Corruption and the criminal law

By Susan Rose-Ackerman[1]

Abstract

The criminal law can play a back-up role in the fight against corruption. The present article discusses five aspects of the criminal law on corruption. First, corruption may be reduced by legalizing some formerly illegal activities and criminalizing others. Second, penalties need to be set to achieve effective deterrence. Third, law enforcement authorities need tools such as plea-bargaining to encourage bribe payers and recipients to cooperate with authorities to uncover corruption. Fourth, corporations and other organizations need to be held responsible for the corrupt actions of their employees. Fifth, because corruption is often a side effect of organized crime activity, authorities need to design strategies to deal with this overlap. In general, the goals of law enforcement should be to determine those corrupt systems that are doing the most damage and to organize the deterrence effort to make corruption costly and to give participants an incentive to report corrupt deals.

Introduction

Corruption cannot be fought solely through criminal law. Too often, Governments announce a crackdown on corruption and a spate of high-profile prosecutions take place, only for the problem to re-emerge soon afterwards as a new group of people takes advantage of the opportunities that remain. A serious anti-corruption effort requires the State to re-examine the relationship between government, citizens and businesses. Governments may need to redesign public programmes, overhaul the public administration and the operation of the political system and become more open to outside scrutiny and input from citizens. Nevertheless, the criminal law can play a role as a backstop lying behind the needed structural changes. Unfortunately, it does not always play that role, even in countries where prosecutions for corruption are common. Sometimes, the

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problem is the biased use of the criminal law to target members of the political opposition; in the extreme, such prosecutions deter opposition to the regime in power but have little impact on corruption. Sometimes, the problem is the weakness or venality of the judicial system. Then, even cases based on strong evidence may fail in court and this possibility deters prosecutors from bringing cases in the first place.

The present article considers the back-up role of the criminal law as an aid to deterrence. There are several aspects to this problem: first, the legalization of certain illegal activities can remove incentives for corruption; conversely, some formerly legal activities may need to be criminalized to deter activities that have much the same effect as outright bribes. Second, penalties should be set to achieve optimal deterrence. Third, law enforcement authorities should have the tools to encourage bribe payers and bribe recipients to cooperate with authorities to uncover corrupt transactions. Fourth, as bribes are frequently paid by people acting in the interest of their employers, corporations and other organizations should be held accountable under the criminal or civil law. This is an issue of particular salience, given the new Organisation for Economic Cooperation and Development (OECD) treaty that requires States to punish overseas bribery by corporations engaged in international business. Finally, corruption is often a side effect of organized crime activity. Authorities need to design strategies to deal with the intersection between organized crime and corruption.

Legalization and criminalization

Countries seeking to deter corruption and fraud may need to decriminalize some activities and criminalize others. When economic activities such as the sale of drugs, gambling or prostitution are criminalized, incentives for corruption are created. Those who engage in the illegal activity may seek to corrupt law enforcement officials in order to continue operating. Thus, one way to reduce corruption is to legalize formerly illegal activities. Policy makers need to ask if the costs of illegality outweigh the benefits. For example, after a short experiment with Prohibition, the United States of America repealed the eighteenth amendment to the Constitution outlawing the manufacture and sale of "intoxicating liquors". Its time in force, between 1919 and 1933, was a period of widespread illegal production and sale of alcohol and endemic corruption of law enforcement officers. The amendment's repeal was supported by many in the law enforcement community. The worldwide debate over legalizing drugs turns on the feasibility of controlling the industry through the criminal law, when law enforcement authorities are vulnerable to corruption. Gambling, formerly outlawed in many American jurisdictions, was also an important source of corrupt receipts for the police. The response in many jurisdictions has been to turn gambling into a legal business, albeit under heavy state supervision and even, at times, state ownership. Thus, countries may need to examine where the line between legal and illegal activity has been drawn and ask if

there are some areas where criminalization is providing few social benefits and encouraging corruption and illegal business.

On the other side of the ledger, new criminal and civil offences may need to be created. Many new democracies have not come to terms with the problem of conflicts of interest among executive branch officials and members of the legislature. Most developed countries use a mixture of criminal sanctions, administrative penalties and ethical codes to regulate civil servants' and politicians' involvement in decisions in which they have a financial interest. Emerging democracies can learn from examining this experience.

In the United States, a mixture of ethical codes and statutory requirements constrains public officials (Gilman 1995, p. 65). Officials are not permitted to "use public office for private gain" and are not to hold financial interests that conflict with their duties, use inside information for personal profit or accept gifts. Both the payment and receipt of bribes are criminal offences. The receipt of a salary from sources outside the Government is against the law, as are payments to officials for representing a private party in a "particular matter" in which the United States has an interest. The law applies to both public officials and those who pay them (Chakrabarti, Dausses and Olson 1997, pp. 597-605).[2] Officials must avoid the appearance of violating the law, even if their conduct technically complies with it.

