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2013-2014 blog posts
by the
Edmond J. Safra Research Lab for Ethics

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"Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness."

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Harvard University

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September 16, 2013:

The Ethical Challenge for Qatar 2022

Ghanem Nuseibeh

In December 2010, the FIFA Committee awarded Qatar the right to host the World Cup in 2022. The day was historic on many levels: it was the first time a Middle Eastern country was awarded the right, the first time FIFA awarded two tournaments at the same time (with 2018 going to Russia), and it was the first time a country of that size was due to host such a major global event.

Almost immediately after the award, there was an unprecedented backlash from the football community. Questions were raised about the merit of the FIFA decision to award Qatar the 2022 games.

This blog post aims to assess the degree to which institutional corruption was present in the FIFA decision to award Qatar the 2022 games. It does not intend to address allegations of corruption in the legal and widely understood sense of the word. It does not address corruption as bribery or "[t]aking this (money) in exchange for that (special favour or privilege)," as mentioned by Lessig (2011).[1]

Lessig (2013) defines institutional corruption as being manifest "*when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, weakening either the public trust in that institution or the institution's inherent trustworthiness.*"[2]

A month after the award to Qatar was announced, FIFA President Sepp Blatter announced his support for the idea that the tournament is moved to winter, given the high summer temperatures in Qatar. This would be the first time ever that the tournament would be held in the winter months. Qatari officials initially expressed opposition to the change of season and insisted on continuing with plans to air-condition the stadia. However, opposition to a summer tournament has waned, and Qatar now appears to accept a move to winter, leaving the decision to FIFA.

The discussion surrounding the award included allegations of corruption. However, this is not the subject of this post and whether or not allegations of this type of "conventional" corruption are proven, is incidental to institutional corruption that affects both FIFA and Qatar.

Qatar's bid included two main pillars that appear to have played a role in the FIFA decision to award. The first was that Qatar is the first Middle Eastern country to host the World Cup. The second was allaying concerns about the temperature in the summer months in Qatar.

Zinedine Zidane, former French international player and ambassador to the Qatar FIFA 2022 bid, said that the victory of Qatar is "a victory for the Arab World."[3] In fact, the whole Qatari bid team spared no argument in conveying this argument. Blatter confirmed in an interview with *L'Equipe* that "[t]here were interventions at different levels so that [FIFA

2022] would go to an Arab country." When it decided on Qatar for 2022, FIFA's intention was to award the tournament to the whole Arab World, especially given that Qatar was the only Arab country to bid for the right to host.

The price that FIFA was prepared to pay was to hold the World Cup in a country where the temperatures are too high for players to be able to play outdoors. Qatari officials made it clear that they intend to build air-conditioned stadia to enable them to host the World Cup in the summer months.

However, shortly after the award, key officials started expressing concern about the merits of hosting the World Cup in Qatar in the summer months. Greg Dyke, the England Football Association chairman said that "[m]y position, and I suspect the FA's position, will be: 'You can't play it in the summer.'" FIFA then announced that it will discuss the possibility of shifting the World Cup in 2022 to winter. Moving the World Cup to the winter months will cause massive disruption to the annual football calendar, as national football associations will need to change their schedule to allow for the World Cup to go ahead.

The question is whether the controversy surrounding the award to Qatar constitutes institutional corruption. The two pillars of the Qatari bid cannot be considered in isolation. Would FIFA have awarded Qatar the 2022 bid, if part of the bid Qatar presented was that the 2022 World Cup would be hosted in winter?

The information currently available suggests that FIFA's eagerness to award the World Cup to an Arab country did not include any illegal or unethical influence. In fact, one might even argue that FIFA's insistence to award the 2022 to an Arab country is more ethical than not awarding it to an Arab country. It may also be argued that awarding the World Cup to an Arab country strengthens FIFA's purpose of bringing football to the whole world. That is certainly the case, if the World Cup is held in the summer months. The public understanding when the award was announced was certainly that the event would be held in the summer. Moving the tournament to winter raises serious questions about the merit of awarding the event to Qatar in the first place. Will moving the tournament to winter weaken public trust in FIFA, and/or its inherent trustworthiness?

To figure out the answer, the following are some of the questions that will need to be addressed:

Wasn't FIFA aware that the temperature in Qatar is unbearably hot during the summer when it made the award? If it did, it presumably accepted Qatar's solution to the heat problem through building air-conditioned stadia. Why has this changed now? Have the engineers designing the stadia concluded that air-conditioning them is technically not possible, and therefore Qatar has in effect reneged on its promise to provide air-conditioned stadia? If that were the case, should the tournament still be hosted in Qatar?

