it is detected that these acted as corrupt intermediaries. Such an effect of rules may be avoided if also the underlying principles are communicated.

EIRIS (2005) carried out an investigation into the performance of almost 2000 companies, rating whether a company has a code of conduct, whether this prohibits bribery, gifts, facilitation payments and political donations, whether whistleblowing systems, ethical

training and compliance structures exist and how well companies communicate these issues. It is important to observe that small and medium sized companies scored considerably worse as compared to large companies.[2] While company specific details were not reported, I dare to claim that multinational firms known for their corrupt record obtain favorable scores. Laufer (2006: 100) makes a related point with respect to Enron, a firm that was highly esteemed for its ethics management prior to its collapse.

Such measurements relate to simple rules. Measuring a value system cannot be done in a checkbox manner. Even where values are absent companies may camouflage this with a superficially functioning compliance system. Such compliance systems can be purchased from consultants and serve to reject responsibility if something goes wrong, (Arlen 1994). Compliance systems can help conducting business free of regulatory scrutiny and corporate liability, (Laufer 2006: 101).

Such rules are a substitute rather than a complement to values. They help to camouflage but not to change. They provide guidance on how to abide by formal rules on anticorruption, but they leave incentives unchanged. Such incentives imply that the rules will be circumvented. For example, while the UK has signed the OECD convention against the bribery of foreign officials it nevertheless stopped the investigation of the Serious Fraud Office into payments of bribes to Saudi Arabian officials, contrary to the convention's principles (Williams 2008).

This shortcoming is not only a problem for anticorruption rules. Also preventive measures sometimes do not aim at advancing a value system but to camouflage an organization's true interests, (Laufer 2006). Private firms, for instance, might be in a prisoner's dilemma, paying lip service to anti-corruption, but at the same time profiting from a corrupt contract. Ethical training would be given to those supposed to stay clean, while the dirty work would be outsourced. In the end ethical training may simply provide firms with official excuses when their employees are caught, resulting for instance in exemption from corporate liability. Ethical training of bureaucrats is likely to face similar limitations.

High penalties and stiff rules (for example on the taking of gifts and expenses for dining) may provoke employees to seek for loopholes rather than follow the spirit of the new rules. Engagement of intermediaries or joint-venture agreements may allow for abiding by new rules while continuing with the payment of bribes. New rules are complied with only at face value because the new rules are taken as a signal to keep some records off the books. While others do the dirty work, those who were the target of stiffer rules will claim ignorance about bribe payments. For example, in a survey of businesspeople Control Risks Group (2006) reports that 32% of US companies believe that their competitors regularly circumvent anticorruption legislation by engaging intermediaries – a higher number than in all other countries included in the survey (Germany, UK, Netherlands, France, Brazil). Is this a reaction to stiffer corporate anticorruption legislation in the USA?

This downside effect does not only relate to individuals but also to group behavior and collective reputation. Groups establish networks of cooperation, which bring about more intricate ways to react to rules. They may react either by subordination or by collective resistance. Higher penalties, increased monitoring or stiffer limits on discretion require legitimacy in order to be accepted and supported by these networks. Such support is desperately needed, because hints by insiders close to an illegal deal are crucial for starting

[2] This is also noted by Erikson (2003) who argues that small and medium sized companies cannot afford the costs of compliance systems. But in such companies the tone at the top is key to the corporate value system. A clear commitment to anticorruption by the leadership can more easily be implemented.

with an investigation. These hints require a corporate culture of anticorruption, an atmosphere where individuals are supported by their colleagues when cooperating with investigators.[3]

In 2007 PricewaterhouseCoopers carried out a Global Economic Crime Survey based on telephone interviews with 5428 CEOs, CFOs and other leading managers. Respondents were asked about the initial means of detecting fraud. Quite striking is the importance of internal and external tip-offs.[4] This reveals the importance of a corporate culture, a bottom-up contribution, in containing corruption.

Table 2: Initial hints on detection of fraud, percent of cases
Source: PricewaterhouseCoopers (2007),
own composition of data from Country Supplements

| | Corporate Culture | | | Corporate Control |
|---|---|---|---|---|
| | *Whistle-blowing system* | *Internal tip-off* | *External tip-off* | *Internal audit* |
| *Russia* | 5 | 8 | 8 | 20 |
| *UK* | 3 | 14 | 9 | 19 |
| *US* | 20 | | 13 | 21 |
| *Denmark* | 7 | 26 | 7 | 19 |
| *Singapore* | 8 | 21 | 14 | 19 |
| *Czech Rep.* | 16 | 18 | 7 | 18 |
| *South Africa* | 16 | 22 | 11 | 20 |
| *Norway* | 9 | 18 | 12 | 15 |
| *Thailand* | | 15 | 19 | 12 |
| *Turkey* | 5 | 21 | 21 | 16 |
| *France* | 8 | 36 | 7 | 14 |
| *Germany* | | 38 | 26 | 14 |
| *Slovenia* | 30 | 15 | 11 | 11 |
| *Switzerland* | 4 | 26 | 30 | 9 |