By way of comparison, French and Canadian conflict-of-interest restrictions have similar goals but use different methods. French law focuses more on administrative than criminal remedies, but shares the fundamental goal of avoiding "an unwholesome alliance between personal financial interest and the exercise of the power of the state" (Rohr 1991, p. 284). Nevertheless, French restrictions seem, in practice, less stringent. Financial disclosure of assets is not required as a routine matter, and post-employment restrictions are poorly enforced (Rohr, pp. 284-286). Canadian (and British) rules are also less restrictive. Parliamentary government puts the prime minister in charge of the legislative agenda. This means that, unlike the United States, conflict-of-interest laws are unlikely to impose more stringent controls on members of the executive branch than on members of parliament. Civil servants are regulated by administrative rules, not statutes (Stark 1992, p. 429).

In practice, the most difficult enforcement problems concern job-seeking. Although, in the United States, government outright quid pro quos seem fairly well controlled by the code of conduct and the legal sanctions behind it, officials are often hired after they leave government service by firms that have business with their previous government employer. The code of conduct states that "employees shall not engage in outside employment or activities, including seeking or negotiating for employment, that conflict with official government duties and responsibilities". Subject to several conditions, former officials cannot represent others before their former employer within two years of termination. The ban is

[2] 18 USC 201, 203, 207, 208.

not absolute, however, as it only applies to issues on which the person worked within a year of leaving government (Chakrabarti, Dausses and Olson 1997, pp. 608-612).[3]

The United States mix of codes of conduct and criminal, administrative and civil sanctions is complex and not always easy to understand or interpret. Some critics argue that United States conflict-of-interest laws are intrusive and counterproductive (Anechiarico and Jacobs 1996; Roberts and Doss 1992). According to these critics, the rules introduce too much red tape, stifle creativity and discourage qualified people from joining the public service. Even if the United States model is too complex to be readily exported, however, it can still provide guidelines for countries beginning to develop norms of professional bureaucratic behaviour. The harshest critics of the United States system do not argue that procurement officers ought to be allowed to own shares in their contractors or accept salaries or large gifts from firms with which they do business. Yet in many developing countries such practices have only recently been recognized as troublesome. To prevent government service from becoming a cynical route to easy wealth, all countries need a basic conflict-of-interest programme that stresses ethical conduct and is backed up by legal sanctions, some of which will involve criminal penalties. But simple and basic rules of behaviour are the best place to start, especially if one of the goals is to avoid turning the oversight process itself into a locus of corruption.

Deterring corruption: penalties

All countries draw the line somewhere between illegal bribery and acceptable "gifts of good will". They criminalize certain businesses such as the drug trade and legalize others. Countries differ in where the dividing line is set, and in this section that judgement is taken as given and an effective deterrence strategy is sought. The sanctioning strategies proposed in the present article are quite different from the conventional penalties, even in developed countries. They focus both on improving the deterrent effect of arrest and punishment and on rewarding those who come forward with documentation on corrupt deeds.

The optimal amount of corruption is not zero, even if no value is given to the benefits received by bribers. Once the costs of prevention are taken into account, the level of deterrence expenditures should be set where the marginal benefits equal the marginal costs (Anechiarico and Jacobs 1996; Becker and Stigler 1974; Rose-Ackerman 1978, pp. 109-119). The deterrence of criminal behaviour depends on the probability of detection and punishment and on the penalties imposed, both those imposed by the legal system and more subtle costs such as loss of reputation or shame (Becker 1968). Law enforcement authorities can vary either

[3] 18 USC 207 (a)-(d).

or both of these variables, but strong empirical evidence is lacking on their relative importance.[4]

Successful detection of corruption depends upon insiders to report wrongdoing. Often, this requires officials to promise leniency to one of the participants. This creates an important paradox for law enforcement efforts. High expected punishments ought to deter corruption, but a high probability of detection can only be accomplished if some are promised low penalties. This section begins with a discussion of deterrence based on expected punishment. In the next section, strategies are considered that take account of the interaction between punishment and the probability of detection.

In some countries, bribe payers are treated more leniently than recipients. Some countries do not even criminalize the payment of bribes.[5] In others, the reverse is true: the criminal law distinguishes between "active" and "passive" corruption. The briber is viewed as the "active" party and the public official as "passive" (Vermeulen 1997). These distinctions do not capture the rich variety of cases. Often, the public official can be described as the active party who extorts a pay-off (Mény 1996, p. 311). In practice, the distinction between active and passive corruption and between extortion and bribery means little because both parties must agree before corruption can occur.

