1. Corruption and conflicts of interest

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Conflicts of interest come in two overlapping forms. First, the interests of different parts of government may conflict. As democratic institutions developed, newly empowered parliaments sought to limit the king’s influence. Monarchs maintained power by providing favors and official positions to legislators. Hence, early efforts were closely tied to an emerging view of the separation of powers, even if some of the benefits were private. Second, the concept refers to conflicts between public roles and private financial interests.1 Today, the first form is less prominent than the second. Of course, powerful presidents and prime ministers can still seek to sway politicians through their control over government posts and spending priorities. Furthermore, certain institutional reforms are unlikely because they conflict with the interests of politicians. Nevertheless, constitutional terms, legal prohibitions, and the division of labor mean that worries about the separation of powers are not at the forefront.2 In contrast, the complexity of modern society means that the second form is pervasive. Individuals play multiple public and private roles with accompanying tensions between their conflicting demands.

An individual may play many roles simultaneously. Those who hold government or political positions as legislators, ministers, party functionaries, judges, presidents, prime ministers, or civil servants also have other responsibilities. They are family members, businessmen, tribal elders, religious leaders, or even criminals.3 A characteristic of modern complex

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1 Cárdenas (2011) summarizes the history of the concept. For an overview that canvasses the legal situation in many countries see Peele and Kaye (2011). On the case of Argentina see De Michele (2004).
2 The remaining areas of contestation concern whether cabinet ministers in parliamentary systems can also serve in parliament and whether national politicians can simultaneously hold political or bureaucratic posts in lower-level governments.
3 On the prevalence of the last in the Indian legislature see Aïdt Devesh and Golden (2011).
societies is that people shift roles over days, weeks, or years. What is appropriate or even required in one role may be inappropriate or illegal in others. Public roles may require a level of objectivity, evenhandedness, and transparency not imposed on one’s private life. Institutions and organizations create their own rules and ethical standards that attempt to socialize people to further the bodies’ aims. These are enforced by legal sanctions and internal rules and by moral suasion and political pressures.

Conflicts of interest arise when a person mixes up his or her roles, furthering, say, the interests of her family or her business when acting as a bureaucrat, judge or politician. Behavior based on one’s devotion to family, tribe or religion may be illicit if carried out in one’s official capacity. Sometimes, of course, private and public interests coincide. A leading business person who becomes mayor of a city may seek to promote economic development, thus benefiting both himself and the municipality. Even in such cases, however, the correspondence is unlikely to be perfect. The businessman might steer contracts to his firm, limiting competition and raising prices. A mayor who accepts outright payoffs in connection with economic development projects may both improve the city’s health and enrich himself, but he does this in a way that imposes excess costs on taxpayers. Bribes increase the cost and number of projects to inefficient levels and distort priorities toward elaborate, specialized projects where bribes are easy to hide.

Although the empirical study of corruption has vastly expanded in recent years, analyses of the broader concept of conflict of interest have focused mostly on campaign finance and on studies of individual countries. Many scholars have studied links between legal sources of campaign finance and voting behavior. Because of the lack of explicit quid pro quos, these studies are often inconclusive. The strongest results come from votes on bills that provide very specific benefits to particular firms. That research is complicated by debates over the proper behavior of representatives. Should they vote as their constituents want or in accord with their view of the broader public interest?

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4 Arellano and Zamudio (2011) stress this aspect of the issue.
6 On the definition of conflict of interest see Peele and Kaye (pp. 338–339). The OECD’s definition is: ‘a conflict between the duty and the private interest of an official, in which the public official’s private-capacity interest could improperly influence the performance of their official duties and responsibilities’ (OECD, 2005: 2).
7 See, for example, the studies cited in Daley and Snowberg (2011).
Another strand of research studies situations where business and politics are deeply intertwined and asks if these political entities have worse economic outcomes and more corruption than others where the overlap is less pronounced. Are the business elite the dominant actors who infiltrate politics and obtain favors at the expense of the rest of the population? Conversely, is it politicians who are dominant and who force firms to do them favors, thus perhaps undermining firm profitability? In the extreme, are the business and political elite the same people who control both the state and the economy, operating in tandem to disadvantage outsiders? Individual country research illustrates the two-faced nature of business/government relations. Consider a few examples. During Suharto’s regime in Indonesia, the stock market value of firms partly owned by his family fell in value when he suffered health emergencies.\(^8\) In contrast, banks in Pakistan with more politicians on their boards had a higher proportion of questionable loans than other banks.\(^9\) These data imply that many bank loans to the politically powerful were not of investment grade. Studies of South Korea show how the political power of the chaebol exacerbated the speed and depth of the downturn in the Asian financial crisis.\(^10\) In the United States, research on the oil industry in California in the first half of the twentieth century shows how the industry influenced policy by providing private benefits to politicians.\(^11\) The case of Italy stands out as one with an intertwined business/political elite. Thus, when he was in power, former Prime Minister Silvio Berlusconi both owned the biggest commercial television station and influenced appointments to the public broadcaster.\(^12\)

