

Corruption as a System of Interlocking Vicious Cycles: Lessons from NationLab

by Loren Cobb¹, PhD & Mike Gonzalez², PhD
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Introduction

The "*NationLab*" series of seminars and exercises in national strategy began in 1997, at the request of the Bolivian School of High National Studies (EAEN). From the very beginning, one of the central themes of NationLab has been a quest for a better way of prosecuting the battle against corruption. The very first one-page diagram of the NationLab concept listed corruption as one of the three primary threats to Bolivian national security (the other two were poverty and the cocaine industry).

Over the intervening years of development in a growing list³ of Latin American countries, the NationLab view of the vicious cycles that entrap entire nations in conditions of poverty and weakness has matured considerably. Corruption remains a central part of this vision, indeed it is now seen as arguably the single most important mechanism holding back economic and social development.

Many of the participants in NationLab seminars and exercises have related to us their personal theories of how corruption operates, and we have gradually incorporated their insights and ideas into a dynamic model. From a relatively simple start, focusing only on the executive branch of government, this model has grown to encompass aspects of the legislative and judicial branches, and the influence of multinational corporations and international banks.

We have learned much from the roughly 3000 men and women from five countries who have participated in NationLab, and we wish we could thank each of them individually for their contributions. What follows is a distillation of everything we have heard and discussed, reflected as best we can in the language of causal diagrams and dynamic societal models.

One view of corruption that we have *not* included in this analysis is the explanation of corrupt behavior in terms of a failure of morality. This is the common idea that corruption among national leaders is caused by inadequate moral instruction in families and schools, and therefore that the best way to combat corruption is to improve moral education. While we do not want to suggest that culture and moral education are not important, we do believe that the available evidence is overwhelmingly against this particular hypothesis. Quite the contrary, it appears that most corrupt behavior is a *consequence* of structural deficiencies in the design of government, regardless of moral education.

In the memorable lament of one NationLab participant, "*Our system of public employment could corrupt even a saint!*" That may be an exaggeration, but we firmly believe that vicious cycles embedded within a governmental system can overcome even the most honest, well-intentioned, and well-trained civil servants. They are either corrupted or driven out of public employment.

An Analysis of Governmental Corruption

Figure 1 (below) illustrates in simplified form one of the self-reinforcing feedback cycles that, once started, can perpetuate corrupt behavior among government officials. To explain how this model works, we will first examine a single cycle in isolation, and then we will look at three additional vicious cycles. Then we will put all of these together, and consider the behavior of the entire system of interlocking vicious cycles. Finally, we will deduce from this system the critical leverage points towards which reform must be targeted if the system is to be purged of corruption.

Cycle J: The Informal Economy

We begin with an uncomplicated but self-perpetuating causal loop that operates in many countries. This is the cycle that passes through the boxes labeled J, K, H, and E in Figure 1, which is itself only a small part of the entire causal diagram (Figure 5). To distinguish this particular cycle from others, we will refer to it as "Cycle J." In general, each cycle will be identified by the label of its most important variable.

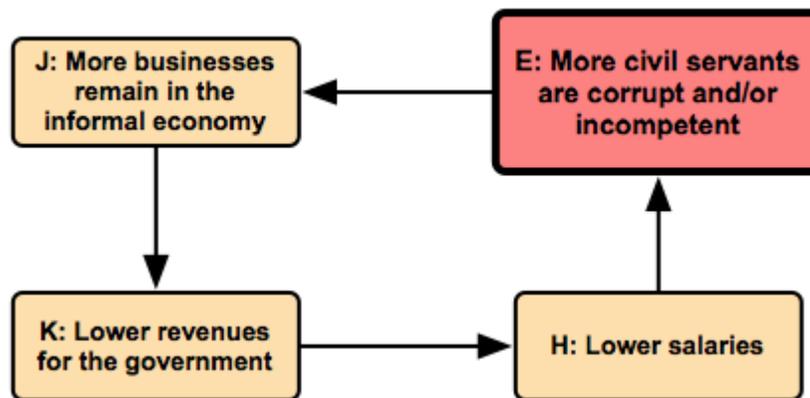


Figure 1: Causal diagram for the influence of the informal economy on the corruption process.

