New Tools to Fight Corruption and the Need for Complementary Reform

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Corruption remains a serious problem for most developing countries, undermining state capacity and incentives to invest besides social cohesion and democratic institutions. It is also an increasingly important problem for many highly developed ones. In Italy, for example, corruption has increased in the last decades and the parliament is now finally struggling to pass a (rather mild)"anti-corruption law". Even in Sweden, a country constantly considered among the least corrupt ones in the world, the problem seems to be increasing according to a recent report by the Agency for Public Management (Statskontoret), which also suggests that the current legislation needs to be improved, for example by offering some form of protection to whistleblowers.

In most Central and Eastern European countries, however, the problem appears particularly serious. Corruption seems to have been rapidly increasing in the region this last decade (The Economist, April 11, 2011 ; Nations in Transit, editions 2001-2012), although there are some virtuous exceptions (for example Georgia and Estonia).

Corruption is often caused by, and at the same time, an instrument for political developments towards autocracy, such as those recently observed in some of these countries (limiting judicial autonomy, democratic participation and the free press). This suggests that in countries where these political developments are taking place we may expect a further worsening of the corruption problem in coming years.

A country that is apparently taking the fight against corruption seriously is India, where a strong grassroots anticorruption movement has developed. The issue has become central in recent political debates and several proposals have been put forward and debated in the parliament. Among these proposals is one by Kaushik Basu, the finance minister's Chief Economic Advisor. He suggests – for a specific class of bribes paid to obtain a service to which one is entitled for – to treat bribe paying as legal while doubling the sanctions against bribe taking (Basu 2011). The logic behind this proposal is to create stronger incentives for bribe-paying individuals to report it to law enforcers and expose corrupt civil servants: reporting should lead to the restitution of the bribe, besides the conviction of the bribe taker.

Since this proposal was made last year, there has been a lively debate both at the Indian as well as the international level. The debate has however been rather informal, and involved some (voluntary and involuntary) misunderstanding of the proposal (see Dufwenberg and Spagnolo 2011 for a short account of this debate). The proposal has been deemed as "radical" by the proponent, and has sometime been treated and dismissed as a theoretical curiosity. In fact, the proposal is similar to existing legal provisions against corruption that have been in place for quite some time in several countries. The proposal is also related to other legal provisions widely used around the world to fight related forms of illegal transactions, *in primis* leniency policies now used by most antitrust authorities to fight

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price-fixing cartels, but also accomplice-witness amnesty and protection program against mafia-like criminal organization (see Spagnolo 2008 for an overview).

We know from academic research on these related revelation schemes that they can be very powerful if appropriately designed and administered, but they may fail or even be counterproductive if they are poorly designed or run (see e.g. Spagnolo 2004, Buccirossi and Spagnolo 2006, Apesteguia et al. 2007, Miller 2009, Bigoni et al. 2009). The exact details how these subtle mechanisms are designed and then actually implemented are crucial to their success.

Asymmetric Sanctions, Leniency and Whistleblowers

As earlier mentioned, the main idea behind Basu's proposal for India, treating partners in corruption asymmetrically is not a theoretical curiosity. It is already present in milder form in the Russian, Japanese and German (violation-of-duty) legislation, where bribe payers face lower sanctions than bribe takers and in the way prosecutorial discretion is used in Anglo-Saxon countries. An analogous provision seems to have also been introduced in China in 1997, and its effectiveness has recently been questioned by some observers, although in a very superficial way. Unfortunately we have no serious evidence of how these legislations have affected corruption.

More generally, the idea of deterring a collaborative crime by shaping the incentives of criminal partners so that one of them has the incentive to betray the others and report information to law enforcers is well established. The Prisoner's Dilemma story, where each among the partners in crime are promised a light sentence in exchange for cooperation to convict the other criminal partners is familiar to most countries' standard law enforcement practice.

These schemes have been the main and most successful tool in the fight against mafia and political terrorism in Italy and other countries, and they are currently regarded as the most important and effective instrument in the hands of competition authorities in their fight against cartels (US Department of Justice, Spagnolo 2008, Acconcia et al. 2009).

Apart from law enforcement, analogous "divide and conquer" schemes have been widely used ever since the Roman Empire in war-related situations to break down enemies' coalitions. They are tools that many do not like on moral grounds, because they induce distrust and betrayal of partners, which some people see as bad even when the betrayed partnership is a criminal one and distrust prevents the criminal activity.

Still related but somewhat different are the whistleblower protection (from retaliation) and reward schemes aimed at inducing innocent witnesses to report a crime. Reward schemes for whistleblowers have been used in the US since the civil war to limit corruption in federal procurement and to fight government fraud (through the False Claim Act, sometimes called the Lincoln Law from the president that introduced it). They have more recently been introduced by the IRS against tax evasion and by the Dodd-Frank Act against financial fraud.