Cross-country results show an association between the strength of the political connections of domestic business firms and corruption. Rigorous limits on conflicts of interest reduce direct business participation in the state. Conversely, appointing politicians to corporate boards does not increase firm value, echoing the results for Pakistani banks. However, firm value does rise when a business person enters politics, suggesting that those firms benefit at the expense of competitors and suppliers.\(^13\) These data need to be supplemented with information on campaign financing, lobbying expenses and regulation, and revolving doors. (The

\(^8\) Fisman (2001).
\(^12\) ‘Oh for a New Risorgimento: Special Report – Italy,’ The Economist, 11 June 2011, at 13–14.
\(^13\) Faccio (2006).
Japanese call it ‘ascent to heaven’; the French, ‘pantouflage’.)\textsuperscript{14} Business leaders do not need to be directly elected to office to have an impact if alternative routes are available.

Although private and public roles can be incompatible, it may be difficult to prove incompatibility in particular cases. That difficulty implies that public institutions should focus on prevention ex ante rather than punishment ex post.\textsuperscript{15} Legal punishment and institutional sanctions need to be available as a backup, but they are likely to have limited impact. On the one hand, the protections of the legal system and its cost and delay will permit some of the guilty to escape punishment. On the other hand, the law may sweep up innocent officials who have offended the powerful, or it may target only those associated with opposition groups.

Conflicts of interest cover a wide range of situations. Both parts of the phrase need to be unpacked. Andrew Stark argues that the concept of ‘conflict’ has evolved from an emphasis on subjective conflicts in the minds of officials to objective indicia that a conflict might exist with some probability. At the same time, the notion of ‘interest’ evolved from objective financial interests to include subjective interests related to ideological, personal, economic, and political matters.\textsuperscript{16} The move to objective measures of conflict is a practical response to the difficulty of probing mental states and reflects a growing lack of trust in the self-serving statements of the powerful. The broader notion of interest reflects a heightened concern for the democratic legitimacy and fairness of public decisions, but it risks conflating individual self-seeking with the necessary expressions of interest and opinion vital to democratic functioning. The impact of the developments that Stark discusses is to sweep a wide range of behavior under the conflict-of-interest rubric.

Conflict of interest is a broad umbrella term that incorporates all sorts of tensions between official and private roles. Illegal corruption and fraud are a subset of this concept where the benefits to the official are financial. The payoffs may induce the official to violate the terms of his official position in return for private gain, or they may be extortion paid

\textsuperscript{14} Examples from France are the director of public affairs at Orange-France Telecom who was previously a top regulator of the industry and a former government official. The senior vice-president of public affairs at Alcatel-Lucent and the director of regulatory affairs at Group Iliad both served in the regulator for six years (examples from personal communication from Akis Psygkas). Similar examples can be found in all countries with regulated private utilities.

\textsuperscript{15} Arellano and Zamudio (2011), De Michele (2004).

\textsuperscript{16} Stark (2011).
to induce the official to do what he ought to be doing anyway. Fraud is an offense that need not involve a third party. The official simply steals from the public coffers.

The challenge for policymakers is twofold. First, they need to ask if some conflicts of interest are so harmful that they ought to be criminalized even if they do not rise to the level of corruption or fraud. Second, has the state set up the right mixture of ex ante prohibitions and ex post penalties? Perhaps ex ante requirements for financial disclosure, divestiture, recusal, etc. are either too lax or too stringent. Do they discourage otherwise qualified people from taking public positions so that the pool of talent is limited? Are they too easy to circumvent by, for example, transferring assets to one’s children or moving assets abroad? Do the rules permit what some call ‘legal corruption’, in other words, behavior that favors wealthy private interests without the need for outright payoffs.

The primary difficulty is the lack of a well-defined concept of the public interest in a representative democracy. Voting by the electorate and in the legislature implies that citizens and politicians will disagree about the best policy. In practice, any policy will benefit some and impose costs on others. Thus, one cannot easily claim that anything against the public interest is corrupt. There is no comprehensive general will in a democracy that implies a particular set of public policies, and public choices need not be consistent over issues or over time.

Bribery, extortion, and fraud are the easy cases. Enriching yourself at the expense of the taxpayers and of citizens seeking to obtain benefits or avoid costs is clearly against the public interest. There is always a superior non-corrupt option that could make everyone better off except those involved in the corrupt deal. Nevertheless, even for these straightforward cases, there remains room for debate about the relative role of the criminal law versus changes in the way government operates to reduce corrupt incentives. The state can simplify or eliminate programs to reduce discretion, introduce competitive pressures, and create institutions that improve government transparency and accountability. Thus, even when the underlying offense is a crime, the policy response can be preventive.

