Is it possible to prevent corruption via controls?[1]

by Maria De Benedetto

INCREASING CONTROLS, DECREASING CORRUPTION?

Let us imagine an ordinary case of corruption, it is not important how recent, nor where it occurs, nor how relevant from an economic point of view. For instance, take a case where a tax officer receives bribes to reduce the amount of taxes owed by a taxpayer; a case in which an officer operating in the local planning office employs delaying tactics in granting permission in order to obtain a bribe; a case which involves a ministerial officer who tries to influence a call for tender in order to favour a particular firm; finally, the case where, during an inspection, an enterprise which has committed a food fraud offers a bribe to inspectors in order to avoid the consequences of the discovered infringement.

In each of these cases, there is an economic interest in gaining extra income through corrupt infringements: these economic interests should be considered as hidden (see M Nuijten, G Anders (eds), *Corruption and the Secret of law. A Legal Anthropological Perspective*, Ashgate Publishing, 2007, p 12) but concrete possibilities which are always present in regulated activities.

Rent-seeking is made possible thanks to corruption but paradoxically it could be made even simpler by ineffective controls over public and private activities such as the previously mentioned activities of revenue collection, granting of permissions, public procurement, or inspections.

Related controls are performed by different kinds of guardians: among them, controls carried out by audit offices or courts of auditors (depending on the legal system), anti-corruption bodies, internal auditors, inspectors in charge of fiscal controls or controls in health and safety at work, environmental protection, food fraud, anti-money laundering, competition and so on.

Even in the presence of such a large number of controls, corruption seems far from being under control and scandals abound all over the world.

Traditional controls have been considered outdated and even counterproductive (on this point, see F Anechiarico, J B Jacobs, *The Pursuit of Absolute Integrity. How Corruption Control Makes Government Ineffective*, The University of Chicago Press, 1996, p 193) and some authors have expressed the idea that it could be better to accept a certain degree of corruption instead of multiplying controls, because corruption is unavoidable (A Ogus, "Corruption and regulatory structures", in *Law & Policy*, vol 26, July-October, 2004, p 342). However, anti-corruption policies should take into account that a balance is needed between the cost of corruption and the cost of controls involved in combating it. Only after this balance has been achieved will it be possible to know what the "optimal amount of corruption" might be (R Klitgaard, *Controlling Corruption*, University of California Press, 1988, pp 26-27).

At the end of the day, the idea that increasing controls means decreasing corruption could be more than controversial.

WHICH INFRINGEMENTS AND WHICH CONTROLS?

Despite the expressed caveats, controls remain a crucial means in preventing corruption. Indeed, human behaviour changes when subject to controls and controls (especially inspections) help institutions in strengthening information and knowledge about the way in which corruption works.

Accordingly, when we adopt an anti-corruption approach we should define the horizon of preventing corruption, in particular we should define which infringements and which controls have to be taken into account.

Corruption infringements – independently from their criminal regulation – are carried out by a public agent in concert with a client (a citizen or an enterprise) in mutual necessity: they both collude, they want to achieve extra-income by breaking rules in a context characterized by secrecy (on this point, A Shleifer, R W Vishny, "Corruption", in The Quarterly Journal of Economics, August, 1993, p 600). When corruption is committed, prevention is no longer possible,

anti-corruption comes too late to be effective.

However, there are many corruption-free infringements in which the public agent and the client (citizen or enterprise) do not collude; on the contrary they act in a completely independent way. Nevertheless, even in these individual corruption-free infringements actors look for extra income and operate in a context characterised by secrecy: the same extra income and the same secrecy which are features of corruption. For instance, a public agent could carry out internal fraud or theft of public properties. On the other side, a client (citizen or enterprise) could carry out infringements in fiscal law, competition law, frauds, etc. (M Robinson (ed), Corruption and Development, London, Routledge, 2004, p 110). When corruption-free infringements are committed, preventing corruption is still possible, an early detection of possible converging corrupt interests is feasible.

Regarding the issue of "which controls?", corruption has long been mainly considered the object of criminal investigation, focusing on detecting and sanctioning specific illicit behaviour and (possibly) achieving knowledge about the way in which corruption works, in order to put in place preventive criminal law measures.

Even though relevant, criminal investigation into corruption cases is not enough for effective anti-corruption policies and preventive administrative law measures are needed. Despite administrative anti-corruption being strictly connected with criminal investigation, the informative potential of criminal investigation is often neither sufficiently available nor understood for anti-corruption policies (as in the case of Italy where there is systemic corruption and effective criminal records are neither structured nor available for administrative anti-corruption).