Every country in the world has an informal economy, defined roughly as that part of the total economy that neither registers with the government nor pays taxes on any transaction. As a percent of the total, informal economies range from an estimated minimum of 13% (The Netherlands) to a maximum of 100% in countries whose national government has collapsed (e.g. Somalia). By definition, the greater the informal economy the smaller the tax base for sales and corporate income taxes, and for individual income taxes that are withheld by employers. Thus any event which increases the size of the informal economy (Box J in Figure 1) causes a reduction in revenues to the national government (Box K). Governments sometimes attempt to counteract this loss of revenue by (a) raising taxes in the formal economy, or (b) raising import duties. Either response is likely to drive even more businesses out of the formal economy. In any event, the total amount of money available to pay government salaries decreases (Box H).

When a government suffers decreasing funds for salaries, it must either reduce the number of positions or reduce salaries. This is a "moment of truth" for any organization. In ideal circumstances the organization will take the opportunity to improve efficiency by eliminating marginal and redundant jobs, but when a government is already riddled with corrupt or incompetent personnel then the politically expedient response may be to pay less than the nominal salary levels (Box H). As actual remuneration falls below the acceptable levels, civil servants have even less incentive to abstain from corrupt practices, and competent personnel begin to leave government employment (Box E).

Finally, as businesses perceive that business taxes and fees are supporting an increasingly corrupt and incompetent government, they will begin to leave the formal economy and move into the informal economy (Box J), and those that are already in the informal economy will be reluctant to formalize their operations. This last step, through Box J, closes the loop. Once such a process begins, it becomes increasingly difficult to arrest.

To summarize, the vicious cycle $J \rightarrow K \rightarrow H \rightarrow E \rightarrow J$ describes the effect of increases in the informal economy on corruption, via the intermediary step of lower revenues for the government. These effects are self-reinforcing, meaning that once it starts it will continue to perpetuate itself.

Cycle I: International Agreements

Poor countries often fare badly in negotiations with multinational corporations, and in bilateral negotiations with more powerful nations. Corruption is a likely factor in this poor performance whenever the negotiations are conducted without transparency. The mechanism is simple and well-known: closed-door negotiations (Box I) offer extensive opportunities for secret side-agreements between participants. Typically these side-agreements enrich the poor country's negotiators in return for concessions that would otherwise never have been accepted (Box L).

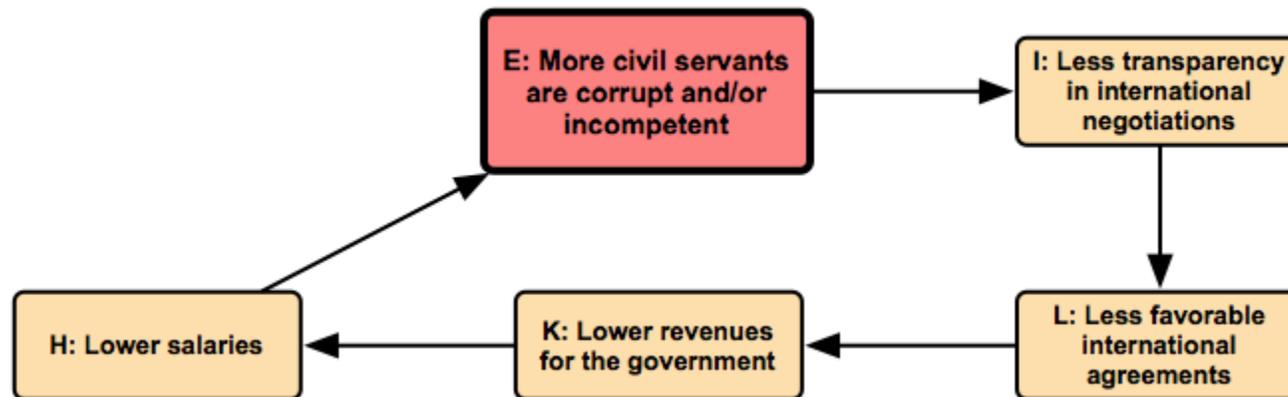


Figure 2: Causal diagram for the effect of less transparency in international negotiations.