With the facts publicly available, there are strong indications that institutional corruption was present in the process that led to the award of the 2022 tournament to Qatar. The question that remains is whether FIFA is concerned about this as calls for it to reform mount. Pielke (2013) has indicated that despite FIFA's reputation being at "an all-time low," according to the British Prime Minister (June 2011), "there appears to be little reason to expect that its public reputation will be anything other than a minor factor in any future reforms."

If reforming FIFA will take a long time to rectify issues such as public trust, is Qatar willing to risk its reputation as a country and as a brand for the sake of hosting the World Cup?

FIFA has several options:

1. Hold the World Cup in Qatar in the summer, as normal;
2. Move the World Cup to winter but keep it in Qatar;
3. Re-vote for the 2022 tournament;
4. Find a compromise.

The first option (no change, as currently planned) has already come under significant criticism. It is becoming increasingly inconceivable for the tournament to be held in Qatar in the summer for a number of reasons, including the health and safety of the players and the fans.

From an institutional corruption perspective, the second option (holding the tournament in winter) is the worst. It will require dealing with dozens of national football associations and convincing them to move their tournaments to winter. It risks leading to further accusations of institutional corruption, and worse.

The third option, a re-vote, may be in FIFA's best interest, and an opportunity to start a new page as far as its public image is concerned.

A fourth and final alternative can be drawn up that takes into account the desire to have the World Cup held in an Arab country, but at the same time not have to change the date. It could still remain a Qatari event, but have most of the games held in cooler parts of the Middle East and restrict the events held in Qatar itself to perhaps the opening and closing games. Whilst such an option requires amending the case that led to FIFA awarding Qatar the tournament, it may be the least damaging from an ethical point of view. Instead of leaving Qatar's reputation damaged, it will enhance it regionally. It will truly make the tournament an Arab event, as Qatar wanted it to be.

FIFA—and, to a lesser extent, Qatar—have a massive task to deal with to clear their names from accusations of institutional corruption.

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1. Lessig, Lawrence (2011), "Two Conceptions of 'Corruption,'" ch. 14 of Republic, Lost: How Money Corrupts Congress—and a Plan to Stop It (Twelve), 226-247, at 226.

2. Lessig, Lawrence (2013), "Institutional Corruption Defined," Journal of Law, Medicine and Ethics, Foreword.

3. Pielke, Roger (2013), "How can FIFA be held accountable?," Sports Management Review, Vol 16, 255-267.

September 23, 2013

Obstructive Criticism: Why Dodd-Frank Is Falling So Far Behind

Gregg Fields

Five years ago this month, the collapse of Lehman Brothers heralded the arrival of the worst economic crisis since the Great Depression. A half-decade on, what's most shocking isn't how much has changed but, rather, how much hasn't.

The calls to prosecute the perpetrators? They have largely gone unheeded. And with the statute of limitations on most possible offenses running out, it's pretty clear that courtrooms won't be meting out meaningful punishment.

In terms of structural change, there were widespread demands to ban dangerous forms of securities trading by government-backed banks, to reinvent the way banks are regulated and even break up the largest institutions, in a repudiation of the long-observed "too big to fail" policy. "Too big to fail" contends that some organizations, if they sink, will take the economy down with them.

Earlier this year, a group of senators including Elizabeth Warren, the Massachusetts Democrat, and John McCain, the Arizona Republican, introduced a Senate bill with these goals in mind. The bill, called the 21st Century Glass-Steagall Act, after the Depression era law that separated Main Street commercial banks and Wall Street investment houses, would "reduce risks to the financial system by limiting banks' ability to engage in certain risky activities and limiting conflicts of interest."

Yet the proposal has gone nowhere. And the institutions at the heart of the crisis, their industry and even their leadership remains largely intact. In fact, in an America that has tired of supporting too-big-to-fail banks, it's worth noting that they're now even bigger. The four largest banks—JPMorgan, Citigroup, Bank of America and Wells Fargo—have assets of $7.8 trillion, according to the most recent Federal Reserve data. When the crisis hit, the top four had $1 trillion less in assets. (Wachovia, reeling in the crisis, was taken over by Wells Fargo, which replaces it as fourth-largest.)

"These banks are too big to manage and they're too big to regulate," Sen. Sherrod Brown, a Democrat from Ohio, recently told the Los Angeles Times. "Too-big-to-fail hasn't been fixed."

Depend On It

For students of institutional corruption, the crash and the responses to it were often, and accurately, attributed to the phenomenon known as dependence corruption. Dependence corruption is typically the result of an institution or individual having dual dependencies with dueling interests.