It is striking to see that in the USA (alongside with the UK and Russia) initial detection comes seldom from tip-offs (see Table 2).[5] A more participatory system where employees openly contribute to anticorruption by help of tip-offs seems to be operating (at least when looking at relative numbers) in Switzerland, Germany and France. This is also emphasized by B. Palazzo (2007), who argues that business ethics is more rules based in the USA, while it is more "community oriented", less universalistic but rather relational in Europe. The relationships between workers and managers are more trusting and informal mechanisms of social control are given higher emphasis. This may contribute to the higher willingness to

[3] Dixit (2004: 82) and Easterly (2008: 96) elaborate on this issue more generally. They argue that top-down and rules-based systems may destroy bottom-up informal systems. This effect arises because malfeasance in the latter system is less harmful to the perpetrators as they can easily shift their activities to the rules-based system. The incentive to guard ones reputation is thus reduced. A similar argument can be made with respect to anticorruption. Networks that aim at containing corruption can be weakened by top-down rules because individual members experience less need to establish a reputation as being committed to anticorruption.

[4] Anecdotal evidence assigns even higher importance to such tip-offs. Tip-offs are provided for one case and internal audits detect other related cases, for example, with the same actors or similar loopholes. It is also likely that internal auditors paint a picture that is too flattering about themselves and thus boost their reputation within the company.

[5] The Sarbanes-Oxley Act in the USA explicitly requires the organizing of corporate whistleblowing systems. One would have thus expected a higher relevance for whistleblowing in the USA. This seems to be more than outbalanced by the other issues mentioned here.

openly complain about malfeasance of superiors and thus to more tip-offs in Continental Europe. In the USA the most important method for detection is internal audit, contributing 21% of all detections. This is the highest figure for all countries surveyed, suggesting a rather top-down, rules based-approach to corporate anticorruption in the US.

## 4 Limiting the leaders

Rules or prevention require an honest leadership to successfully contain corruption among employees and bureaucrats. But it is more difficult to foster integrity among the leadership itself. Governments (as well as company boards) must limit self-seeking among their own ranks. Strong competition for leadership roles, be it general elections for public offices or tournaments for economic leadership positions, is commonly seen to be insufficient to prevent malfeasance. Press freedom and a high level of **transparency** contribute to holding senior office holders accountable.[6] This provides a clear motivation for bottom-up approaches to anticorruption. NGOs and citizen watchdogs have started to request more information on government operations, claiming their right to access to information. They put social pressure on perpetrators, complain about malfeasance of administrators and politicians, voice their concern with respect to political priorities and blow the whistle on criminals. Grassroots initiatives by civil society are a core contribution to anticorruption. For many multilateral institutions this shift towards civil society has dramatically changed their daily operating procedures.[7] Building coalitions that surpass the classical boundaries of government has become essential in fighting corruption.

The importance of bottom-up approaches is also documented at the cross-country level. Press freedom is clearly a bottom-up approach to improve accountability of the public sector and ultimately to reduce corruption. There is substantial evidence that countries with high levels of press freedom have lower levels of perceived corruption, (Lambsdorff 2007:46-47). These correlations are robust to controlling for standard influential variables, for example income per head. While the causality is trickier to ascertain a good deal of the causality is likely to run from press freedom to lower levels of corruption. Press freedom is a core bottom-up ingredient to lowering corruption.

Bottom-up approaches can less be controlled by superiors. At times, they may even be in conflict with anticorruption strategies chosen by business and political leaders: Revelations of misconduct may come at the wrong time, they are not balanced with the other overall goals of an organization, they may even endanger the leadership itself. But precisely due to this, bottom-up approaches can credibly commit a whole organization towards anticorruption. Attempts to fully control anticorruption are similar to an autocratic regime

[6] There are, however, also some problems with increased transparency. One concern is that transparency may support the monitoring of corrupt reciprocity, (Pechlivanos 2004). Bribers may prefer a transparent environment if this allows them to avoid opportunism among public servants. Likewise, non-transparent bureaucracies may at times prevent corruption, because bribers would have a hard time 1) finding the right person to bribe and 2) observing whether the bribee reciprocates honestly. In a similar spirit it is standard practice that public procurement requires some limits on transparency: Bidders are not supposed to know the incoming bids of their competitors. Some secrecy must prevail until all bids are jointly opened. The reason is that bid-rigging would be facilitated if transparency is introduced at the wrong stage. The principle of transparency, therefore, will undergo a more fine-tuned interpretation. Instead of advocating unlimited disclosure of all information, comprehensive information management systems that provide key data to stakeholders would have to be put in place. Their design will remain an important issue for the years to come.