The direct consequence of these concessions is that more of the economic benefits of the agreement go abroad, and fewer remain at home. This reduces the benefits for the poor country, and, either directly or indirectly, reduces the income of the government (Box K). As in the previous example, this results in lower total funds for government salaries (Box H), and ultimately in an increase in the incompetence and corruptibility of all civil servants. They will be less likely to insist on transparency in future international negotiations, and so the cycle continues.

To summarize, the vicious cycle $I \rightarrow L \rightarrow K \rightarrow H \rightarrow E \rightarrow I$ describes the effect of less transparency in international negotiations on corruption, via the intermediary step of lower revenues for the government.

Cycle C: The System of Justice and Public Security

When the judicial system of a country is compromised by corruption and incompetence (Box C), then the consequences are very serious for all levels and sectors of society. In particular, an ineffective judiciary allows organized crime to advance. Among the first signs to appear are increased sales of illegal drugs, protection and extortion rackets, kidnapping for profit, and gambling. Supported by profits from these illegal businesses, organized crime then usually moves into the construction⁴ industry, and from there into a variety of high-cash-flow enterprises (Box F). One of the costs of illegal business is extensive bribery, to purchase protection from the law and regulatory agencies. The initial targets of this pattern of bribery are the police and the prosecutor's office, but in the end almost all agencies of government are affected (Box E).

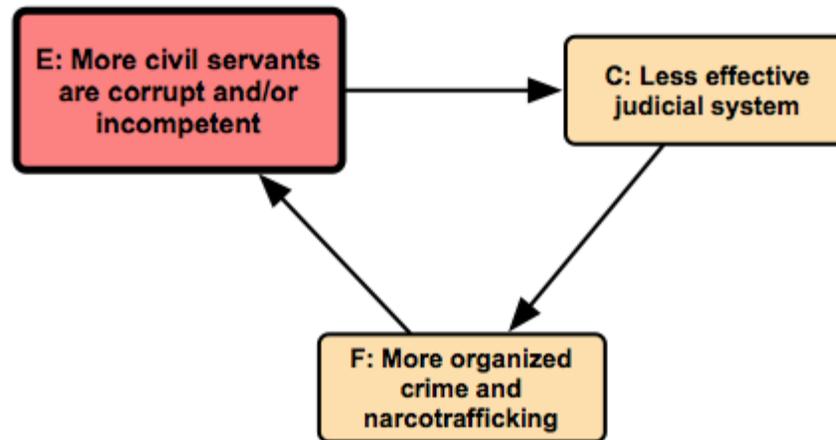


Figure 3: Causal diagram for the influence of the judicial system on the corruption process.

When magistrates and judges are appointed as part of the political patronage system, then their subsequent judgments in political cases will be subject to severe conflicts of interest (Box A).

To summarize, the vicious cycle $C \rightarrow F \rightarrow E \rightarrow C$ describes the effect of decreasing competence of the judicial system, via the intermediary step of increased organized crime. The patronage system (Box A) feeds and maintains this vicious cycle.

Poverty, ethnic discrimination, and rural-urban migration all play an important contributory role in this vicious cycle by dramatically increasing juvenile delinquency. When systems of juvenile justice respond by sending as many violent juveniles to prison as possible, then prisons become, in effect, *universities of organized crime*. How best to cope with this phenomenon is beyond the scope of this paper, but the first step is awareness that prison is not necessarily the best response to juvenile delinquency.

Cycle A: Political Appointments

Of all the vicious cycles that perpetuate corruption, this may be the most insidious and least understood, with the most far-reaching effects. It is also one of the more complex cycles, so we have saved it for last.