A frequently cited example is the credit rating agencies that simultaneously were supposed to provide guidance to investors in risky mortgage securities, while also pleasing their fee-paying clients, the investment firms selling the securities. The evidence is that the agencies' greater loyalty was ultimately to the latter.

And of course, there was the dependence corruption of Congress. As outlined by Larry Lessig, director of the Edmond J. Safra Center for Ethics, in his bestselling book *Republic, Lost*, Congress depends on Wall Street donations for campaigns—a conflict with the Congressional mission to be "dependent on the people alone," as it was phrased in the Federalist Papers No. 52.

And yet, campaign contributions in federal races from the FIRE sector—which comprises finance, insurance and real estate—rose to $664 million in the 2012 election cycle from $513.3 million in 2008, according opensecrets.org. Lobbying expenditures for the FIRE sector topped $487 million last year, up $30 million since 2008.

Shortchanged

Why haven't things changed? The crisis produced a 2010 law that was supposed to yield fundamental change. It's called the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is designed to bolster bank safety, empower regulators and, in the process, restore the public confidence that is all too often a casualty of institutional corruption.

But Dodd-Frank is now over three years old and is only plodding toward becoming the law of the land. According to Davis Polk & Wardwell, a law firm that closely tracks the law, some 280 regulatory rules were supposed to have been written by now. But the deadline has been missed for more than 61 percent of them.

Dependence corruption alone can't explain the slow pace. Although some regulators may have motivations for pleasing bankers—such as the possibility of going to work for them at higher pay—they clearly don't have the immediate financial dependence of donor-seeking Congress members or fee-based ratings agencies.

Rather, the inertia of Dodd-Frank reveals yet another form of institutional corruption. Call it *obstruction corruption*. Obstruction corruption is linked to, but different from, dependence corruption. Dependence corruption is characterized by mutually beneficial relationships that ultimately don't serve the public interest.

Obstruction corruption, in essence, is the mirror image of dependence corruption. Obstruction corruption prevents the formation of relationships that could produce reform. Laws that are long, complex and subject to interpretations that produce interminable delays are a frequent sign of obstruction corruption. It helps explain why more than 61 percent of the Dodd-Frank rules deadlines have been missed.

In its research, Davis Polk has several examples of how hopelessly obstructed the path to implementing Dodd-Frank is. For instance, many analysts have noted that Dodd-Frank is lengthy—over than 2,300 pages long.

But that's just a preview. In a highly entertaining infographic, Davis Polk notes that there have now been 15 million words of regulatory rules written—or 42 words published in the

Federal Register for every word in the law itself. (It would also equal 28 copies of Tolstoy's *War and Peace*.)

That comes to 13,789 pages of Dodd-Frank rules—and remember, more than 60 percent of the deadlines haven't yet been met. If you're looking for a central source, forget it: the rules have been created by 10 different regulatory agencies.

Davis Polk found that 4,259 public meetings have been held regarding Dodd-Frank, and notes that the longest proposed rule, a mortgage disclosure requirement from the Consumer Financial Protection Bureau, is 342 pages long.

Washington Inaction

Robert Kaiser, the associate editor and senior correspondent of the Washington Post, was there when Dodd-Frank was created. He is the author of *Act of Congress*, a riveting recent book borne of months of eyewitness reporting while former Rep. Barney Frank and former Sen. Chris Dodd, both Democrats, pushed the measure through Congress.

In a recent lecture to the Edmond J. Safra Center for Ethics, Kaiser said the delays and complexity were no surprise. "You could not write Dodd-Frank regulations in Congressional committees," he said. It would simply take too long. "All big modern bills have left rule-writing to the regulators."

And that's a problem, Kaiser said. He used as an example the much-heralded Volcker Rule, named for former Federal Reserve Chairman Paul Volcker. The Volcker Rule is intended to prohibit banks from gambling with their own money on so-called proprietary trading, in risky securities like derivatives.

But amid a withering onslaught of lobbying and regulatory in-fighting, the effort has stalled. "The Volcker Rule, three years later, is not written," Kaiser said.

That delay points to the institutional corruption phenomenon that Malcolm Salter, Harvard's James J. Hill Professor of Business Administration, Emeritus and adviser to the Edmond J. Safra Center, refers to as "gaming."

Gaming is "one of the most corrosive forms of institutional corruption in business," Salter wrote in "Lawful but Corrupt," a December 2010 working paper. "Institutional corruption refers to company-sanctioned behavior and relationships that may be lawful but either harm the public interest or weaken the capacity of the institution to achieve its primary purposes."