[7] For a recent debate about World Bank policy in joining top-down and bottom-up initiatives see http://info.worldbank.org/etools/BSPAN/PresentationView.asp?PID=1685&EID=808 .

that attempts to improve its international reputation by controlling the media, an approach that cannot claim widespread approval.

Still, there are various problems and unanswered questions about such bottom-up initiatives.. Civil society relates to voluntary organizations and institutions outside government and commerce who contribute to the functioning of society. Its representatives are sometimes attributed the legitimacy of speaking for the interests of population at large, which is certainly a highly disputable development, (Møller 2002). Some feel that we are short of altruistic actors who may deserve such legitimacy outside elected government positions. Approaches by civil society towards anticorruption are also open to abuse. In this regard it is interesting to note that bankers and government officials are sometimes more honest than NGO employees, at least as reported by a baker in New York who kept record on how much money was returned for the bagels and donuts he left at business offices, (Levitt 2006).

Thus, there are some unresolved issues relating to the proper role of NGOs and civil society in politics. It is less disputed that bottom-up initiatives on anticorruption need a critical mass of supporters in society. Successful bottom-up initiatives must therefore embrace more than just a few altruistic actors in civil society. Is it possible to recruit them?

## 5 Bottom-up desire for anticorruption

There are many reasons to abstain from corruption apart from the extrinsic motivations commonly considered. For example, Fisman and Miguel (2006) show that diplomats from countries with high perceived levels of corruption did not pay their parking tickets in New York. To the contrary, diplomats from countries such as Canada, Denmark, Finland, Japan, New Zealand, Norway, Sweden, Switzerland and UK revealed no unpaid parking violations although there was essentially zero legal enforcement. Containing corruption, it seems, is not only related to explicit top-down measures.

“Homo homini lupus”, (man is a wolf to man) was Thomas Hobbes’ argument for a strong state. In a top-down fashion it should overcome the downside effects of individual maximizing, including corruption. A philosophy of bottom-up, to the contrary, asks why individuals may deliberately start to engage in anticorruption. Moral sentiment must obtain its role but it is likely to represent a rather limited base for recruiting our anticorruption activists.

Individuals have many reasons to abstain from corruption. Threats of punishment from superiors and courts may not be the most important. Corrupt actors are perhaps even more influenced by other factors such as the expected opportunism of their counterparts, (Lambsdorff and Frank 2007). A briber is commonly given only the promise of future favors, but often they end up paying twice or never receiving what they were promised. This unreliability of corrupt counterparts may induce honesty and good governance even in the absence of good intentions. This effect is labeled the **invisible foot** in Lambsdorff (2007): The unreliability of corrupt counterparts induces honesty and good governance even in the absence of good intentions.

There are many further reasons why individuals prefer to commit to anticorruption. Those who are willing to take bribes are of limited value to their superiors and clients, (Lambsdorff 2007: 58-108). The government has no interest in auditors who cannot commit to abstain from falsifying their reports. Companies equally seek to guard their financial interests and would not employ auditors who are willing to take bribes from fraudsters rather than reporting corporate fraud. These auditors will ultimately be jobless. Investors avoid countries

whose government cannot commit to protecting firms and their property rights once these have sunk their costs. Such governments suffer from limited foreign direct investments. The government will not hire tax inspectors if these give in to temptations for extra income. Fearing to be fired, such tax inspectors will rather seek methods for guaranteeing their trustworthiness as a means to qualify for the desired profession.

These effects, maybe much more than moral considerations, are responsible for grassroots initiatives for fighting corruption. Various business networks have in the past been established with the goal of (peer-) monitoring their members, helping each of them to commit to anticorruption. Even for intermediaries, who are sometimes the facilitators in arranging corrupt deals, a network has been established that aims at signaling honest dealings of its members (http://www.traceinternational.org). In a similar spirit, Transparency International has implemented the idea of Integrity Pacts, where the procuring government department and all bidders agree on a monitoring system and tailor-made penalties to avoid bribery in public procurement.

Who represents bottom-up? We should depart from an altruistic ideal when answering this question. A commitment to honesty can be part of a maximizing strategy. Such strategies must be encouraged in order to broaden the base for anticorruption at the grassroots level. Bottom-up can embrace even those who are tempted to pay and accept bribes.

## 6 Conflicts between top-down and bottom-up

Conflicts of top-down and bottom-up are standard in managerial science. This conflict has also been well recognized for business ethics, (Kaptein 1998). But this topic has only little been explored for anticorruption. There is evidence from experimental investigations for labor markets, revealing that a good deal of behavior is due to intrinsic motivation, fairness and reciprocity, (Camerer 2003: 95-100). Employers may thus offer wage premiums so as to provide incentives for good performance even if this performance cannot be observed. Employers may disregard laborers who are willing to work for low wages. What is most interesting, employers may abstain from punishing shirking and prefer to blindly trust in the good performance of their laborers. This type of trust is often positively reciprocated by increased efforts among employees. To the contrary, increased monitoring often goes along with a certain level of distrust that crowds out the intrinsic motivation of employees and limits their willingness to commit themselves to integrity, (Lange 2008: 711; Palazzo 2007: 124).