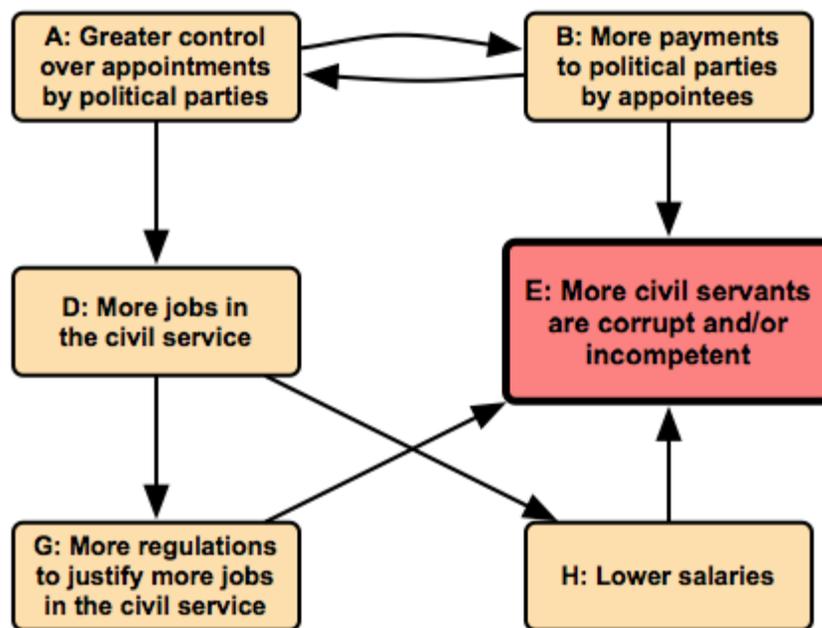


Figure 4: Causal diagram for the influence of the spoils system on the corruption process.

In the political systems of almost all nations, the president has the right to make appointments within the executive branch, beginning with cabinet positions and going down many levels deep into the bureaucracy. In most nations the sheer number of appointments exceeds the ability of any president to handle them, and so the power of appointment in effect devolves upon the political party of the president (Box A). However, political parties are subject to much less legal scrutiny and regulatory supervision than the president, and so opportunities inevitably arise for party leaders to solicit payments from would-be appointees in return for favorable consideration (Box B).

When prospective appointees have to pay a fee to a political party for employment, then the normal process of hiring on grounds of competence is increasingly undercut and subverted. In many countries, bureaucrats not only pay a "finder's fee" for an appointment, they must also pay a percentage of their salaries to the party for as long as their employment lasts. In other words, in order to be appointed in the first place, prospective bureaucrats must begin by compromising their ethical principles. The monthly percentage paid to the political party is, in effect, an *unproductive tax* on the salaries of all political appointees. All of this leads to an increasingly corrupt and incompetent civil service (Box E).

Once political parties come to depend upon payments by appointees for their employment, the temptation arises to expand the number of jobs over which the parties exercise control of appointments. One way to do this is to move additional jobs into the domain of political patronage (Box A), thus further corrupting the system. Another way is through the legislature: the party in power can expand the size of the civil service by enacting legislation that creates additional civil service jobs (Box D). In extreme cases these additional jobs are *phantoms*, meaning that the holder of the position need never show up to perform his or her duties.

In order to justify adding more jobs to the civil service, the legislature creates new regulations which these new jobs will administer (Box G), and new fees to support these regulations. Every new regulation provides additional opportunities for extracting bribes from the public (Box E). In addition, the increasing regulatory burden inhibits the movement of businesses from the informal to the formal economy (Box J), and acts as a counter-productive tax on business.

A System of Interlocking Vicious Cycles

Let us now step back for a moment, and contemplate how these four vicious cycles interlock and reinforce each other (Figure 5, below).

First, observe the existence of a very tight loop between Boxes A and B, which represents the system of party control over patronage jobs, and the financing of political parties through payoffs from job holders. Because this vicious cycle is so tight and powerful, and generates such large quantities of untraceable cash, it is in fact the driving force behind the corruption of the entire government.

Second, while this core process directly corrupts the civil service and subverts hiring and promotion for merit, it also drives the steady increase in unproductive or phantom jobs in the civil service and, indirectly, the uncontrolled increase in new regulations and fees imposed by the legislature on the public and business community.

Third, the legislature, which is primarily made up of members of the political party that controls the presidency, becomes corrupted by the necessity for passing laws that support and expand the patronage system.

Fourth, as incompetent and corrupt lawyers come to dominate the prosecutor's office, the judicial system itself becomes corrupted. Once both the legislature and the judicial system have been thoroughly compromised, there is no possibility for the government to fix itself. All internal checks and balances have been rendered ineffective, and the entire government becomes little more than a system for the employment and enrichment of the political elite.

