Understanding the Private Side of Corruption: New Kinds of Transparency, New Roles for Donors

Do we know enough about corruption in the private sector? This Brief discusses gaps in our knowledge and how donors can help tackle the problem. The goal is to improve both the dialogue and outcomes of anti-corruption efforts, by facilitating a new kind of transparency.

I. Probing the Private Side of Corruption

Nearly all cases of corruption involve private-sector participants. Bribery and extortion are the classic examples: a restaurant owner might offer money to a health inspector to avoid fines, while the inspector might cite imaginary violations unless the owner pays up. But other variations abound (Johnston, 2005): Shanghai businessmen, tax and customs officials, and police conspired to steal export taxes paid on empty shipping containers, the contents of which they had already sold on domestic markets. In many democracies politicians trade access to officials for contributions or outright bribes. Public officials may become silent partners in businesses or bogus “privatizations”, or do business using government facilities and information.

By now we have learned a great deal about the public-sector sources of corruption, and about ways to enhance public accountability and efficiency. The private side of corruption, however, is less well understood. Evidence is scarce and closely-guarded: even clear victims may not report corrupt demands. Risks and incentives, particularly over the long term, are poorly understood. Collective action problems

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are severe: many businesspeople and citizens, accustomed to thinking of
reform mostly as a public good, will let others assume the risks and burdens
of fighting corruption, knowing they stand to benefit from any eventual
successes. Why do some firms or individuals pay up while others do not?
What leverage over corrupt officials might private interests hold, and how
can their positions be strengthened?

A World Bank conference in June, 2007,1 probed such questions, reaching agreement that extending
our knowledge base is a must. This
Brief explores that issue further, suggesting that extensive knowledge
can be obtained relatively easily, and
that incentives can be rebalanced through new forms of transparency
such that self-interest becomes a force
for reform. International donors are
central to those scenarios, but not just
as sources of funding. Rather, there
are new roles donors can play – as
guarantors for new partnerships, and
as backers of “integrity trusts” – that
can make more effective use of scarce
aid resources.

II. Gaps in Our Knowledge

If corruption consisted only of bribery
and extortion, its private side would be easily understood. Bribes are
offered by private parties seeking
specific benefits; often something they
are not normally entitled to receive (a
permissive inspection or favorable tax
assessment) or that is officially uncertain
(a contract awarded competitively).
But sometimes payments are offered
for outcomes which should happen
anyway, such as timely and accurate
payment of invoices. Extortion is
initiated by officials, often involving
benefits to which the private party
is already entitled (a license, for
example), but officials may also make
threats, manipulate uncertainties, or
promise better results than procedures
usually allow.

In the real world things are not so
simple: public and private figures
may collude rather than seek leverage
over each other. Some people may
occupy public and private roles,
simultaneously or sequentially, and
public-private boundaries may be
unclear or contrived. Explicit demands
and offers may not be needed. Some
corrupt officials cannot be counted
upon to “deliver”, yet private parties
may still pay up, fearing violence or
exclusion from future deals. “Quid”
and “quo” may be difficult to identify
and compare; at times large favors
can be had for surprisingly small
payments (Bardhan, 1997). Eventual
paybacks may be unknown when up-
front benefits are delivered: political
donations or official favors may simply
create obligations useful later on. Quid
pro quo logic may not even apply:
payments to Japanese politicians by
Lockheed, for example, guaranteed its
bids would be considered – but nothing
more.

Complexities and risk also proliferate
over time and across whole industries.
A company that pays bribes may gain
short-term advantages but label itself
a target for future extortion. Payoffs
can create trails of evidence requiring
further payments if they are to be cov-
ered up; the long-term costs of corrup-
tion thus can far exceed initial benefits.
By contrast, refusing to pay may lose
a contract today but pay long-term
dividends in terms of reduced legal
expenses and access to markets in less
corrupt countries. A reputation for
honesty will deflect some demands,
and officials pressed to check corrup-
tion may find it advantageous to deal
with honest firms.

Other factors shaping the private side of
corruption include a firm’s competitors
(many or few, and how their ethics are
perceived); its exposure to risk and
regulatory pressures; relationships
between headquarters and local
operations; the number and type of
its customers; whether its operations
require large initial investments
and lead time, are likely targets for
privatization or nationalization, are
mobile (a data services firm) or tied to
specific places (mining); and whether
they seek short-term gain versus profits
sustained over time. Thus the private
side of corruption cannot be reduced
to the immediate stakes of bribery or
extortion. Indeed, businesses may
have leverage over officials, reasons
to resist corrupt temptations, and
opportunities for mutual support that
are not obvious. Identifying those
possibilities is not just an academic
issue but also a critical dimension of
reform, and essential if we are to put
donor resources to effective use. All
of that requires new research methods,
theory, resources, and above all, backing by international aid donors.