Bribery can be more usefully distinguished on the basis of its social harm (Shleifer and Vishny 1993).[6] Considering whether the briber is entitled to the benefit received and whether or not scarcity exists produces three categories: an illegal benefit, a legal but scarce benefit and a legal benefit that is not scarce if allocated honestly. If the benefit provided is illegal, the social harm of corruption is the distortion introduced by corrupt pay-offs. If the benefit is legal but scarce, the corrupt official gives preference to bribers over other potential beneficiaries. The social harm is the net cost of allocating by willingness-to-bribe instead of by the stated criteria of the corrupted programme. Finally, the benefit may be legal and appear scarce only because of corrupt public officials. The social cost is then the distortion created by the officials' efforts to generate pay-offs. In deciding how to allocate law enforcement resources, the degree of social harm should be the most important variable. Holding constant the cost of enforcement, the highest priority should be given to the allocation of illegal benefits. In the abstract, it is difficult to rank corrupt transac-

[4]One study using United States data from the period 1970-1984 showed that both a greater probability of conviction and longer prison terms deter corruption (Goel and Rich 1989).

[5]In an interview in Taiwan Province of China in 1995, the Justice Minister Ma Ying Jeou complained that Taiwanese law did not make it a crime for a citizen to offer a bribe. He claimed that the lack of such an offence "seems to encourage businessmen to give out all kinds of gifts" and has been "a major obstacle to rooting out the *hung bao* culture [of giving money in red envelopes to officials]" (*Far Eastern Economic Review* 1995).

[6]Law and economics scholars distinguish between bribery and extortion, depending upon whether the payer receives "better than fair treatment" or must pay to be treated fairly (Ayres 1997, pp. 1234-1238; Lindgren 1988, p. 824); however, both are often combined in practice (Ayres 1997, pp. 1236-1237).

tions that affect the allocation of legal benefits. The social costs depend upon the damage done by using a willingness-to-pay criterion, on the one hand, versus the inefficiencies and inequities of officials' efforts to design in bottlenecks and scarcity, on the other.

Regarding punishment strategies, a ranking of the social harm of different kinds of corruption can help set enforcement priorities. However, the penalties actually levied on the convicted should be tied not to these social harms, but to the benefits received by the corrupt. Assuming that society does not give positive weight to corrupt gains, the goal is to reduce corruption as far as possible in spite of limited law enforcement resources. In order to deter bribery, at least one side of the corrupt transaction must face penalties that reflect its own gains. Because the chance of detection and conviction is far less than one, those convicted should sacrifice a multiple of these gains. From a pure deterrence point of view, either side of the corrupt deal can be the focus of law enforcement efforts. From the point of view of public acceptability, however, bribers who seek legal benefits are likely to arouse public sympathies, not blame. Whatever the focus, actors should face expected penalties tied to their own benefits from corruption.

The penalties imposed on officials should be tied to the size of the pay-offs they receive and the probability of detection. If penalties are not a function of the size of the bribe, an anti-corruption drive would quickly confront a paradox. A high fixed penalty will lower the incidence of corruption, but increase the size of bribes paid. If the penalty is high, officials must receive a high return in order to be willing to engage in bribery.[7] Thus, the expected penalty should increase by more than a dollar for every dollar increase in the size of the bribe (Rose-Ackerman 1978, pp. 109-135). This could be done either by tying the penalty levied upon conviction to the size of the bribe or by increasing the risk of detection as the size of the bribe increases. However, if the probability of detection is lower for small pay-offs, the penalty for each detected offence should reflect the low incidence of detection. This could mean that those convicted of petty bribery could face harsher penalties than those found to have taken larger bribes.

On the other side of the corrupt transaction, a fixed penalty levied on bribers will lower both the demand for corrupt services and the level of bribes. However, it will have no marginal impact once the briber passes the corruption threshold. To have a marginal effect, the penalties imposed

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[7]For example, anecdotal reports by correspondents with Radio Free Europe/Radio Liberty claim that in Kiev, a drunk-driving ticket can be avoided with a bribe of US$ 50. In Prague, by comparison, a similar ticket will be forgiven for a $100 "donation". The claimed reason for the difference between Prague and Kiev is that the average monthly salary of a traffic policeman in Prague is five times higher than that of his counterpart in Kiev (Radio Free Europe/Radio Liberty 2001). Perhaps the chance of being caught is higher as well. Other sources find that the overall incidence of corruption is lower in the Czech Republic than in Ukraine. Thus, when accepting a bribe has a high expected cost, this will both deter corruption and raise the size of the bribes that are paid.

on bribe payers should be tied to their gains (their excess profits, for example), not to the size of the bribe.[8] Bribes represent a cost to those who pay them; thus penalties should not be tied to these costs unless they are a good proxy for the briber's benefits.