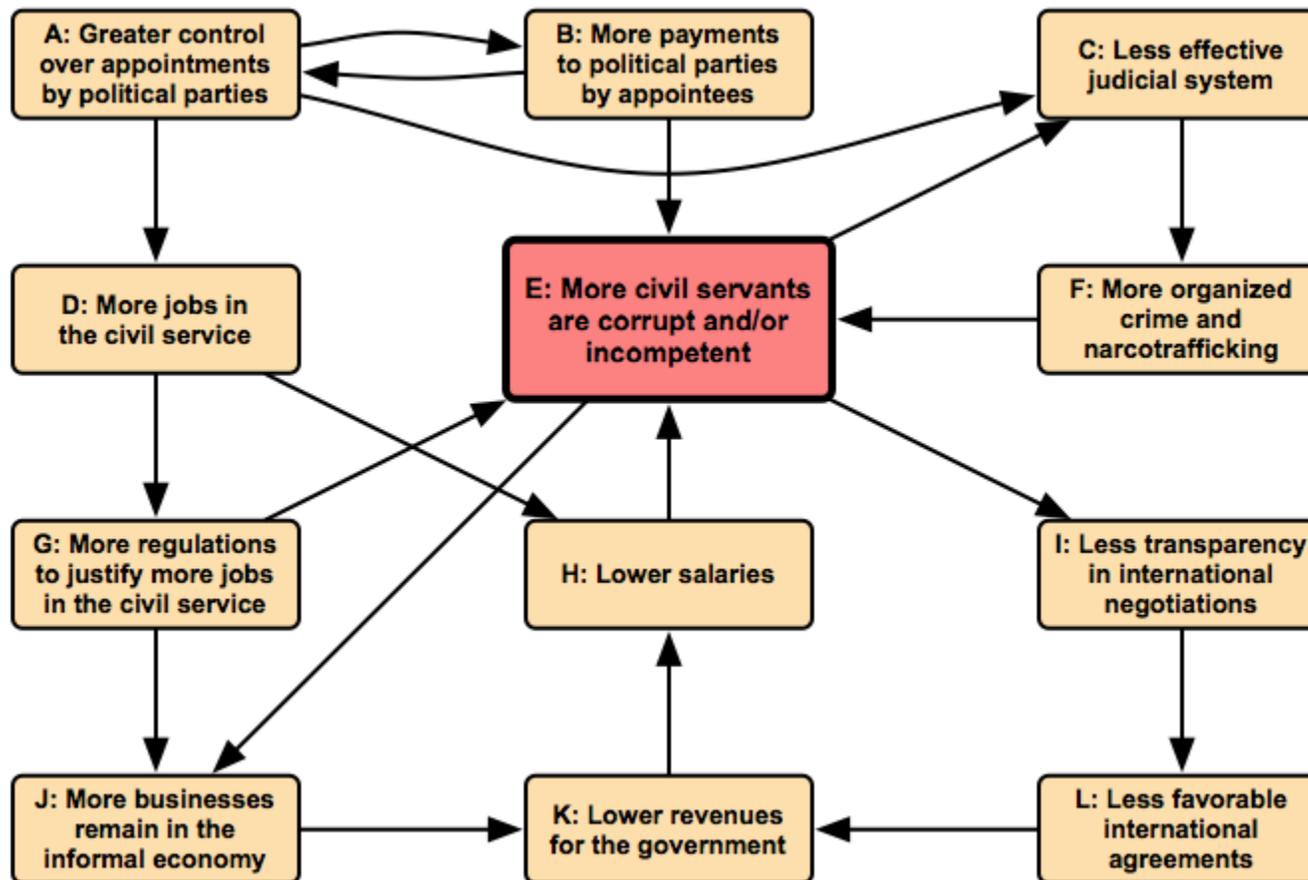


Figure 5: Full causal diagram of the corruption process.

Leverage Points for Reform and Correction

When all branches of government have been thoroughly compromised by corruption and incompetence, then each of the interlocking vicious cycles must be broken, more or less simultaneously. Merely breaking one cycle while leaving the others intact is an exercise in futility. To make things even more difficult, each cycle can be broken only by applying the correct tactical approach, and these approaches differ depending on the cycle. There is no one single tactic that works for any cycle.

As before, we will present tactics for the easiest cycles first, progressing up the scale of difficulty to the most complex cycle.