III. Key Questions

A long list of questions could guide research. A wish list:

- What are the most common types of corruption in which firms and citizens participate? What influences encourage those types as opposed to others? How can we best understand the full consequences of participating in corruption?
- How pervasive is corruption in a given sector of an economy or society? What are the stakes and payments, and how predictable are they?
- What factors make private parties more, or less, vulnerable to corruption?
- What corporate organizational structures, internal controls, kinds of business, market and political situations, and other aspects of the business environment strengthen the positions of private parties vis-
- à-vis predatory officials?
- What does corruption really “buy”? When are corrupt deals more, or less, likely to be honored? What are the long-term costs and benefits, and how do they typically compare to short-term benefits?
- What are the attitudes and knowledge levels of citizens and businesspeople as regards corruption? What makes reform more or less credible? Would greater understanding of corruption be a meaningful deterrent?
- Can private-sector cooperation alter the balance of incentives shaping corruption?

Getting at the Evidence

Even this incomplete research agenda
raises sensitive issues of legality, con-
fidentiality, competitive strategy and
advantages, and proprietary interests
in data. Reliable information is far
from a given: corruption, after all, is
clandestine, potentially highly profit-

able, sometimes linked to violence and, above all, usually illegal. How can we proceed?

In some instances actual data on corrupt dealings and firm behavior will not be necessary. Formal modeling and statistical techniques can generate hypotheses that can be tested using existing data (see, for example, Chen, Yasar, and Rejesus, 2007; Svensson, 2003). For other sorts of questions more detailed data will be needed. Dedicated surveys (Reinikka and Svensson, 2003) of small and large businesses, households, and public officials can be invaluable; examples include work by the World Bank, some national chapters of Transparency International, and the Instituto Tecnológico y de Estudios Superiores de Monterrey (Gamboa-Cavazos, Garza-Cantu, and Salinas, 2007). They help us estimate amounts paid in corrupt transactions, the frequency and predictability of such events, time spent dealing with bureaucrats, obtaining a license or registering a business, and the availability of meaningful recourse. Equally valuable, if less common, are focus-group projects probing more subtle attitudes (see, for example, Miller, Grødeland, and Koshechkina, 2001). These techniques offer extensive knowledge, but can be expensive.

**Indicators and Benchmarks**

Less expensive and equally promising are indirect observations of the effects, and the incentives sustaining corruption (Johnston, 2007; Arndt and Oman, 2006 is an excellent overview of corruption measurement issues). Consider two hypothetical cities: in one registering a business takes 15 days and involves five steps, while in the other it requires 160 days and 29 steps. The amounts of corruption in the two processes can never be measured directly, but it is reasonable to guess that a long timespan and numerous steps might be effects of past corruption, as officials have produced income by dragging their feet and contriving new requirements. They are also incentives sustaining corruption: lost time is lost money, bribes are seen as “speed money”, and each bureaucratic step is a potential “tollgate”. Where the steps are fewer and the process faster, there are likely to be fewer officials with their hands out, and less reason to pay. Such indicators can be gathered, analyzed and published – without mentioning the names of specific firms or citizens – in easily-understood forms at relatively little cost. They can also be compared to benchmarks: time to register a business can be compared to multi-city averages, while prices paid by government for (say) petrol can be compared to market prices. The well-known “Citizen Report Cards” in Bangalore, India (Thampi and Sekhar, 2006) bring citizen assessments of government services to the attention of officials, who work with civil society on improvements. The Extractive Industries Transparency Initiative seeks to publicize prices paid by private firms to governments for commodities such as ores and crude oil; there, too, significant departures from reasonable prices might flag the effects of past corruption and incentives creating more of it.

Other indicators might include prices paid for public procurement of basic commodities; the speed and accuracy with which invoices are paid; or the number of business inspections and time required to deal with them. All can be compared in detail to benchmarks compiled in other jurisdictions and in the private sector (for other examples see Johnston, 2007). Looking at government performance shifts the emphasis from culpability and wrongdoing to positive outcomes – efficiency, transparency, accountability – a major advantage for analysts and donors seeking cooperation in developing countries. Finally, such indicators and benchmarks allow successful managers and leaders to claim credit for improving governance, or to be held accountable for failure.