United States law does little to recognize this asymmetry between bribe payers and bribe recipients in its prescribed punishments. The criminal penalties are equivalent: both payers and recipients of bribes can be fined "not more than three times the monetary equivalent of the thing of value [that is, the bribe] or imprisoned for not more than fifteen years, or both".[9] This is appropriate for officials who receive bribes, except that multiplying by three may be a poor measure of the risk of detection and punishment. The actual probability of detection is likely to be well below one third. The law, however, does recognize the asymmetry of corrupt transactions by permitting the President to rescind any contract or other benefit if there has been a conviction under the statute governing bribery, graft and conflicts of interest. The United States can also recover, in addition to any penalties, "the amount expended or the thing transferred or delivered on its behalf, or the reasonable value thereof".[10] This right of recovery is designed to avoid losses to the Government. It is a weak deterrent to corrupt pay-offs because the recovery is not multiplied by a factor that reflects the probability of detection.

If expected penalties do not increase along with the benefits of corruption for bribers and the recipients of bribes, the Government may be caught in a trap where high corruption levels beget high corruption levels. A low-corruption equilibrium may also exist, but be unreachable in small steps from the status quo. A high-corruption equilibrium occurs when the net rewards of corruption increase as the incidence of corruption increases. This might occur, for example, if the probability of detection falls when corruption is widespread and if penalties levied upon conviction are not adjusted to take account of that fact. If most public officials take bribes, overwhelmed law enforcement officials may uncover only a small proportion of the corrupt transactions.

Any multiple-equilibrium case, however, can be converted into a single-equilibrium, low-corruption case with the appropriate choice of law enforcement strategy or a change in the information conditions. Strategies that tie expected penalties to marginal gains can remove a society from a high-corruption trap. Doing so, however, may require a large increase in law enforcement resources to tip the system to a low-corruption equilibrium.

[8]Alternatively, if potentially corrupt firms are repeat players, they can be deterred by debarment procedures that prohibit corrupt firms from contracting with the Government for a period of years. To have a marginal effect, the debarment penalty should be tied to the seriousness of the corruption uncovered. For examples of debarment see *Nikkei Weekly* (19 February 1996) and Thacher (1995), who describes the practices used by the New York City School Construction Authority.

[9]18 USC 201 (a).

[10]18 USC 218.

The good news is that the sharp increase in enforcement resources need not be permanent. It must simply be sufficient to tip the system to a lower corruption level (Lui 1986, pp. 21-22). The idea is to change expectations. A concentrated clean-up campaign can change expectations about others' cooperation in the corrupt system. Once a new low-corruption equilibrium has been established, it can be maintained with reduced enforcement resources provided the honest are willing to report corrupt offers and law enforcement officials follow up on reports of malfeasance (Cadot 1987; Rose-Ackerman 1978, pp. 137-151).

Deterring corruption: rewards

Effective deterrence is impossible unless the police can obtain relevant evidence; this is a difficult task because often the participants are the only people who know of the corrupt deal. The probability of detection is a function of whether any of the participants has an incentive to report to the police. In this context, police promises of low penalties or even rewards are often essential.

Let us suppose, first, that the benefit is legal and would be freely available in an honest world to those who now pay bribes. Because the bribers receive benefits to which they are legally entitled, they are likely to believe that they are extortion victims who would be better off in an honest world. Such bribe payers are potential allies in an anti-corruption effort who may cooperate in efforts to eliminate pay-offs. They should not be punished heavily, because leniency will give them an incentive to report corrupt demands and will encourage the beneficiaries of public programmes to demand services that are free of pay-off demands. Public prosecutors need to have flexibility under the law to reduce charges and to seek lower penalties for those who cooperate in an anti-corruption inquiry, even if they have paid or received bribes themselves.

Let us consider, next, a scarce but legal benefit that is corruptly allocated to many individuals who would not qualify if pay-offs were eliminated. Neither those who pay nor those who receive bribes will voluntarily report the corrupt transaction. Those shut out of the process, however, have a grievance. For example, disappointed bidders for public contracts can facilitate efforts to limit corruption (Alam 1995). They should be rewarded for coming forward with evidence, even if the reason they lost the bid was not moral scruples but their own unwillingness to make a large enough pay-off.

Bribes paid to obtain illegal services are likely to be the most difficult to control. Bribers are often also engaged in other illegal activities and those who fail in their corruption efforts can hardly come forward to claim that they should have been the ones obtaining the illegal benefit. Nevertheless, the very vulnerability of bribers can be used to uncover corruption. They may accept lenient treatment with respect to, say, a violation of the drug laws, in return for providing evidence in a corruption trial. Deterrence will be aided if the law enforcement authorities can make

deals, even with admitted criminals, as a means of uncovering corrupt networks and illegal business organizations.