Dodd-Frank, with its hundreds of required rules, is a prime gaming opportunity, Salter predicted at the time. And that proved true, he contends in "Is Financial Reform Being Gamed?," a paper published recently by the Edmond J. Safra Center. "The current rule-making process has already extended way beyond the two years originally envisioned for conforming to the Dodd-Frank Act—a result of the complexity of the issues involved, extensive comment periods of proposed regulations, aggressive industry lobbying, and the inability of regulatory agencies to agree on final regulatory language," Salter wrote. Like Kaiser, he argues that the fate of the Volcker Rule is far from certain, noting that among other problems, "Congress left plenty of leeway for regulators to design (bend?) how the final rule will look," Salter wrote.

Disinterested

Obstruction corruption and gaming appear to have gathered momentum in the deregulatory fervor that has gripped much of Washington for more than 20 years. But accompanying them has been an equally important trend that might be referred to as *dis*regulation. Disregulation refers not to the loosening of oversight, which we often describe as deregulation. Rather, it involves simply banning rules altogether.

For example, much of the economic carnage in 2008 was due to losses on derivatives, those complex and risky contracts that left the major banks way too leveraged for their own good.

But the derivatives market didn't collapse because of bad, or broken, rules. The truth is, there weren't any: the Commodity Futures Modernization Act of 2000 specifically obstructed the Commodity Futures Trading Commission from regulating them.

Similarly, many Americans undoubtedly wondered where the regulators were when banks amassed such risky portfolios. Bank deposits are guaranteed by the FDIC, and taxpayers have the FDIC's back. Risky securities trading was historically confined to the trading houses like Merrill Lynch (and Lehman Bros.), which had no government backing.

However, the Gramm-Leach-Bliley Act of 1999 demolished the wall between Main Street banks and Wall Street traders. "Today Congress voted to update the rules that have governed financial services since the Great Depression and replace them with a system for the 21st century," then-Treasury Secretary Lawrence H. Summers said at the time. By repealing the Depression-era Glass-Steagall Act (which incidentally was just 37 pages long), Gramm-Leach-Bliley effectively disregulated banking.

As Kaiser said in his lecture: "Regulatory waiving has been a central part of the legislative process in this modern era."

Dodd-Frank may yet prove to be the true reform legislation that it was touted as in 2010. But if so, it will clearly have to overcome the institutional corruption challenges of dependence corruption, obstruction corruption and disregulation.

"Much of Dodd-Frank is dying on the vine," Bart Chilton, a commissioner with the Commodity Futures Trading Commission, which has been charged with regulating derivatives, told Yahoo Finance's "The Daily Ticker" earlier this year. "Lobbying, litigation and lawmakers who have tried to defund and defang Dodd-Frank have all brought rule writing to a crawl."

September 26, 2013

From New York to Hebron: The American Treasury's Support for Jewish Settlements in the West Bank

Uri Blau

Al-Shuhada Street in the West Bank city of Hebron is a microcosm of the Israeli-Palestinian conflict with its mixture of Palestinians, Jewish settlers, and soldiers patrolling around military checkpoints. It's very far, in every possible aspect, from the skyscrapers of Manhattan, but some of what is happening here is sponsored by American tax-deductible donations.

Approximately 1,000 Jewish (permanent settlers and religious Yeshiva students) people live in four different neighborhoods of Hebron, a small minority compared to the 170,000 Palestinians living in the city. Of these Palestinians, about 30,000 reside along the Al-Shuhada Street or bordering the Jewish neighborhoods, a part of the city officially called "H2." The Temporary International Presence in the City of Hebron describes the bleak economic outlook for the population of H2: "In 1994, the once main market street of Hebron, Al-Shuhada street, was closed by military order for Palestinian vehicles and pedestrians."

Hebron is home to the Cave of the Patriarchs, the burial sites of Abraham, Isaac, Jacob, Sara, Rebecca and Leah, so many Jews and Muslims consider the city as a sacred place. And as such, Hebron has its followers, supporters and above all the ones contributing financially from their fortunes to support the settlers. As one of them described the situation to me, "Hebron is a brand name."

The settlers know their best audience and have a unique way to appeal to visitors—and to encourage their donations. "Isn't it about time you took your children to visit their great-grandparents in Hebron?" suggests the website of The Jewish Community of Hebron, the most reputable local non-profit in charge of fundraising for its people. "New armored buses, inspiring guides, Hebron's historic sites and our pioneering spirit—all come together to make this tour your most moving day in Israel!"

This kind of advertisement works. The Hebron Fund—only one example—is an American-based non-profit recognized by the IRS for tax-deductible donations, which has raised over one million dollars in 2011 in funds for these settlers. Most of this money went to the Jewish Community of Hebron organization. According to a promotional brochure, the organization utilized the money to build a gym, purchase a school bus, install ATV for security patrols, and more.