Experimental evidence also reveals that intrinsic motivation may limit corruption. In one of the first investigations, Frank and Schulze (2000) focused on individual tendencies to engage in corruption in procurement. They find that a significant number of participants did not maximize payoffs. In a later contribution, Schulze and Frank (2003) extended their analysis and observe that threats of penalties crowd out this intrinsic motivation. That is, some intrinsically motivated participants that may have abstained from taking bribes were induced by the threats of penalties to follow a maximizing strategy, alongside with the taking of bribes.

There are other downside effects of top-down approaches. Penalties on the taking of bribes imposed without mercy deter bureaucrats from taking bribes but may disallow them from acting opportunistically afterwards, (Lambsdorff and Nell 2007; Lambsdorff and Frank 2007). For example, at a court in the city of Bochum, Germany, an employee of the road construction authority confessed to accepting bribes for contracts relating to marking roads.

Beginning in 1987, and lacking business experience, he passed on names of competing firms in a public tender. After this incident, he received an envelope filled with DM 2000 from the private firm who obtained the favor. “Suddenly I knew that I had begun to be at his mercy,” was the statement made in court. This reveals how a first small payment made him dependent on the briber and forced him to comply with the briber’s demands afterwards, (Lambsdorff 2007: 158). Quite often, the penalty imposed for a first small gift, taken by mistake, marks the starting point of a corrupt career rather than serving as a watershed against malfeasance.

We are short of a theory that reveals how to best balance top-down and bottom-up. There is currently also no model that links environmental constraints to the choice of an anticorruption philosophy. But we can ask ourselves whether a top-down approach can avoid some of the aforementioned repercussions by better integrating the bottom-up endeavors.

## 6.1 Leniency

Some anticorruption activists employ the term “zero tolerance” to signal their uncompromising attitude towards corrupt actors. This is a morally loaded term, and it can backfire badly. First, while leniency may partly reduce the deterrent effect of penalties, it is commonly assumed to lower enforcement costs and reduce future harm, (Shavell 2004: 523-524). Second, sometimes insiders are trapped by minor malfeasance and unable to report to prosecuting authorities who have committed to zero tolerance.[8] Nell (2007a) investigates the criminal codes of 56 countries and detects 26 countries with leniency provisions for “active bribery”, that is the payment of bribes, but only 3 with provisions for “passive bribery”, the taking of bribes. This is quite unfortunate, because public servants utterly need a method for turning themselves in to prosecutors with limited harm for themselves. Public servants should thus be given incentives to blow the whistle after having obtained a bribe.

Qualifications for being treated leniently can be quite divert and some approaches have been criticized recently. There is a tendency to sanction firms only if they failed in avoiding malfeasance of their employees. Firms would not be punished if they behaved properly as an organization and if corruption was related only to individual misconduct. Leniency would thus be exercised if proof of adequate compliance systems is provided. However, Laufer (2006: 99-129) argues that such a type of leniency reduces the repressive pressure of the legal code and subsequently corporations may reduce their incentives to effectively contain misconduct. Firms may be treated leniently if they can prove their compliance efforts even if these efforts were ineffective.

A related problem arises for leniency in exchange for accepting an outside monitor to impose internal reforms after being suspected of malfeasance. This approach is currently taken by the World Bank within its voluntary disclosure program and has gained prominence in the US Justice Department, (International Herald Tribune, April 9 2008: Leniency for Big Corporations in the U.S.). It is alleged to lower the deterrent effect of corporate liability while producing uncertain compliance outcomes. Proving compliance then produces an unusual game, because firms obtain the incentive to produce evidence on compliance rather than incentives to install effective compliance systems that enhance ethical behavior itself, (Krawiec 2005). This may explain the finding by Ernst & Young (2008) who report that US

[8] This type of “entrapment” is emphasized by Shavell (2004). A related argument is brought forward by advocates of „marginal deterrence“, (Shavell 2004: 518). The idea is to deter more harmful acts because its sanction exceeds that for a less harmful act. If penalties for accepting gifts are already large, bureaucrats feel less deterred to actually provide the promised favor in return.

senior executives consider allegations of bribery or corrupt business practices to be predominantly unpleasant because they increase costs of compliance.

This problem arises in particular because those who engage in the compliance service industry and the associated regulatory bodies tend to bias upward their capacity in actually reducing corruption. If the results from table 1 are also valid for corporate anticorruption, which is not an unreasonable assumption, the capacity of top-down rules in reducing corruption is lower than commonly estimated. Leniency would in this case be linked to the wrong action. The core conclusion is thus that leniency should not be given to firms merely based on the idea that these have good compliance systems. Such a type of leniency would be misleading because the effectiveness of compliance systems are difficult to evaluate by outsiders, they can be afforded only by large companies, and they mislead the firms to visible rather than effective anticorruption. Once recognizing this, other types of leniency provisions become superior in reducing corruption.