There is considerable variation across legal systems in the ability of police and prosecutors to make deals with those accused of crimes. The prevalence of plea-bargaining in the United States is well known and is used not just to save prosecutors' time, but also to facilitate investigations of white-collar crime such as corruption. Charges are routinely dropped or reduced in return for a person's cooperation in an ongoing investigation that seeks to implicate those at the top of a corrupt pyramid or on the other side of the transaction.

Some claim that plea-bargaining does not occur in the civil-law countries of continental Europe. However, several scholars have shown that although it has been formally forbidden in some countries, in practice it is quite common.[11] In recent years, some European countries, most notably Italy, have revised their penal procedure codes explicitly to permit plea-bargaining, an innovation that ought to make corruption investigations easier. In Italy, the new code, adopted in 1988, permits plea-bargaining that reduces sentences and appears de facto to envisage bargaining over the charge (Fassler 1991, pp. 263-265).

When organizations are the locus of corruption, one option is a system that rewards "whistle-blowers" within firms and public agencies who come forward with evidence of wrongdoing. Reporting the peculations of others can be dangerous. If corruption is systemic, a person who reports wrongdoing risks being disciplined by corrupt superiors and attacked by co-workers. One study of corruption in China suggests that this is a serious problem (Manion 1996). The whistle-blower may even end up being accused of corruption (*New York Times* 6 March 1998). Thus, Governments should consider promulgating statutes that protect and reward those who report malfeasance (Pope 1996, pp. 59-61). The United States, for example, has two such statutes: the False Claims Act rewards those who report irregularities in government contracts and protects private-sector whistle-blowers from reprisals (Howse and Daniels 1995; Kovacic 1996).[12] The Whistle Blower Protection Act protects whistle-blowers inside government agencies from retaliation.[13]

The False Claims Act pays whistle-blowers a share of the total penalties and other damages levied against firms for wrongdoing that has injured the Government. The rewards are available to people both inside and outside the firm, although not to government officials with direct responsibility for detecting contract violations. If the whistle-blower brings suit and is successful, he or she can recover 25-30 per cent of the penalty. If the Justice Department opts to join the action, the minimum recovery is reduced to 15 per cent because the Government will bear most of the legal costs. Unsuccessful private plaintiffs must bear their own legal costs, but not those of the firm, unless the court determines

[11]Fassler (1991, p. 246) cites the relevant articles in English.

[12]31 USC Sections 3729-3731.

[13]Pub. L. No. 101-12, 5 USC 2302 (b) (8).

that the suit was clearly frivolous or vexatious (Howse and Daniels 1995, p. 526).[14] The law also protects whistle-blowers from retaliation by their employers.

A number of objections have been raised to this statute but, on balance, the law appears to serve a valuable purpose and can complement efforts at internal monitoring. In particular, the idea that corporate whistle-blowing will undermine internal control efforts seems misplaced. As Robert Howse and Ronald Daniels (1995, p. 537) argue, "the fear of being exposed to prosecution as a consequence of external whistle-blowing may be an important incentive for some corporations to adopt credible internal disclosure policies and procedures". The main problem in countries in the process of establishing the rule of law will be to clarify what practices are illegal and subject to criminal penalties. It will not make sense to protect or reward whistle-blowers unless it is made clear what they should be looking for.

Sometimes public officials claim that large firms virtually force bribes upon them. This seems a little disingenuous because the pay-offs are a cost to the firms involved. Nevertheless, to the extent this claim is credible, public officials could come forward with evidence of corrupt offers and seek protection under the Whistle Blower Protection Act. Firms would predictably defend themselves by arguing that the official demanded the pay-off. The distinctions in United States law may be useful here. Under the False Claims Act, the court can reduce the award for a whistle-blower who was involved in wrongdoing, but only if he or she planned or initiated the wrongful conduct. The award need not be eliminated, however, unless the whistle-blower is convicted of a crime.[15] Prosecutors with the authority to grant criminal immunity can thus set up a kind of a race in which the first to report the corrupt transactions will be rewarded, while the others are punished.

Corporate criminal liability[16]

Corporations have legal personalities, but this does not turn them into real human beings. For some commentators, this lack of humanity implies that corporations ought not to be subject to the criminal law because they cannot have mental states and so cannot be "guilty". Applying the criminal law to corporations gives them procedural protections and a presumption of innocence that are designed to protect the rights of individuals, not legal constructs (Thompson 1987, pp. 76-77; Khanna 1996).

The potential criminal liability of "legal persons" is an accepted part of United States law. By contrast, in many civil-law countries, organizations are excluded from criminal liability, although the trend may be changing

[14] 31 USC 3730 (d) (4).