The Hebron Fund also helped pay the $50,000 annual salary of Menachem Livni, who served as the CEO of the Jewish Community of Hebron until 2011. In the early 1980's, Livni was a member of the Jewish Underground which carried out attacks in the West Bank. He was convicted and sentenced to life in prison for his part in killing three Arab civilians and maiming two Palestinian mayors in car bombings. Granted a reduction of his original life sentence, Livni was released from prison in 1990. Upon his release, his friend Noam Arnon—a current senior member of the Jewish Community organization—praised the actions committed by Livni and his associates in a radio interview: "They are heroes because they decided to sacrifice themselves, their future, their families, for the security of Jews," he said.

Hebron is only one instance of a trend in recent years, which shows settlements or right-wing Israeli organizations adopting a new business model: raising funds through American tax-deductible charitable donations. Pro-Palestinian organizations also raise money through American non-profits, but their money, obviously, is not used to finance Jewish settlements.

Another similar example is the Central Fund of Israel—"promoting charitable activities in Israel," according to its mission statement—which has raised over 10 million dollars in 2011 alone, mostly for activities aiding Jewish communities in the West Bank.

One of the Israeli organizations that raises money via the Central Fund of Israel is called Honenu (from the Hebrew word for "amnesty"). As shown in an article I published in 2005, Honenu has collected money for the benefit of Yigal Amir, the convicted assassin of late Prime Minister Yizhak Rabin. On their website, after offering two paths for donation (online or by check) Honenu declares firmly and clearly: "ATTENTION AMERICAN DONORS: The IRS will allow US tax deductions only to those donating by the above 2 choices."

And there are even more examples. In an article published in *Haaretz* in 2009, I exposed that the American Friends of Ateret Cohanim, a non-profit organization based in New York, sends millions of shekels worth of donations to Israel every year for overt political purposes, such as buying Arab-owned properties in East Jerusalem. In their recent IRS report for the year 2011, the American Friends of Ateret Cohanim declared they have raised over one million dollars to promote their goals.

As a way to promote and encourage donations, the U.S. tax code enables non-profits to receive tax-exempt status if they engage in educational, charitable, religious or scientific activity. However, such organizations are forbidden by IRS guidelines to engage in any political activity. The latter is broadly defined as any action, even the promotion of certain ideas, that could have a political impact. Financing land purchases in East Jerusalem would, therefore, seem to violate the organizations' tax-exempt status.

There is hardly any way to know the full extent of this phenomenon, given the sheer number of non-profits in the United States. According to the National Center for Charitable Statistics (NCCS), more than 2.3 million non-profits operate in the US, with 1.6 million of them registered with the IRS. A *New York Times* piece, published in 2010, offered the guesstimate of "at least 40 American groups that have collected more than $200 million in tax-deductible gifts for Jewish settlement in the West Bank and East Jerusalem over the last decade."

While the former Palestinian main market in Al-Shuhada street remains shut, these large sums of money continues to help build houses, schools and synagogues for Jewish communities in the West Bank. These considerable tax-deductions help to perpetuate the settlement movement in the West Bank—the same movement that the official American foreign policy stance opposes, considering it an obstacle for a possible peace agreement in the region, as reiterated again by President Obama a few months ago during his visit to the Middle East.

September 30, 2013

Hacking a Hackers' Conference: Institutional Corruption and Networks in DataGotham 2013

Sebastián Pérez Saaibi and Juan Pablo Marín Díaz

On September 12, 2013, I attended the DataGotham conference in NYC. This is truly a one-of-a-kind event for Data Geeks. In an atypical presentation at a conference of this kind, I talked about *Institutional Corruption*. The title of my presentation: **Using Networks to Model Institutional Corruption** (see slides).

Rather than focusing merely on the tools and techniques people are using to crunch and munch on their data, DataGotham brought together professionals from across the NYC data community for intense discussion, networking, and sharing of wisdom. Its main goal, as the organizers *Drew Conway, Hilary Mason, John Myles White* and *Mike Dewar* put it, is to "tell stories about what problems people are solving, and the highs and lows of that process."

The purpose of my talk was to show these DataGeeks that computational tools can be used in contexts that are way out of their comfort zones; as fellow Juan Pablo Marín Díaz and I have used it to monitor institutional corruption across boards of Colombia's 50 largest companies (see our previous lab post).

I started by posing a daring analogy: I related Network Science and Institutional Corruption to Bacon and Ice Cream. That is, these topics sound seemingly disparate, and most people would think they have nothing to do with each other. But then, there's **Bacon Ice Cream**, and it's astoundingly popular. The trick lies in how to use network tools in the context of institutional corruption.