Lambsdorff and Nell (2007) model optimal penalties in bribery transactions and investigate the effect of leniency as an instrument for containing corruption.[9] They find that leniency in exchange for self-reporting can lower the incentives to become engaged in corruption if all of the following conditions are met: First, self-reporting must actually increase external investigators' knowledge, second, it must have the capacity to help in prosecuting others, and third, it should only be given to successful corrupt actors. These conditions ensure that corrupt partners have an incentive to cheat each other.

While leniency in exchange for self-reporting is a widely used concept, the three conditions mentioned above are hardly ever matched. The third condition in particular requires some explanation. Leniency in case of self-reporting should not be given to businesspeople who were cheated by public servants. Otherwise it could provide businesspeople with a credible threat to blow the whistle, which then forces the public servant to deliver on his or her promises. The corrupt agreement would be supported by this threat and bottom-up anticorruption endeavors would be countered, (Buccirossi and Spagnolo 2006). Thus, leniency should be granted only to those businesspeople who did obtain the requested corrupt service. Likewise, public servants who were cheated and not given a bribe should not qualify for leniency. Milder punishment should only be granted to public servants who were successful in obtaining a bribe. In a nutshell, one should give leniency in exchange for self-reporting, but not for unfinished bribe transactions.

Another concern with respect to leniency is whether a regulatory or prosecutorial body should have discretion in granting it. Overall, there should be some limits to discretion. First, judges' and prosecutors' commitments may not be credible. It is not uncommon that those cooperating with the authorities ultimately received a higher punishment than negotiated with the prosecutors. Promising leniency may then be regarded as cheap talk and remain ineffective. Second, the above mentioned recommendations might not be in line with prosecutors' gut feelings of fairness and deterrence. For example, if an entrepreneur reported after having obtained the contract, he would walk away rich but mildly punished. While a commitment to such a design of penalties would be desirable, prosecutors and judges may

[9] The argument has some relation to the one provided by Arlen (1994). She notes that corporations facing liability may lose the incentive to monitor their employees: They fear that knowledge of misconduct may serve as a reason for being held liable. Indeed, some corporations facing such adverse incentives may prefer ignorance. Arlen points out that these adverse effects can be overcome if information disclosed by a corporation cannot be used against it in criminal litigation. This is only a small incentive. Broader guarantees of lenient treatment in case of self-reporting may provide for even stronger incentives.

dislike enforcing it if they are endowed with sufficient discretion. Third, prosecutors and judges might themselves be susceptible to misusing their discretionary power. In the worst case they would grant leniency in exchange for favors, increasing corruption in the judicial system rather than helping to deter corruption. Thus, clear rules on leniency provision are superior to discretionary application. Some discretion along the lines of the three above mentioned conditions, still, are unavoidable. Prosecutorial authorities must be trusted to impartially check in how far self-reports have advanced prosecutors knowledge beyond existing investigations, to what extent these can be helpful in prosecuting others and whether corrupt transactions were completed.

Interestingly, some legal provisions are likely to stabilize corrupt transactions rather than to discourage them. Former Article 215 (2) of the Turkish Penal Code granted leniency only if the public official had not yet reciprocated on the bribe, (Tellenbach 1997: 642), contrary to the above mentioned recommendations. Remarkably, according to Article 215 (2), the bribe-giver was even entitled to reclaim the bribe in case of self-reporting. A culture of anticorruption that tries to increase the risks of bribery is seriously undermined by such legislation.

## 6.2 Debarment

It is broadly accepted that not individuals but whole companies should be punished for malfeasance so as to provide incentives for improving corporate culture. Where this is lacking, firms may pay lip service to anticorruption but unofficially inform their employees that getting contracts is all that counts. But it remains uncertain *how* companies should be punished. Debarment (and the shorter-term suspension) of companies is often recommended in this respect and applied in public as well as private procurement. After this system was implemented by the US Department of Defense in 1983 many other countries and private companies followed this precedent.

But there are many problems with this tool. If a criminal conviction in court is required, debarment is imposed after many years of legal dispute. It may then hit a totally altered company, operating under a different leadership and shareholder structure. The burden of proof is also rather high, suggesting that many cases would be decided in favor of the briber where reasonable doubts remained. This process can be speeded up only at the risk of losing a clear legal basis for debarment, implementing it potentially without waterproof evidence.