[15] 31 USC 3730 (d) (3).

[16] For a fuller discussion of the issues raised here see Rose-Ackerman (2002).

with the incorporation of corporate criminal liability into the French criminal code in 1992 and into the Council of Europe's Criminal Law Convention on Corruption (Council of Europe 1999, art. 18). After the French revolution, France was the source of the prohibition of organizational criminal liability. Its code was adopted widely in Europe and has influenced criminal law in parts of the world where the civil-law tradition has been exported. Current French law, however, establishes criminal liability for organizations for a set of specified offences, including active corruption or peddling of influence (Orland and Cachera 1995, p. 114 and appendix, arts. 433-1 and 433-25). The law includes some special penalties for "legal persons", including the possibility of larger fines, exclusion from government procurement contracts and placement under various types of probation or court supervision (*Code Pénal* 2001, arts. 131-38 and 131-39).

The Netherlands has permitted corporate criminal liability since the mid-1970s, but Italy and Germany have constitutional provisions precluding corporate guilt, and the Belgian courts have refused to find corporations guilty of crimes. In Germany, however, administrative bodies can impose fines on corporations as well as on natural persons (Orland and Cachera 1995, p. 116; Khanna 1996, pp. 1488-1491). In Poland, corporate criminal liability does not exist, although legal persons can be required to pay damages for the negligence of their representatives (Council of Europe 2000, p. 21). The key issue for law reform in these and other countries is to find ways to hold legal persons responsible for organizational acts.

Organizations should not be anthropomorphized when discussing rights and responsibilities. Nevertheless, corporations can have responsibilities that cannot be reduced to individual obligations (De George 1993; Donaldson 1989). These responsibilities stem from "the practices of the organizations—the internal and external patterns of relationships—that persist even as the identities of the individuals who participate in them change" (Thompson 1987, p. 76; French 1979; Cooper 1968). The issue of corporate responsibility is important in the corruption context because, in the business world, most bribes are paid by employees and agents, not by top management. If pay-offs help a firm obtain business, managers and owners may hope to facilitate their subordinates' bribery, while remaining ignorant of the details.[17] Thus, one would like the law enforcement system to give top management an incentive to control the corruption of their subordinates. The important issue for policy is whether corporate criminal liability is the best way to do this or whether a system of civil fines and injunctions can serve the same purpose more effectively.

According to Jennifer Arlen (1994), if corporations are held criminally liable for the corrupt acts of their employees and agents, top management may not support an effective monitoring system. She analyses this

[17]Top managers will hope to rely on their subordinates' ability to rationalize such pay-offs. In one experimental study, business students and managers expressed a strong commitment to honesty as a value, but over 70 per cent were willing to pay a bribe to obtain business. The most frequently expressed justification was that "the first duty of a manager is to reach the company's goals. Therefore, it sometimes becomes necessary to forget about ethics" (Rosenberg 1987).

problem for the general case of corporate crimes and concludes that a number of alternative rules are superior to present United States law that imposes pure strict liability on firms. One possibility is a negligence rule, under which firms are only liable if they have neglected their internal enforcement responsibilities. For such a rule to be workable, however, the courts must be able to evaluate internal firm behaviour, which is a difficult task. One solution may be the drafting of quite precise directives that state what type of internal monitoring is required.

The United States Foreign Corrupt Practices Act does this by supplementing its prohibitions against paying bribes with accounting provisions that apply to firms within the jurisdiction of the Securities and Exchange Commission. These firms must establish accounting systems that accurately reflect transactions involving the firm's assets, and they must have an effective system of internal accounting controls. Firms and their managers can be subject to both civil and criminal penalties for violating these accounting provisions (Jadwin and Shilling 1994, pp. 679-680; Nobles and Maistrellis 1995, pp. 9 and 19; Pickholz 1997, p. 237). There is no formal due diligence defence to the Act but, in practice, firms that establish and enforce effective internal control systems appear to experience more lenient treatment. The Federal Sentencing Guidelines also reward internal firm efforts to detect and punish violations of the law (Nobles and Maistrellis 1995, pp. 18-24). Thus, United States law attempts to counter management's incentive to insulate itself from the profit-maximizing malfeasance of employees and agents. Nevertheless, some insulation is currently possible through the use of foreign firms as sales agents (Nobles and Maistrellis 1995, p. 25). The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions holds firms responsible for the corrupt acts of their agents in international business transactions. This Convention has the potential to spur an interest in the promulgation and enforcement of corporate codes of conduct among multinational firms throughout the world.