The distinction between preventive measures and ex post enforcement applies beyond outright corruption, but the appropriate mixture is less clear. Some will argue that what they are doing is completely appropriate and should not be sanctioned or prevented. Consider a few examples. An

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17 See Rose-Ackerman (1999) for a fuller discussion of these options and Rose-Ackerman (2010) on the role of the criminal law.
appointee to a regulatory agency argues that her experience in the regulated industry or in a civil society group makes her uniquely qualified, not conflicted. A well-off politician from a farming background argues that his experience makes him best suited to represent a farming state. A judicial nominee points to his experience as a Wall Street lawyer as giving him needed expertise. A politician accepts funds from wealthy private interests and claims that they will make her independent of party politics.

Criminalizing these behaviors appears counterproductive. Instead, one set of responses involves transparency and easy public access to information, requiring officials to give reasons for their actions subject to neutral standards, and requiring that people either divest themselves and their families of certain financial interests or recuse themselves from choices where they have a conflict. However, in the legislative process transparency is not sufficient if there are collective action problems not solved by knowledge. Even if one holds a delegative theory of democracy – under which legislators ought to represent the interests of their constituents – transparency may not be enough. Rather, as Dennis Thompson argues, ‘constituents in any state or district may quite properly instruct their representative to seek, through the procedures of the legislature, standards to govern the conduct of all representatives.’ Citizens may care about the ‘moral health and political efficacy of the institution as a whole’, not just the private benefits provided by the government.18 A relaxed attitude toward legislative conflicts of interest ignores the importance of these attitudes. In the bureaucracy, the cabinet, and the courts a different sort of collective action problem limits the efficacy of disclosure. Citizens face collective action problems if they seek to discipline these officials. However, a turn to the criminal law is too blunt and accusatory an instrument in many cases. Those who care about the moral health and efficacy of the state are likely to support generic preventive measures to suppress the most important conflicts.

Although private financial gain always raises conflict-of-interest concerns in public life, most public choices further some interests and impose costs on others. Those affected by such decisions need to be informed when decisions are made and to have an opportunity to argue for or against a policy, as advocates, not impartial observers. In a judicial proceeding, one can try to create neutral adjudicators who lack any interest in the outcome beyond competent fact finding and the skilled application of the law. In practice, such neutrality may be difficult to

achieve, but it remains a goal. In the legislature and in the executive, however, such neutrality is not even in principle possible or desirable. Political life requires the participation of affected interests. The problem is both to avoid a takeover by any one interest and to limit the pursuit of private gain by those meant to represent constituency groups.

One response is a corporatist body, deciding by unanimous consent, that includes representatives of all the affected interests. The traditional model comes from the field of labor relations where peak associations of labor unions, business associations, and government ministries meet to set labor policy – minimum wages, average wage increases, working conditions. The agreements may require nominal parliamentary approval, but they are de facto the responsibility of this body: national policy is made by interested parties who have to compromise to reach agreement. The identification of these decisions with the public interest arises from the claim that all the relevant interests are well represented. It breaks down if labor leaders accept bribes from business, if labor unions only represent a subset of all workers, if business associations omit important sectors, and if government officials do not bring in other interests, such as those of consumers. These problems undermine corporatist processes, but only the first in the list is a conflict of interest. The members are explicitly meant to represent the interests of their constituencies.

Similarly, an industry regulatory body might include people with strong ties to the industry as well as representatives of consumer and environmental groups, state and local governments, etc. Neither a person with industry ties nor an employee of an environmental group would be criticized for advocating positions close to those they represent, either de jure or de facto. Neither a rigid industry spokesman nor an uncompromising environmentalist would be a good choice for such a body, but such a person’s problem is not a conflict of interest.

In many federal regulatory agencies in the United States a multi-member board can have no more than a majority from one party (usually three out of five). These commissioners are appointed in a partisan process but operate as a decision-making body under majority rule. If a Democratic appointee espouses policies that track those of Congressional Democrats, that behavior would not be a conflict of interest. Party balance in the agency is meant to permit debate across party lines and achieve a result that is more politically acceptable than one produced by an ostensibly independent expert decision-maker. Of course, that does not always happen. Commissioners can be swayed by the hope of subsequent employment in the regulated industry. Conflict-of-interest rules would apply to those blandishments, not to the partisan nature of a commissioner’s decisions.
In short, conflicts of interest mainly create a problem when personal economic gain conflicts with one’s responsibility as an agent. One may be an agent of broad public values, as when a judge applies the law. However, one may also be an agent of a political party, a geographical constituency, or an interest group, whether economic or social/ideological. If a public body is constituted for the purpose of bringing together diverse interests to make policy or to advise politicians, then it is legitimate for its members to seek to further the interests of their own principals, however narrow they may be. This model of decision-making may be unworkable or undemocratic in some situations, but the body’s problems cannot be solved by strict conflict-of-interest rules. Of course, members should be prevented from gaining financially at the expense of their own principals and at the expense of the body’s functioning. The broader point is that such conflicts should be carefully distinguished from broader issues of institutional design.

REFERENCES


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