If criminal investigation is not enough, it could be important to strengthen, as much as possible, administrative controls (controls over administrative activities) and administrative investigation (controls over private economic activities) coordinating and structuring them as part of a well-working network. As is well known, administrative controls operate on the side of public agents (such as internal controls, budgetary controls, controls performed by national courts of audit, internal inspections and so on) while administrative investigations operate on the side of private agents (such as inspections conducted by authorised officials on products or business premises, activities, documents, fiscal law, competition law, frauds).

In short, infringements can be carried out with or without corruption. Corruption is not necessarily present with fiscal evasion, various kinds of fraud (agriculture, food, etc), competition infringements, false declarations (to achieve, for example, social benefits), money laundering and so on. Such corruption-free infringements may sometimes have criminal relevance but in some jurisdictions may also be simple administrative violations.

In any case, these corruption-free infringements prepare the ground for corruption because they require (in the same way as corruption) extra income and secrecy, and in this way they have a strict relationship with corruption.

Controls over administrative activities (administrative controls), controls over private activities (administrative investigation) and criminal investigation have been established to limit the dangerous tendency to opportunistic and non-compliant enforcement but they operate from a less than fully-informed position (see A Greycar, R G Smith (eds), Handbook of Global Research and Practice in Corruption, Edward Elgar, 2011, p 289): only by operating together and strengthening their relationship can they produce an efficient and effective flow of information, which is indispensable for early detection of corruption cases.

FIVE "MEMOS" FOR ANTI-CORRUPTION POLICIES

Anti-corruption policies have become even more pressing for states: at every level of government agreements and treaties produce (and are producing ever more frequently) a complex framework of state obligations not only to repress but also to prevent corruption (see J Bacio Terracino, *The International Legal Framework Against Corruption. State's Obligations to Prevent and Repress Corruption*, Cambridge, Intersentia, 2012; for a first analysis see OECD, *Public Sector Corruption: An International Survey of Prevention Measures*, Paris, 1999). Take, for example, the World Bank for which anti-corruption policies have become a sort of condition for developing countries to obtain loans; consider the recommendations and evaluation reports of GRECO, Group of States against Corruption; consider also the OECD recommendations, for instance on Transparency and Integrity in Lobbying and on Combating Bribery of Foreign Public Officials in International Business Transactions.

Even though economic literature has provided strong contributions on corruption, empirical analysis about its determinants (see D Serra, "Empirical determinants of corruption: A sensitive analysis" in *Public Choice*, 2006, p 225) are not sufficiently developed for the moment and cannot represent a decisive help in structuring a common and undisputed horizon for anti-corruption policies all over the world.

However, if it seems difficult to adopt a common and general formula to combat and prevent corruption, a first step could be simpler to agree on some points, five warnings which could constitute a shared framework for anti-corruption policies.

7

First, *controls have a hybrid nature* because they are not only a way to respond to corruption but they could also be an occasion for corrupt transactions. So, regulators and guardians (inspectors, internal auditors, etc) should know that when a control is established an opportunity for illicit profit arises and that a control should always be justified and proportionate (on this point, see J Monk, Reform of *Regulatory Enforcement and Inspections in OECD Countries*, OECD, Paris, 2012).

Second, *controls are a cost*; all corruption controls involve costs for institutions in charge of the task of controlling something or someone as well as for enterprises and citizens involved in those controls (R Klitgaard, *Controlling Corruption*, op cit, p 27). It should be clear that, when a control is established someone has to pay for it.

Third, *administrative capacity of controls is limited* and controlling everything is simply impossible. It should be clear that institutions cannot eradicate corruption and that they have to manage and to maximise their capacity to fight it.

Fourth, *planning controls is not a simple task* because the already mentioned lack of information about corruption makes effective planning of controls very difficult. Choosing if, when, what and how to control is a tricky but crucial aspect of anti-corruption policies and needs to be based on adequate knowledge.

Fifth, *sanctions following controls must be effective in order to deter*. It is very well known that if the risk of being sanctioned is low, increasing fines could influence the size of the bribe instead of encouraging compliance (S Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform*, Cambridge University Press, 1999, p 54). Deterrence, in fact, depends on effectiveness of controls.

At this point, some very general and short suggestions could be summarised for regulators and guardians involved in anti-corruption objectives.

It should be better to *limit the number of controls and design them well* (in order to avoid side-effects as far as possible, such as when controls are considered an opportunity for corruption); to *make controls proportionate and effective* (in order to justify their costs); to *fix sustainable objectives in anti-corruption policies for controls* (in order to achieve some results); *to increase information on how corruption works and to improve the quality of data* (in order to plan effective controls); and to *establish and to apply proportionate, well calibrated, certain and effective sanctions* (in order to make them a deterrent).