A second issue is whether procurement agencies have discretion in deciding whether or not to allow bids by debarred firms. If they do, more practical considerations can be recognized such as whether a supplier is indispensable, has contributed to uncovering a case of corruption or has implemented effective reforms after detection. But a discriminatory application of this tool can easily undermine its legitimacy. For example, Karpoff et al (1999) carry out statistical analysis of the stock market valuation of US defense procurement contractors that have been suspended between 1983 and 1995. After two days the stock market valuation on average dropped by 4.5 percent after the announcement of a suspension. But the effect is less pronounced for the government's most important contractors. Those ranked as important (from a list of 100 most important in all sectors) experience only a drop of 1.4 percent, whereas other companies suffer from a 14.1 percent decrease of their stock market valuation. This finding is most likely related to the higher influence exerted by the first group of companies. The authors conclude that influential contractors are the winners from these suspensions, because they pay small fines but fully profit from the better reputation of their industry. The authors even find that influential contractors did not experience a decrease in overall government contracts following a suspension. They report

anecdotal evidence that contracts were postponed until the end of the suspension period, that they obtained contracts as subcontractors, or that they profited from bureaucratic discretion.

There are further problems with debarment. The penalty that results from debarment often does not well correlate with the seriousness of the criminal act. A small grease payment may ruin a firm that depends on government contracts while a substantial kickback remains without consequence for a firm that did not intend to compete for future government contracts.

Overall, the impact of debarment on a corporate anticorruption culture remains uncertain. It may in fact even become negative because bottom-up efforts may be discouraged. The core problem is that companies that proactively report on the malfeasance of their staff are still threatened with debarment. This may keep them from handing over relevant cases to prosecutors and procurement agencies. They will instead threaten internal whistleblowers and try to suppress the relevant evidence. Firms should thus be given incentives to blow the whistle after having finalized a corrupt deal. Such incentives are difficult to implement in systems of debarment.

## 6.3 Nullity of corrupt contracts and those induced by corruption

Courts commonly do not enforce corrupt agreements. They follow the principle that those who operate outside the law cannot claim the law's protection. The nullity of the corrupt contract often entails a further legal consequence: bribes cannot be claimed back. This invokes a severe risk to bribe payers, evidenced in many cases of failed corrupt transactions, (Lambsdorff 2002). This legal judgment is important for anticorruption. It clearly helps to increase the risks among corrupt actors and thus well serves to reduce corruption. It should be further investigated to what extent courts worldwide adhere to this principle and civil laws are in line with it.

Some anticorruption activists go further with their request for nullity. Consider a contract for government construction that is induced by a bribe to a procurement official. Pope (2000) argues that governments should have the right to declare such contracts void. Similar provisions can now be found in various government procurement guidelines and those of private firms.

In practice such rights are unimportant as mostly the procurement authorities avoid the extra effort of starting upfront with a new tender and settling the complicated mutual claims if a contract was declared void. But there is also a dismal effect on bottom-up endeavors to anticorruption. Construction firms that detect bribes paid by their employees would be inhibited in cooperating with prosecutors and the government. Whistleblowers in these companies would risk their jobs and prefer to stay silent instead. Furthermore, only companies that were successful in bribing are sanctioned by this type of penalty. Retaliation becomes less costly, which is likely to stabilize a corrupt transaction.

Finally, there might even be cynical repercussions. If the government is uncertain about the profitability of a contract it may delegate negotiation to its most corrupt bureaucrats. The bribes taken by them would provide the government with the option to cancel a contract at a later stage. By threatening cancellation the government could even blackmail the companies. As before with debarment, only the influential firms could withstand this type of extortion and be the winners in such an ugly game. The government instead loses incentives to avoid the bribe-taking among its bureaucracy, (Nell and Schlüter 2008)..

Siemens currently undertakes immense efforts to comply with anticorruption standards. Interestingly, while many German firms fear to be hurt equally by uprising corruption scandals, none of them come out in the open. Such openness, however, may be necessary to rebuild a corporate culture. But the openness would backfire for many firms: Contracts that were obtained by help of bribery might be nullified, as it happened to Siemens.

## 6.4 Contract penalties

In addition to debarment and nullity some procurement guidelines entail provisions on contract penalties. These must be paid by the contractor if bribes are detected. There are various advantages to such a type of penalty, widely recognized in the literature, (Polinsky and Shavell 2008). First, the penalty merely shifts resources from one party to another but does not entail further social costs. Contrary to this, debarment produces disadvantages to the public by limiting competition and the nullity of contracts imposes costs for repeated and delayed contracting. This argument parallels the disadvantages of socially costly prison terms, widely discussed in the literature.

Second, the resolution of conflict would be done by civil courts (or arbitrators) with a less stringent burden of proof. The risk of a wrong judgment is thus more fairly shared among the contracting parties. To the contrary, criminal courts may fail in deterring acts where reasonable doubts of misconduct remain. Third, penalties once imposed can at a later stage be revoked without substantial disadvantages to the contractor. To the contrary, debarment and nullity produce sunk social costs that cannot be recovered if a wrong decision is reversed at a later stage. Penalties can thus be imposed quickly because reversal of such an initial decision comes at mild costs. Overall, contract penalties are thus an attractive option for public as well as private contracting.