I then gave an intro to the Edmond J. Safra Center's definition of Institutional Corruption: *an influence that diverts an institution from its purpose or weakens its ability to achieve its purpose*…What followed was a brief description of how we modeled the network composition of Colombia's 50 largest companies, as described in our previous post.

I mentioned how the Lab's Innocentive contest was the window through which we found out about the E.J. Safra Center's brilliant initiative to source ideas for Institutional Corruption. That was the starting point for our relationship with the center.

My talk was part of a series of "lightning talks" modeled after the ignite format; short five minutes condensed talks meant to raise awareness and inspire. The most interesting part of the event came afterward, when people approached me and asked insistently about two topics:

First, how a couple of guys from Colombia had built a Predictive Analytics startup (see **Aentropico**). Second, people were truly interested in learning more about how to get involved and work in problems that tackle institutional corruption in one way or another.

It was even more refreshing to hear from people like Cathryn Posey, founder of Tech By Superwomen, who recently won Code For America's first annual data hackathon with her project Open Judge, which created a web and mobile platform to search for information about judges and the gifts they receive.

People are thrilled about the possibilities of working in deep, complex problems that have both social and economical implications that impact our daily lives. And I personally think that's great news for the people working on institutional corruption and the world in general. It's great to have data crunchers, visualizers and applied mathematicians on board. And now, for the journey…

October 1, 2013

Blurred Lines: Institutional Corruption and the Ethics of a Government Shutdown

Gregg Fields

When people become members of Congress, they take an oath that is, overall, pretty inspiring. But with the federal government in the midst of a progressive shutdown, it is worth probing a bit deeper to reconcile the oath of office with the hopeless gridlock that has gripped official Washington for several years now.

"I, (name of Member), do solemnly swear (or affirm) that I will support and defend the Constitution of the United States against all enemies, foreign and domestic; that I will bear true faith and allegiance to the same; that I take this obligation freely, without any mental reservation or purpose of evasion; and that I will well and faithfully discharge the duties of the office on which I am about to enter. So help me God." Each member of Congress must make this oath before being sworn in.

While there is more than enough partisan political mudslinging to go around, and much speculation on who will benefit or suffer the most politically from the shutdown, the horse-race analysis that focuses on who will win, place or show doesn't sufficiently address the ethical issues involved.

For the purposes of research conducted at the Edmond J. Safra Center for Ethics, the broader question might be examined through the prism of institutional corruption. That question might be framed this way: Is the government shutdown a form of, a result of, or a cure for, institutional corruption? If Washington is riddled with institutional corruption—and a great deal of research from the Safra Center indicates it is—then it is legitimate to ask if Congress is supporting and defending the Constitution with this shutdown. Conversely, it's worth exploring whether members of Congress are failing to faithfully discharge their duties of office.

Historical Perspectives

Of course, feelings of distrust and disgust related to government have a long and prominent history in the United States. Those sentiments can be found at virtually any point along the left to right political continuum. For the modern conservative movement, one compelling view of government was framed in Ronald Reagan's first inaugural address in 1981. "In this present crisis, government is not the solution to our problem; government is the problem," Reagan told a stagflation-weary country, which warmly embraced his message, if his two landslide victories are any indicator.

Nevertheless, there is also widespread evidence that Americans of many different political persuasions believe shutting the government down is, to paraphrase the oath of office, an evasion of Congressional duties. Even believers in American exceptionalism seem to feel this is—well, an exception.

A Washington Post-ABC News poll released Monday found that only one in four approve of Congressional Republicans' handling of the budget negotiations that have produced the standoff. Yet, Democrats didn't fare a whole lot better, with just 34 percent approving of their conduct. President Obama, whose landmark Affordable Care Act produced the funding feud with the House that led to the shutdown, fared best. But with 41 percent approval he still fell well short of a majority.

To help delineate the role of institutional corruption in the current imbroglio, it's useful to turn to the writings of Dennis Thompson. Thompson, the Alfred North Whitehead professor of political philosophy at Harvard, developed the concept of institutional corruption in the 1990s, particularly in his book *Ethics in Congress* (The Brookings Institution, 1995).

"Like all forms of corruption, the institutional kind involves the improper uses of public offices for private purposes," Thompson wrote in his introduction. "But unlike individual corruption, it encompasses conduct that under certain circumstances is a necessary or even desirable part of institutional duties."

The role of money was central to Thompson's argument. Money "can corrupt the quality of decisions and policies of government. But money can also corrupt the process, even when it is not possible to point to specific ways in which the outcomes of the process are corrupted," Thompson wrote on pages 115-116.