TOOL-BOX; GOOD RULES AND GOOD PRACTICES

As we have seen, preventing corruption via controls regards both regulators (who establish and design control mechanisms) and guardians (inspectors and other institutions in charge of controls). They should take into account the already mentioned five warnings: controls have a hybrid nature, controls are a cost, administrative capacity of control is limited, planning controls is difficult, sanctions following controls should be effective in order to deter.

The anti-corruption tool-box contains, thus, good rules and good practices.

Good rules

Good rules are needed in order to reduce the impact of corruption.

A first and general point is that we need *fewer but better quality rules*. Regulation is considered a direct factor for promoting bureaucracy and, as a consequence, a factor for increasing corruption (See V Tanzi, *Corruption Around the World: Causes, Consequences, Scope, and Cures*, IMF Staff Papers, vol 45, no 4 (December), 1998, p 10). Moreover, the same law-making process – due to lobbying and to consultation processes (see A Ogus, "Corruption and regulatory structures", op cit, p 341) could create opportunities for corruption. Furthermore, legislative inflation facilitates creative compliance and infringements. Indeed regulators should limit, as much as possible, the quantity of regulation but they should also work to increase its quality, making use of ex ante and ex post evaluation, effective and transparent consultation, and economic analysis of regulation.

A second point concerns *rules which establish sanctions*: they should be considered *as incentives* (or disincentives). An incentive/disincentive approach in regulation (see J A Gardiner, "Controlling official corruption and fraud: Bureaucratic incentives and disincentives", in *Corruption and Reform*, 1986, p 42) suggests combining "carrots and sticks" (S Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform*, op cit, p 78). In fact, sanctions express an intrinsically economic logic, which could greatly help regulators to make laws effective, even if sometimes it could be better to impose non-monetary sanctions (N Garoupa, D Klerman, "Corruption and the optimal use of nonmonetary sanctions", in *International Review of Law and Economics*, 24, 2004, p 220), such as disqualification from operating in the market for being a "bad actor". Alternatively, it would be better to operate via incentives, rewarding enforcement (G S Becker, G J Stigler, *Law Enforcement, Malfeasance, and Compensation of Enforcers*, p 13) and compliant groups (J A Gardiner, T R Lyman, "The logic of corruption control", in A J Heidenheimer, M Johnston, V T Levine (eds), *Political Corruption. A Handbook*, p 837).

A third point regards *rules when designing institutions and procedures*, by which is possible to produce favourable (or non-

favourable) conditions to transgress and to corrupt: regulators should be conscious of this. This happens when regulation increases bureaucratic and discretionary powers as well as monopolies (A Ogus, *Corruption and regulatory structures*, op cit, p 331) giving to government officials procedural discretion over the provision of goods (such as licences, permits, passports and visas) allowing them to collect bribes from private agents (A Shleifer, R W Vishny, "Corruption", op cit, 599). This effect is more likely to result when institutions are structured in a way which seems to be less resistant to corruption (S Rose Ackerman, "Which bureaucracies are less corruptible?", in A J Heidenheimer, M Johnston, V T Levine (eds), *Political Corruption. A Handbook*, Transaction Publishers, 1993, p 808).

Thus, if it is necessary to strengthen anti-corruption objectives then good organisational and procedural design increases in importance.

Good practices

Not only are good rules important in preventing corruption but also good practices, because only concrete enforcement moves law in theory towards law in practice.

A first aspect which should be analysed from a practical point of view is the role of information. There is an unavoidable lack of knowledge and information about corruption in institutions in charge of controls. Knowledge and information must be improved thanks to a continuous flow of data between criminal investigation, administrative controls and administrative investigation. Information should, however, be managed by a monitoring and filtering activity capable of focusing on its meaningful aspects in order to prevent corruption cases (R Klitgaard, *Controlling Corruption*, op cit, p 94).

A second aspect regards *reducing controls*. As previously mentioned, controls produce costs for enterprises and citizens, costs which constitute administrative burdens and which should be reduced according to recommendations which come from institutions at different levels of government. National governments are adopting strategies for reducing administrative burdens in inspections, as in the UK Hampton Report (HM Treasury, *Hampton Report, Reducing administrative burdens: effective inspection and enforcement,* March 2005). International organisations are currently debating inspection reforms as a general topic because inspections are considered more and more decisive for regulatory enforcement (see, recently, OECD, *Regulatory Enforcement and Inspections,* 2014).

A third aspect concerns *cooperating in controls*.