Breaking the Informal Economy Cycle

The first step in breaking this cycle is a direct attack upon excess and phantom jobs in the civil service, and on regulations and fees whose only purpose is to provide civil servants with the opportunity to extract bribes from the public and business communities. Compared to other kinds of reform, a case in favor of this reform can be made in the media without great difficulty. Everyone hates bureaucrats with too much power, especially small businessmen, and so this is likely to be a popular reform. International banks and donor countries can help by insisting on regulatory reform that follows widely-accepted international standards.

The second step is to remove all pointless legal and regulatory barriers to the process of formalizing businesses and industries of all sizes. This effort should be accompanied by a program of tax incentives for rapid formalization.

Once the process of streamlining regulations has begun, this cycle slowly converts itself into a "virtuous cycle." More businesses find reasons for moving into the formal economy, which raises government revenue, and in turn salaries begin to improve. Gradually, over many years, the general competence of the civil service is more likely to increase — but only if other vicious cycles are broken.

Improving the Transparency of Negotiations

As with the Informal Economy cycle, breaking the Transparency of Negotiation cycle requires an outcry from the people in favor of reform, and a vigorous public education campaign from the media. For this cycle, however, it is absolutely essential that international bodies participate by bringing pressure on multinational corporations to abstain from closed-door negotiations and the associated side-agreements, kickbacks, payoffs, and bribes. Without international pressure on multinational corporations, the probability of breaking this cycle is very low.

On the other hand, the economic benefits to a nation of improving its ability to conduct transparent negotiations are very large and arrive very quickly. This is because of the sheer magnitude of the typical injury to the national interest that an imperfect negotiation can entail. It is not at all uncommon for such an injury to exceed \$200 million in just one occurrence, and an injury of this magnitude is a staggering blow to the economy any developing nation. It is sobering to realize that every year there are many nations that suffer blows of at least this magnitude.

Systems of Justice and Public Security

Unlike the rest of the civil service, a system of justice must be cleaned from the top down. This is true not just for judicial systems, but also for militaries and any other "command" system in which higher layers exert extraordinary power and authority over lower layers. In such systems, if an upper layer is corrupt then exchanging corrupt for honest employees at a lower level is fruitless: the new employees will quickly face situations in which their only choice is between supporting their corrupt superiors or leaving their jobs.

If the highest court in a nation is corrupt, how can judicial reform proceed? One answer is to make use of larger international venues and groupings to which the nation belongs. For example, the Commonwealth of Nations has occasionally served this purpose for its

member nations, on an *ad hoc* basis. The International Criminal Court in The Hague is another possibility. The OAS and ASEAN have not yet set up agencies to offer such services, but this step may lie in the near future.

Another answer is to rely upon a special court, with special prosecutors and extraordinary (though temporary) power. In order to gain public support for such a measure, a special court of this nature must have a clearly defined lifetime, clearly delimited powers, and precisely identified targets. The opportunity to establish a reform at this level presents itself very rarely, for example immediately after the conclusion of a civil war, or in the wake of a massive corruption scandal. As with all other types of reform, a well-timed and comprehensive media campaign is absolutely crucial. Reformers should take action only when a good opportunity presents itself, and if there is no opportunity in sight then they should work on educating the public and building the will of the people to support drastic steps when the time arrives.

International agencies of justice can assist with templates for model legislation, procedures and mentors for special courts, and pressure on key political leaders at critical moments. However, without the will of the people such assistance is generally ineffective.

Once the reform process is underway, it should move systematically from the top of the judicial system downwards, level by level, taking care that a thorough investigation and prosecution at each level be conducted before proceeding to the next level below.

In this process, a *Truth and Reconciliation Commission*⁵ is often an invaluable tool for mobilizing and energizing public opinion, especially when it has been politically necessary to institute a broad amnesty for certain classes of past illegal acts by the police or military. The role of the Truth Commission is to reveal what misdeeds were actually done, even in the absence of prosecution. Without a Truth Commission, political healing from the effects of gross violations of human rights is unlikely to occur. South Africa, Chile, and El Salvador are examples of successful Truth and Reconciliation Commissions.