**IV. Donors, Data, and a New Kind of Transparency**

No research, by itself, will eradicate corruption. Together, however, donors, business people, and officials can help create a new climate of transparency – an environment based on cooperation and aimed not just at demonstrating compliance with rules but also at changing basic incentives, opportunities and deterrents. That sort of transparency requires new partnerships, extensive resources, and involvement by international donors in ways both familiar and new.

Transparency augmented by cooperation can make private parties less vulnerable to corrupt pressures. Where levels of government and corporate performance are widely known and judged against clear benchmarks, it will be more difficult to conceal bribes, kickbacks, nonperformance of duties, or “sweetheart” contracting. Where the extent of corruption in an economic sector, and the longer-term risks and costs it incurs, are more clearly understood, businesses will be less tempted to pay up out of fear that competitors are gaining advantages. Where private-side incentives are more clearly understood, reforms can be proactive and comprehensive rather than reactive and targeted to past practices. Where citizens and businesses compile evaluations of public services that managers and political leaders cannot ignore, they will be less vulnerable to pressure from corrupt officials and political leaders will have clearer reasons to combat abuses.

**New partnerships, new roles for donors**

Those goals require new knowledge based on lasting partnerships among researchers, business, citizens, public agency managers, political leaders, and international aid donors. But such partnerships involve risks for all participants. Why, for example, would firms and agencies want to release transaction data that might become evidence of corruption? Why would citizens feel secure evaluating the behavior of agencies and officials that have abused them in the past? Why would donors want to underwrite a process that might embarrass the governments and officials with whom they must work, and who are charged with executing funded initiatives and repaying loans? There are no easy remedies to such problems, but donors have formidable assets – funds, a base of experience, access to analytical and business expertise, and considerable prestige and credibility – which open the way to special roles that may not have been obvious.

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2 See, for example, Enterprise Surveys (World Bank Enterprise Analysis Unit): http://www.enterprisesurveys.org/

3 Transparencia Mexicana has conducted ambitious and sophisticated household surveys of bribes paid to obtain thirty-five basic services; see http://www.transparency.org/news_room/latest_news/press_releases_nc/2006/2006_05_09_it_mexico_corruption_level__1
One such role is that of guarantor, or honest broker, maintaining trust and a commitment to positive incentives and changes in a transparency-building process that will seem unfamiliar and possibly threatening to many parties. Donors can define their agendas in terms of positive values – integrity, accountability, a sound economy, and better governance – rather than in terms of unmasking corrupt individuals and practices. Such abstract commitments should be supported with real resources: creative formulae can provide support, publicize and reward success, and – where necessary – apply conditionality or withhold aid. The indicators-and-benchmarks assessment strategy outlined above fits such strategies well, allowing donors and their partners to set specific, attainable, positive goals. Bringing the price paid by government for basic commodities closer to market levels, bringing the quality of public services up to agreed targets, and cutting the time and steps involved in routine functions are all definable goals. These goals have real anti-corruption payoffs which offer something positive to all parties.

Donors could also facilitate the flow of information by establishing independent “integrity trusts”. Such bodies would gather information from businesses, but publish results only for whole sectors rather than for individual firms. If businesses launch “integrity pacts” – pledges not to pay bribes on pain of losing a bond they have posted – an integrity trust could oversee such deals and reward those honoring their commitments. Similarly, they could connect public agencies with the citizens and businesses monitoring their performance, taking charge of data-gathering and publication, mediating disputes, and building trust. Credible “integrity trusts” would require scrupulous honesty and confidentiality; neither government nor private bodies in a given society may enjoy such trust, but a respected international aid donor could oversee the project effectively. The donor would reward participation in the trust’s day-to-day operations, and penalize breaches of confidentiality or reprisals by any party.

Those sorts of partnerships will thrust donors into new roles that might require charter revisions in some cases. But they would shed unprecedented light on the private role in corruption and the factors shaping it – in the process, creating invaluable new knowledge, building trust, and turning adversarial situations into long-term partnerships. By fostering the new sort of transparency sketched out above, they use knowledge, trust, and self-interest to rebalance critical incentives. Doing so benefits donors as well as societies, as they will no longer have to underwrite the cost of governance improvements while depending upon the willingness of others to pursue reform solely as a public good.

Bibliography and Further Reading


Chen, Yanjing, Mahmut Yasar, and Roderick M. Rejesus. 2007. “Factors Influencing the Incidence of Bribery Payouts by Firms: A Cross-Country Analysis.” Journal of Business Ethics (Forthcoming October; published online 14 April; available for purchase at http://www.springerlink.com/content/x567358175g3217/?p=9320a794b1c540c39b0c60f8d059622&pi=1


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