Administrative cooperation in anti-corruption is needed in each single state between different institutions (anti-corruption bodies, other guardians but even any other kind of administration) because preventing corruption is not only a question of finding crimes, at the very end of the process,

but of making legitimate profit simple, extra income difficult and dangerous, and crimes economically inconvenient (see, in general, M De Benedetto, "Administrative Corruption", in J Backhaus (ed), *Encyclopaedia of Law and Economics*, Springer on-line, 2014).

Furthermore, corruption is not just a national phenomenon. Single states cannot keep it under control and European as well as international cooperation is needed (see, on this point, C Stefanou, H Xanthaki (eds), *Towards a European Criminal Record,* Cambridge University Press, 2008).

CORRUPTION STARTS FROM RULES: TAKING CORRUPTION ASSESSMENT SERIOUSLY

There is a direct proportionality between legislative inflation and corruption incurred during controls: the more regulation the more possible violations and, consequently, the more opportunities for officers in charge of controls to prey on citizens and enterprises, and to obtain bribes.

Controls are themselves a hot topic, especially in those legal systems where economic activities are strictly regulated: both regulators and guardians should know that this is the status quo. Nonetheless, controls may sometimes be effective (in some countries or in some regulated sectors), in other words they could be useful for maintaining a framework of general legality. In cases such as this, well performing public officers should be rewarded and incentivized in order to strengthen the system of controls and to continue their good work.

Controls, on the other hand, may sometimes be ineffective (in other countries or in some other regulated sectors). Ineffective controls contribute to increasing an area of unreported illegality. Here it could be important to inculcate in legislation a sort of competition between involved interests and to empower administrative investigation, establishing widespread mechanisms of automatic alert (red flags) for corruption (for instance, the European Anti-Fraud Office (OLAF) produces "compendiums of anonymised cases which comprise a short description of the techniques used by fraudsters, vulnerabilities and fraud indicators". Contributions by individual single public officers which have helped in detecting corruption cases should be appreciated and rewarded.

Furthermore, controls may be effective but corrupt, ie controls are capable of detecting infringements but can be used as a way to gain extra income. In this case, it is absolutely necessary to improve knowledge about the way in which infringements (before) and corruption (after) work, for instance by recourse to something such as leniency programmes in competition law which incentivize detection and transparency. It should also be important to improve understanding about specific administrative mechanisms

9

which could facilitate corruption. This activity represents a real intelligence, crucial in order to give guidelines for the regulatory flow. Furthermore, corrupt public officers and enterprises should be sanctioned quickly and heavily.

From an anti-corruption perspective, some kinds of regulation seem to present more risks than others (R Baldwin, M Cave, M Lodge, *Understanding Regulation: Theory, Strategy and Practice,* Oxford University Press, 2012, p 236), especially when they create or reinforce monopolies or discretionary powers, allowing bureaucratic agents to manage incentives and disincentives for other officials, citizens or enterprises (see S Rose-Ackerman, *Corruption and Government: Causes, Consequences and Reform*, op cit, p 39).

Early detection of corruption would mean making a diagnosis of "corruptibility" starting from rules, analysing them with criminal eyes and highlighting – where possible – the dangerous influence of interest groups on legislators. This approach has been recently developed by analysts who have described grand corruption scandals in Italy, corruption carried out completely "going by the book", such as in the MoSE Project scandal (G Barbieri, F Giavazzi, *Corruzione a norma di legge. La lobby delle grandi opere che affonda l'Italia,* Rizzoli, 2014).

This leads to important consequences for anti-corruption controls because better regulation, based on robust gathering of evidence, allows controls to be planned in a more effective way.

Therefore, regulation should be prepared by a sort of *corruption impact assessment* or other tools which may help to identify and remove recurring factors causing corruption. In some legal systems, corruption impact assessment (CIA) has been introduced, even if with different approaches and methodologies, for instance in the framework of regulatory impact analysis (Czech Republic), or as a specific tool oriented to identifying corruption risk factors in legislative procedures (Independent Republic of Korea) (on this point, see A Tamyalew, *A Review of the Effectiveness of the Anti-corruption and Civil Rights Commission of the Republic of Korea,* World Bank, May 2014).

Two main areas of possible corruption could be found in institutional functions: when regulation establishes sanctions (ie a situation that enterprises and private individuals want to avoid) or when establishes incentives (ie a situation that enterprises and private individuals want to achieve). Related administrative functions present a high probability of corruption temptations and should be carefully monitored.

In such cases, selective and effective controls capable of influencing the personal cost-benefit analysis about corruption (the choice to corrupt or to be corrupted) should be carried out with the purpose of making corruption at least and simply economically inconvenient (See J A Gardiner, T R Lyman, "The logic of corruption control", op cit, p 833).

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