Reforming the Civil Service

It is the opinion of the NationLab team that the single most important and effective target of reform is the patronage system, the system which conveys to political parties undue powers over appointments to the civil service. This system cannot be reformed in a single year, nor in a single presidential administration, nor even in a generation. This is essential to understand: civil service reform is an unglamorous multi-generational process that must be started by far-sighted political leaders who cannot expect to see the benefits in their own lifetimes. It calls for the very highest levels of strategic and creative vision on the part of politicians and their supporters.

Unlike the reform of command structures (e.g. the national police and military), civil service reform is best conducted from the bottom upwards. There are sound political reasons for this: political parties cannot be expected to lightly relinquish their primary sources of income and power. They can be expected to resist every attempt to reform the patronage system, unless the reform is packaged in such a way that the impact of any one step in the reform process has only small effects on funding.

Historically, civil service reform begins with the establishment of a special agency which will ultimately have the sole power to hire and promote public employees within the civil service, and to terminate their service for just cause. At first, however, it is only given this power over its own employees, and those at the *very lowest rank* of government employment. The essential characteristic of this special agency — the characteristic which if violated will ruin the entire reform enterprise — is that the employees within its purview

must be *absolutely* protected from political interference with respect to hiring, promotion, and termination. This power must be supervised by a special committee of the legislature, chosen for their integrity, and enforced by a special system of courts and hearing panels, newly established for the purpose.

Once such a system is in place, then successive presidents can expand its purview gradually, step by step up the hierarchy of employment in the public sector. In the United States this process began with the Pendleton Act of 1883, and continued until the 1980s; in other words, it was a process that required almost a full century. Compared to European nations, the process in the United States is still not complete, and indeed has been regressing under both political parties over the last twenty years.

Summary

Based on what we have learned and seen during eight years of national strategic exercises and seminars, conducted in a variety of nations in Latin America, these are the important lessons:

1. Anti-corruption efforts that are focused purely on moral and ethical education are doomed to failure. Ethics are not sufficient when the design of the governmental system itself creates powerful and self-perpetuating incentives for corruption.
2. Anti-corruption efforts that simply increase criminal penalties for corruption are equally fruitless, for the same reason. Even the death penalty (as implemented in China, for example) is not sufficient to reverse systemic corruption.
3. Corruption and incompetence in government invariably go together; one cannot be separated from the other, nor should they be considered distinct problems.
4. The system of allocating government jobs by political patronage, administered by the political party that controls the presidency, is the single most powerful vicious cycle contributing to public corruption. However, it is not the only such vicious cycle, and it cannot be attacked in isolation from the others.
5. At least three further vicious cycles which perpetuate corruption exist. To describe these in terms of each one's critical variable, they are as follows: the informal economy, the systems of justice and public security, and the procedures for conducting critical international negotiations.
6. Systems of justice and public security must be reformed from the top down, because they are command hierarchies. Special courts and prosecutors are usually necessary, and these may sometimes have to come from outside the country. A *truth commission* is required whenever an amnesty has been in effect, to heal deep political wounds.
7. It is critical for the economic health of a nation to implement full transparency in international negotiations. The beneficial effects will be rapid and strong.
8. Phantom jobs in the civil service must be eliminated as rapidly as possible, along with all regulations and fees that provide too many opportunities for graft and bribe-seeking. At the same time, procedures for entering the formal economy must be streamlined for all businesses, and care must be taken to mitigate the potentially heavy effect of taxation on newly-formalized enterprises.

9. To break the power of the patronage system, first establish a civil service commission with unassailable powers over hiring, promotion, and termination of a small number of low-ranking public employees. Then, over the course of many presidential administrations, gradually increase the purview of this commission, level by level, from the bottom upwards. Ultimately, political patronage must stop at the level of deputy assistant cabinet ministers. All positions below this rank must be permanently and absolutely protected from political interference.

¹ Ætheling Consultants, Louisville, Colorado.

² Northrop-Grumman IT, Miami, Florida.

³ The nations are: Bolivia, Dominican Republic, Ecuador, El Salvador, Paraguay, Perú, and Uruguay. For more information on the *NationLab* series of seminars, see: <http://www.Aetheling.com/NL> .

⁴ http://www.transparency.org/global_priorities/public_contracting/key_sectors/construction_and_engineering .

⁵ For guidance in how to establish a Truth Commission, visit <http://www.truthcommission.org> .