Organized crime and international criminal enterprise

Illegal businesses seek to operate securely by paying off the police, politicians and judges or by permitting them to share in the profits of illegal businesses. But such businesses are also vulnerable to extortionary demands. Law enforcement authorities, from the police to prosecutors and judges, can demand payments to overlook criminal law violations or limit penalties. If the evidence of criminal behaviour is clear, such businesses will be unable credibly to threaten to report corrupt demands.

Of course, illegal businesses are hardly innocent victims. They often actively try to corrupt the police. They seek not only immunity from prosecution for themselves, but also assurance of monopoly power in the illegal market. Both in the United States and in Latin America, gamblers and drug dealers have paid officials to raid their competitors or to restrict entry (Rose-Ackerman 1978, p. 163; *New York Times* 12 May 1996; *New*

York Times 30 July 1996; *Washington Post* 28 January 1996). In Thailand, some local public authorities shelter criminal enterprises both from competition and from the law (Phongpaichit and Piriyarangsan 1994, pp. 51-97). In the Russian Federation, those engaged in illegal businesses sometimes engage in outright intimidation of potential rivals, often paying off the police not to intervene in their private attempts to dominate the market (Handelman 1995).

The danger for economic development arises when organized criminal groups begin to dominate otherwise legal business; southern Italy, the Eastern European countries and those of the former Soviet Union are cases in point. Several Asian and Latin American countries face similar risks. Organized crime groups can use the profits of illegal enterprise not only to assure the complicity of public officials, but also to infiltrate legal businesses. The profits generated by illegal businesses, earned without paying taxes, can then be reinvested in legitimate business and in obtaining public contracts (Gambetta 1993; Varese 1994).

The stakes are especially high in Eastern Europe and the countries formed after the collapse of the Soviet Union. Nothing less than the entire wealth of the State is up for grabs. The value of sharing in the privatization of a socialist State dwarfs the benefits of sharing in the privatization of a public utility in Western Europe or a steel mill in a developing country. Both criminal groups and legitimate business concerns seek to share in the wealth. If criminals can create an atmosphere of uncertainty and threaten violence they will drive competitors away, especially Western firms, leaving the criminal groups with a free run (Shelley 1994). In fact, foreign direct investment from legitimate business has not been large in the countries that once formed the Soviet Union and it varies greatly from country to country (United Nations Conference on Trade and Development 2000). One explanation for these results is the weakness of state institutions and the corruption and organized crime influence to which this gives rise. Although a recent study argues that privatization in Eastern Europe and the former Soviet Union has been, on balance, beneficial in spite of admitted problems, the authors point to serious deficiencies in the legal system (Kaufmann and Siegelbaum 1997).

Even in developed countries, some legitimate businesses are especially vulnerable to criminal infiltration. Organized crime is both wealthy and unscrupulous. It is willing to use not only bribery, but also threats and violence to enforce its contracts and get its way. In the most successful examples, the legitimate businesses that operate under Mafia protection earn sufficient monopoly rents to make them supporters of the continued influence of organized crime. Diego Gambetta and Peter Reuter (1995, p. 128) provide a list of the factors favouring the emergence of Mafia-controlled cartels. In the most favourable cases, product differentiation and barriers to entry are low, technology is unsophisticated and labour unskilled, demand is inelastic and the industry consists of a large number of small firms. Private garbage collection provides a good example. Entry is inexpensive; all that needs to be purchased is a truck. However, because garbage trucks operate alone on the public streets, it is relatively easy to

intimidate unwanted rivals by attacking their trucks without attracting police attention. To minimize the risks for organized crime, but at a cost, the Mafia can pay the police to look the other way (Reuter 1987).

Similarly, the ability of a business to corrupt officials to gain approval of a licence to enable it to operate and to deny such approval to its rivals yields an obvious competitive advantage. Labour unions, with or without connections to organized crime, can use this tactic. For example, an official of the United Union of Roofers in Philadelphia was convicted of bribing an official of the Occupational Safety and Health Administration to harass non-union roofing contractors.[18]

Legal businesses that benefit from prime urban locations are especially at risk in countries with weak or corrupt police forces. This includes restaurants and shops serving tourists and business travellers. Manufacturers can hide in out-of the-way locations (Webster and Charap 1993), but service businesses cannot "go underground". If the police are unreliable, criminal groups may demand protection money from businesses and threaten to attack those that do not pay (De Melo, Ofer and Sandler 1995; Webster 1993; Webster and Charap 1993).

Businesses such as road repair and building construction that do considerable business with the State are also prime candidates for falling under the influence of organized crime. If organized crime has already corrupted a Government in order to run its illegal businesses, it may be a relatively short step from there to making pay-offs to obtain public contracts on favourable terms. In the extreme, organized criminal groups manage cartels that share contracts and pay off public officials to buy their complicity, or at least their silence. In southern Italy, for example, a survey revealed that over half of the small and medium-sized businesses had reported that they had withdrawn from a public tender after pressure from criminal groups or their political allies (*The Economist* 5 February 1994).