Those words were written 18 years ago, in a year the federal government also shut down. In that sense, they accurately reflect the gridlock that has now crippled the capital of the world's most powerful country for nearly two decades. Whether you feel the blame for any shutdown is with the House, the Senate or the White House, it's worth noting that the leaders of each branch proclaim their conduct is justified. The shutdown may seem to be a corruption of the oath of office. But as Thompson noted, it's hard to pinpoint specifically where the process became corrupted.

The Spirit's Not Willing

In the book *The Spirit of Compromise* (Princeton University Press, 2012), co-authored by Thompson and Amy Gutmann, president of the University of Pennsylvania, they make the case that breaking through such logjams is a prime responsibility for those in office. "Compromise is difficult, but governing a democracy without compromise is impossible," they wrote.

Set aside for a moment one obvious question: If a democracy isn't functioning, is it still a democracy? Rather, consider what about Washington today makes compromise an unattractive option. After all, the president and members of Congress run for positions of governance.

The evidence clearly suggests voters think government should be running. In a September 23 CNBC All-America Economic Survey, Americans opposed defunding Obamacare 44 percent to 38 percent. And if it meant shutting down the government and defaulting on U.S. debt, 59 percent of Americans oppose defunding Obamacare. So clearly Congress isn't dependent on the people alone when making its governing (or non-governing) decisions.

What are these other dependencies? A great deal has been written about the influence of Tea Party activists on the Republican efforts to defund Obamacare, which is at the heart of the budget impasse producing the shutdown.

But it's important to point out that Obamacare, which passed along partisan lines, was itself full of gifts for deep-pocketed political players. The White House, for instance, preserved pricing power for pharmaceutical companies enacted under the Medicare Prescription Drug, Improvement and Modernization Act of 2003, winning vital support for Obamacare from Big Pharma.

Similarly, the White House abandoned plans for a "public option" form of health care insurance that would have saved government an estimated $150 billion by increasing competition with private health insurance providers, noted Lawrence Lessig, director of the Safra Center, in his 2011 book *Republic, Lost*. "The lesson here is obvious," Lessig wrote on page 184. "There are 'institutional constraints' on change in America."

(Those constraints perhaps explain the sluggish pace of implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act, the other landmark legislation of Obama's first term. According to the Davis Polk law firm, which tracks the law's progress, regulators have missed more than 60 percent of the rule-making deadlines for Dodd-Frank.)

Just as the current budget standoff revolves around money, so does money elevate the role health care plays in the national agenda. In 2011, the U.S. spent $2.7 trillion on health care, according to figures from the Centers for Medicare and Medicaid Services, a federal agency.

The health sector was the top-ranked industry in lobbying spending in 2012, according to opensecrets.org, which estimated it spent $488.96 million. So far this year, as of the end of July, it has spent another $243 million on lobbying, according to opensecrets.org. As for campaign donations, various health-related entities contributed $83.8 million to members of Congress in the 2012 election cycle. Presidential candidates got $42 million from the health sector, opensecrets.org said.

A Federal(ist) Case

Obviously, such huge volumes of money have the potential to shape public policy priorities. And that's a problem, Lessig writes, because Congress, as outlined in the Federalist Papers No. 52 "ought to be dependent on the people alone." Clearly, Congress—and for that matter, the White House—are dependent on constituencies other than the people alone when it comes to how the federal government is run (or isn't.) Lessig refers to this condition as "dependence corruption." That is, dependence on constituencies whose interests conflict with serving the public. "That competing dependence produces an error," he writes on page 20 of *Republic, Lost*. "A corruption."

How this will all play out isn't clear. But clearly the stalemate that has produced protracted paralysis isn't something Reagan would look fondly on. At least on that hopeful inaugural day, he pledged to restore public trust by reforming government to serve the public interest. "Now, so there will be no misunderstanding, it's not my intention to do away with government," he said after taking his oath. "It is rather to make it work—work with us, not over us; to stand by our side, not ride on our back."

In Reagan's view, it would appear, faithfully discharging his duties meant running government, not closing it down.

October 8, 2013

McCutcheon v. FEC: Murky Money and the Rise of [More] Mega-Donors?

Jennifer Heerwig and Kate Shaw

The Supreme Court will hear arguments today in McCutcheon v. FEC, a case that could seriously undermine the substantive limits on the flow of money into federal elections. Although *Citizens United* dramatically changed the campaign finance landscape, its direct impact was limited to independent spending; the case did not touch the scheme that regulates the money individuals give directly to candidates, party committees, and other political committees. *McCutcheon* represents the first time the post-*Citizens United* Court will consider any aspect of the limitations scheme that has governed federal elections for nearly forty years.