Three pending questions remain. First, the basis for the size of penalties is sometimes linked to the contract value. For example, the procurement guidelines by the Deutsche Bahn AG (German Railways) entail penalties of 2%, 5% or 7% of the gross contract value, depending on the seniority of the briber in the contracting firm.[10] There tend to be general problems associated with such penalties. On the one hand, the gross contract value is a bad basis for determining the penalty. The temptation to pay a bribe is proportional to the net marginal profit that can be achieved from successful bribery. In some sectors such as retail and banking gross revenues are large and deterrence would be large. The opposite would be the case in services such as consultancy contracts where few costs are subtracted from gross revenues, producing large incentives to pay bribes. On the other hand, bribes differ with respect to their severity. A small gift to a secretary should not entail the same legal consequences as a large kickback to a senior official or manager. Thus, a better base for penalties would be the size of the bribe (or favor).[11] Given that bribes often tend to be rather

[10] The United States Sentencing Commission uses the value of a contract and the size of bribes as a basis for the size of penalties.

[11] Polinsky and Shavell (2008) emphasize the general principle that penalties should be equal to the social harm of an act divided by the probability of detection. This is motivated by the idea that individuals should carry out acts that violate criminal codes if their individual benefit exceeds the public harm. The public harm of corrupt acts is difficult to determine, however. What is the harm of a contract secured by help of a bribe if this contract would have gone to another bribe paying company otherwise? Also loss of reputation produces represents a harm that is uncertain to measure. In this perspective, relating penalties to the size of the bribe would be a feasible second-best alternative. Two further issues run in favor of this soilution: First, the size of bribes has the advantage of being better linked to the actual criminal misconduct, not its uncertain repercussions, which corrupt actors tend to bias downward. Second, the probability of detection can be increased where public harm is particularly high, making sure that bribery does not become a dominant strategy in areas that are particularly hurting for the public.

small in order to achieve sufficient deterrence 50 times the size of a bribe may be an acceptable contract penalty.[12]

Who should obtain the penalty? This is the second core issue that has led to dispute. If the penalties accrue to the procurement authority (and the government or firm behind it) there is an adverse incentive: the procurement authority would profit from its own organizational failure. A cynical repercussion would be that the firm allows its employees to take bribes so as to request the monetary penalty thereafter. A better solution would be to assign the penalty to a charity, maybe after costs for detection are subtracted. Another solution would be to assign rights to restitution to the unsuccessful bidders, which can be claimed from the collected monetary penalty. Rewards to whistleblowers may also be paid from these funds.

A third question is how to deal with companies that proactively report the bribery of their own staff. Leniency should be guaranteed in this case, maybe reducing the penalty to 10 times the bribe. This design reveals a clear advantage of contract penalties over different penalty schemes. The reduction in the penalty can be made transparent and announced upfront, assigning clearer legal rights to a firm that comes forward with evidence. To the contrary, debarment systems may also attempt to treat cooperating firms more leniently but risk a less transparent decision that may favor the influential firms.

Despite these advantages, in practice contract penalties are only seldom applied. I am unaware of the reasons for this failure. It may not provide advantages to influential firms, suggesting that there are political-economic reasons to its small practical relevance. Contract penalties are considered by Transparency International in its integrity pacts and clearly deserve more application and research.

## 6.5 Whistle-blowing systems and anticorruption culture

Whistle-blowing systems are a first step towards bottom-up. But they need more than just a hotline to turn in anonymous hints. More elaborated internet-based systems have been developed that allow prosecutors or compliance officers to interrogate while retaining the anonymity of whistleblowers. Another approach is by having ombudsmen outside the company that serve as a contact to discuss issues of corruption with whistleblowers while being legally bound to keep the identity of their informants confidential. This more personal approach may be better suited for some whistleblowers, but it may also be difficult to implement by a multinational company with employees scattered around the globe. In any case it clearly helps in communicating delicate hints to leaders in companies and public administration.

Stringent compliance rules are quite often helpful to whistleblowers, because they support them in detecting malfeasance and encourage them to report this. More delicate are the grey areas. What should whistleblowers do if rules are skillfully circumvented? How should superiors react to such a whistleblower? For example, a whistleblower may report that his or her firm's payments to private partners were passed on to public officials. Such hints by whistleblowers put companies in an uncomfortable position and may even induce criminal liability of the company's board. Some companies tend to hide behind their pro-forma compliance rules: their intermediaries have signed anticorruption codes, no hints exist that any payments have been passed on to public officials, thus there is no need to investigate the

[12] There exist cases where the size of bribes or favors cannot be determined. A procurement officer, for example, may fail in reporting a conflict of interest and award a contract to a close relative. A "market value" for a bribe should be guessed in this case, using evidence on bribery in related cases.

case further. A whistleblower tends to obtain little support for his actions: official rules just tell another story. Anticorruption should provide a forum for discussion to such employees rather than discouraging them by pointing to rigid rules. A true anticorruption culture requires a different approach. Increased due diligence would be required in this case and leaders should seek to clear their companies of all allegations. The cases thus reported should be collected and serve as a basis for revising the codes of conduct.