The wealth, unscrupulousness and international connections of many organized criminal groups prevent control by any one country. The danger is that, rather than being a stage of development that will wither away over time, criminal activity becomes so intertwined with politics that it is difficult to tell them apart.

It follows that anti-corruption efforts should be coordinated with another international campaign: the fight against organized crime. There are two reasons for this: first, both corrupt rulers and international criminal enterprise benefit if it is easy to launder money across national borders. Accepting bribes will be more attractive if it is relatively easy to deposit the funds outside the country. Thus, strong international action against money-laundering can help mitigate both problems. Second, the existence of large-scale illegal businesses is likely to have a corrupting influence on government, especially law enforcement and border control. Corrupt rulers and illegal businessmen feed on each other. Illegal businesses must pay bribes in order to operate. The bribe receipts, being

[18]United States v. Traitz, 871 F.2d 368, 375 (1989).

illegal, are themselves especially likely to provide capital to illegal businesses worldwide, which reduces the cost of capital to them and fuels their growth relative to legal business ventures.

If corruption is combined with organized crime, the problem for domestic law enforcement is multiplied. The experience of developed countries in fighting organized crime may be useful in some contexts. In developing countries, which tend not to be used to confronting organized crime, a combination of training and law reform is a useful first step. But such reforms are unlikely to be sufficient unless the economy is strong and competitive. The State may need to make more direct efforts to reduce the excess profits available to criminal entrepreneurs in legitimate business.

One solution is promoting the entry of well-capitalized legitimate businesses that, with some state help on the law enforcement side, can compete with Mafia-dominated firms. For example, the courts mandated the entry of large multinational waste management firms into the trash-hauling industry in New York City. This strategy reduced the influence of organized crime and lowered garbage removal costs for the commercial businesses not serviced by the Sanitation Department. State prosecutors estimated that garbage removal fees of $1.5 billion in 1995 were inflated by as much as $400 million. In recent years, the cost of garbage removal has fallen by 30-40 per cent for most businesses (*New York Times* 28 February 1994; *New York Times* 30 July 1995; *New York Times* 23 December 1995; *New York Times* 11 May 1998).

A country's links to the broader world can either limit or expand the scope for organized crime. On the one hand, an open trading and investment regime will make it easy for both contraband and the profits of crime to flow across borders. The existence of banking havens where black money can come to rest makes domestic criminal activity less risky because money can be easily hidden abroad. On the other hand, open borders facilitate investment by outsiders in a country. If these outsiders are not part of the domestic criminal bodies and are not associated with such groups elsewhere, they may challenge entrenched groups. Of course, if such investments are costly and dangerous, few may make the effort, but a country's openness to foreign investment at least makes them worth consideration.

One role for international organizations and for law enforcement agencies in developed countries is the compilation of information on questionable transactions, combined with the prosecution of individuals and organizations based in developed countries that do business in developing countries.

Conclusions

Under criminal law, finding the right mix of penalties, rewards and undercover law enforcement is not easy. Nevertheless, one important lesson of the economic analysis of crime is clear: anti-corruption policy should never

aim to achieve complete rectitude. Those who take an absolutist position are likely to impose rigid and cumbersome constraints that increase, rather than decrease, corrupt incentives. The goals of law enforcement should be to isolate those corrupt systems which are doing the most damage to society and then to organize the deterrence effort to make corruption costly on the margin and to give participants an incentive to report corrupt deals.

The criminal law can deter corruption in several ways. First, substantive criminal law may need to be re-examined to determine if some private activities might be decriminalized, thus reducing corruption and the involvement of organized crime. Alternatively, some currently acceptable activities, such as conflicts of interest, may need to be regulated or outlawed. Second, penalties for paying and receiving bribes ought to reflect the marginal gains of bribers and the recipients of bribes. The former should be penalized in proportion to the gains that bribes make possible; the latter in terms of the benefits of the pay-offs themselves. Third, given the background level of penalties, prosecutors and investigators ought to be able to reward those who provide useful information that helps authorities uncover hidden corrupt networks. This will often involve making deals with those who have paid and received bribes in the past. Fourth, issues of individual responsibility should not deter law reformers from finding ways to hold organizations such as corporations legally responsible for the corrupt acts of their agents. This may involve holding the organizations criminally liable themselves, but similar results may be possible with purely civil penalties, provided that they can be tied to corrupt acts that are related to the enterprise's activities. Finally, special efforts will often be needed to counter the influence of organized crime, especially when it operates on an international scale: international cooperation is needed to unravel corrupt networks and recover the proceeds of illegal businesses.

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