When witnesses are working in the same organization as the wrongdoers, or when the latter are powerful individuals (besides being prone to commit illegal acts, like violent retaliation), blowing the whistle typically generates very harsh consequences for the witness; ranging from various forms of harassment in the organization, to the loss of job, isolation and directly or indirectly induced death.[1] Legal action is typically slow and uncertain but immediate, certain, and very

[1] The sad recent stories of Sergei Magnitsky in Russia and of S.P. Mahantesh in India clarify that this risks are real.

costly, while whistleblower protection provisions are typically imperfect (if present). This is why, even with a relatively efficient legal enforcement system like the American, large rewards are seen as necessary and justified to induce more whistleblowing and compensation for its consequences.

Trust, Distrust and Corruption

In some sense, one can see Basu's proposal of legalizing bribe paying for services one is entitled to (while doubling sanctions for bribe taking) as transforming potential accomplice-witnesses into potential innocent whistleblowers. The question is then whether this scheme will induce more people to blow the whistle and consequently fewer bureaucrats to demand/accept bribes. Some observers have suggested that this provision might instead induce more people to pay bribes because it makes it legal and thereby may erode moral norms against bribe paying.

In Dufwenberg and Spagnolo (2011), we argued that amending Basu's proposal in a way resembling leniency programs used in antitrust, where immunity is awarded only if the wrongdoing is reported to the law enforcement agency, is one way to avoid sending the signal that bribe paying is now legal. The real problem for these schemes is therefore whether at the end they will really induce bribe payers to report.

The way these revelation mechanisms deter corruption is by generating "distrust" among potential partners in crime (Bigoni et al. 2012). By making it very attractive to report to law enforcers for one party and very costly to be reported for the others, these schemes may deter illegal cooperation by ensuring that the parties cannot trust each other.

However, for these schemes to generate distrust and produce their potentially strong deterrence effects, the risk that accomplice-witnesses and other potential whistleblowers report must be a real one. For this to be the case, whistleblowers must trust the law enforcement agency to which they report. The example of leniency policies in antitrust is illuminating. In the US, as long as competition authorities retained discretion, colluding firms rarely applied for reporting under the leniency program. It was only when the Department of Justice gave up discretion by making immunity "automatic" – subject to an explicit set of conditions being satisfied – and committed to this policy through published rules that firms started to again to report information on cartels.

Besides a high risk of being reported, for these schemes to elicit reports and produce deterrence it is also necessary that sanctions for convicted parties are sufficient. To continue the parallel with antitrust enforcement, even after the authorities gave up discretion on the programs, they are not inducing cartel members to report in other countries than the US.

Indeed, the most serious problem for the success of the Basu proposal, as well as for that of the leniency-based modification put forward in Dufwenberg and Spagnolo (2011), remains whether witnesses/bribe payers will trust the law enforcement agency to which they should report the crime. If the law enforcement agency is inefficient or also corrupt, reporting may lead to further harassment or worse, rather than protection and justice.

When protection programs are poorly administered and law enforcement agencies inefficient or corrupt, so that potential witnesses don't trust law enforcement agencies, it becomes very difficult to induce whistleblowers to report, as well as dangerous for the whistleblower.

A second important reason why these schemes may fail to generate reports and to produce the intended deterrence effects is, as we mentioned, the low sanctions against bribe takers. Recent experimental results (in Bigoni et al. 2012) suggest that reporting incentives

provided by leniency programs are only effective in deterring collusion if the sanctions for the convicted partners are sufficiently strong. If not, these schemes may have no effects or even perverse ones (they reduce the sum of expected sanctions, and because of their complexity, they could be manipulated; see e.g. Buccirossi and Spagnolo 2006). Basu did suggest doubling the sanctions for the bribe payers. This, however, may or may not be enough for the case at hand, and would require a more thorough evaluation.

Note than in the case of corruption, there is an additional reason for sanctions to be reinforced, in particular by the requirement to always remove from office the convicted bribe taker. The reason is that if the bribe taker is not removed from office after the report, bribe payers may fear that after whistleblowing the bribe taker may retaliate in future interactions.

Conclusions

Asymmetric sanctions as proposed by Basu (2011) and leniency conditional on reporting as proposed by Dufwenberg and Spagnolo (2011) have the potential to deter corruption in a systematic way. Necessary conditions for this to happen, however, are that:

a) Sanctions are sufficiently robust to ensure that the increased risk of being convicted because of a report by a whistleblower dominate on the lenient treatment offered to induce reports;

b) Potential whistleblowers trust that the law enforcement institutions will act on the report and protect them from retaliation by the corrupt and their friends, rather than harass them.

Countries with sufficiently independent and efficient law enforcement institutions should definitely consider introducing or reinforcing their revelation schemes, asymmetric treatment or leniency conditional on reporting, to counter the current widespread increase in corruption.

Simply introducing these schemes in countries with weaker institutions, in particular with a low level of independence of law enforcement agencies, may do more harm than good: after all they imply reduced sanctions and their complexity makes them easily manipulated.

These schemes can be very useful for these countries, but only if they are introduced as part of a broader set of complementary reforms that include increased judicial independence and the creation of a specialized law enforcement unit with particularly high levels of accountability and independence, able to credibly offer to whistleblowers at least confidentiality and protection from retaliation, if not monetary rewards.

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