This does not seem to be common practice. Instead whistleblowers are often frustrated. Companies point to their compliance with official rules and request whistleblowers to drop their allegations. In some countries, such as Germany, even severe malpractice by companies does not allow whistleblowers to inform prosecutors. If they violate this requirement they can be fired without previous notice and face prosecution themselves. A culture of anticorruption requires the opposite. Whistleblowers deserve lenient treatment even if they provide information to third parties. They must be legally protected against harassment and be given the right to inform third parties in case of severe malpractice.

The bottom-up development of codes of conduct and their constant readjustment are needed for this purpose. But in reality we observe that codes of conduct are often written by external experts, imported from benchmark companies and simply distributed to firms' staff. This observation made by Kapstein and Wempe (1998: 857) is still valid today. Even when employees are requested to confirm and approve these codes of conduct this does not help in making them part of corporate or public culture. Kapstein's well known claim that "a code is nothing, coding is everything" deserves more recognition as a bottom-up method for developing a corporate culture of anticorruption. Ex-cathedra indoctrination on corporate ethics is likely to fail where the real dilemmas arise. Such a bottom-up culture can also be enhanced by training in the detection of red flags. Such training can sharpen employees' awareness in the grey areas where rules are still absent. Helpdesks should be available for those seeking immediate advice. Such helpdesks (either by telephone or via internet) allow employees to voice their questions, concerns or fears without making them known to peers, subordinates and superiors.

Compliance offices must become responsive to the views contributed from employees themselves. Without this bottom-up support, the rules invented by compliance offices will be futile or even counterproductive.

## 7 Policy implications and conclusion

Anticorruption can be effectively organized by exploiting the concept of the invisible foot, (Lambsdorff 2007). This concept embraces two issues. First, economic actors want to commit to anticorruption as a means to preserve their trustworthiness towards their superiors and clients. Such an intrinsic motivation must be recognized and encouraged. Second, corrupt actors must be seduced to betray each other so as to destabilize corrupt transactions.

In this light, a comprehensive anticorruption strategy must embrace both top-down and bottom-up elements. This paper analyzed their interaction. I showed that merciless penalties, debarment and the nullity of a contract induced by bribery fail in this regard. They are in conflict with bottom-up endeavors to contain corruption. Companies who want to stop their corrupt record find themselves trapped in a vicious circle, because the malfeasance of the past implies penalties without pardon, lost contracts and debarment from future contracts. This will induce them to rather continue with their illicit operations. In the public sector, likewise, public officials find themselves trapped after a minor error. Often the taking of gifts

qualifies for harsh penalties. After a minor error public officials are therefore at the mercy of the bribers, who can force them into a corrupt career.

Various methods can ameliorate bottom-up endeavours with top-down rules. For example, clear rules on leniency can well serve to encourage bottom-up actions against corruption. If leniency is given to public servants who obtained a bribe, self-reporting helps them to end their corrupt career. Leniency should also be offered to bribers in exchange for self-reporting. This will help to catch the big fish and render bribe-taking a risky business. Contract penalties in public and private contracting can also work well, in particular when joined with rewards given to whistleblowers and leniency in case of self-reporting.

Contrary to these recommendations, leniency is often given in exchange for documented anticorruption efforts. This is likely to fail because measuring and evaluating the success of anticorruption is extremely difficult and currently overestimated. Such provisions will favor the large and influential firms that can afford costly compliance programs but not the ones that can successfully establish a corporate culture of anticorruption.

Siemens lately imposed strict rules on gift-giving and dining, fixing the maximum allowances to levels that appear quite below business standards. Similar rules are often defended on the premise that one must safeguard against the initial temptations. But there are various problems to such a strategy. Due to such rules some employees are captured in a circle of corrupt complicity after an initial minor error. For them, the initial perpetration becomes the starting point of a corrupt career. They find it difficult to reject the truly corrupt demands when they observe that they have something to hide or might be blackmailed for their initial error. Others simply dislike the moral rigor and feel less inclined to contribute to the development of a corporate culture of anticorruption. Groups may (and already did in the case of Siemens) revolt against the excessively authoritarian tone and encourage disobedience. The overall measure might have done more harm than good.

Anticorruption is a deserving crusade where ethical considerations are often needed to provide guidance to key actors. But morality is an insufficient guide. Instead, we must get incentives right in order to increase the risks of corrupt behavior and the economic returns to integrity.

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