Background

Federal law limits contributions to candidates, political party committees, and other political committees in two separate ways. First, it limits the amount of money any individual can give to a candidate for office (currently $2,600 per election), political party committee (currently $32,400), or other political committee (currently $5,000 or $10,000, depending on who establishes the committee). Those "base limits" are not at issue in this case—at least not explicitly.

Second, the law imposes an *aggregate* limit on the amount any individual can contribute during any two-year cycle to all candidates, parties, and committees. This limit is raised slightly with each election cycle to adjust for the effects of inflation. The current aggregate figure for 2013-2014 is $123,200. This basic structure has been in effect since 1974, and the Supreme Court has upheld it against constitutional challenges.

In 2012, Republican Shaun McCutcheon, together with the Republican National Committee (RNC), challenged the aggregate limit, with McCutcheon arguing that he wished to contribute, and the RNC that it wished to receive, more than the law's aggregate limit allowed. The lower court rejected the challenge, explaining that the Supreme Court has held that the law's base contribution limits are justified by the important government interest in preventing corruption or the appearance of corruption, and that the aggregate limit is justified by the need to prevent contributors from circumventing the base limits. The case is now before the Supreme Court.

Consequences and Predictions

If the Court does indeed strike down the aggregate contribution limit, what will be left of campaign finance regulations? Invalidating the aggregate limit wouldn't necessarily lead to the demise of the base limits (although the logic of the Court's decision could cast significant doubt on the durability of those limits). But without the aggregate limit, the base limits could be easily evaded through the formation of multiple committees designed to aid the same candidate or set of candidates. That is, the elimination of the aggregate limit would render the base limits far less effective at keeping super-wealthy individuals from donating hundreds of thousands—if not millions—of dollars to their favored candidates.

<u>Murky Money</u>

In a campaign finance system without aggregate limits, disclosure requirements may be the last, fully viable method of regulating the campaign finance system. But are disclosure requirements alone an adequate regulatory safeguard? In a piece forthcoming in the *Georgetown Law Journal*, we examine this important possibility. Relying on the Longitudinal Elite Contributor Database (LECD)—an original database developed by one of the authors to track campaign contributors over $200 in federal elections—we explore the realities of the FEC's existing disclosure regime. We conclude that disclosure, at least in its current form, is inadequate to inform the public and prevent corruption—two key objectives of campaign finance regulation.

One common misconception about our current disclosure system is that the FEC tracks individual contributors as they give money from one election cycle to the next. But, in fact, the FEC catalogues *contributions*—it does not follow unique individual *contributors* over time. And although donors are legally obligated to provide their full name, address, and occupation with their contributions, the quality of information reported to the FEC is generally poor. Contributors often fail to provide required pieces of information, provide false or misleading information, or provide different versions of the same information over time.

Since the FEC doesn't track unique donors, we're already hard-pressed to detect the biggest, most consistent donors in federal elections. But this problem will be especially acute if, in a post-*McCutcheon* world, a small number of individual donors are able to swamp the campaign finance system with dollars that are spread across dozens of unique committees. There's no limit to the number of committees that can crop up—including committees whose purpose is to support a single candidate for office. And a donor who gives $5,000 each to dozens of separate committees, each of which exists solely to support a particular candidate, begins to look a lot like a donor who gives hundreds of thousands of dollars to that candidate directly.

In this way, political money could be funneled from a tiny core of mega-wealthy donors directly to candidates. Within the current disclosure regime, we won't be able to identify these mega-donors without significant data cleaning. Since donors will potentially make contributions to dozens of unique entities, we won't be able to isolate large contributions (potentially funneled through dozens of unique committees), as savvy political journalists have done with super-PAC donors in the past several election cycles. If the Court strikes down the aggregate limits, we'll have an influx of "murky money"—money that is disclosed to the FEC by law, but exceedingly difficult to trace given the current disclosure regime.

<u>More Mega-Donors</u>

Of course, an influx of money from ultra-wealthy donors will increase the dependence of our elected officials on the wealthiest Americans.[1] Using the LECD, we estimate that in

2008, just 0.5% of adult Americans made contributions large enough to be disclosed to the FEC. This tiny minority of donors who meet the FEC's threshold for disclosure is already an unrepresentative slice of the American electorate. But the degree of representational distortion—that is, how much campaign donors differ from the American electorate on politically salient characteristics like wealth—increases with the size of donations.

Using the LECD, for instance, we estimate that the median home value of itemized donors is between $350,000 and $399,999 compared to approximately $180,000 for the American population. But mega-donors donors—donors who have given 50% or more of the legal aggregate limit—are wealthier still.[2] A *majority* of mega-donors own homes worth at least $750,000, and *over a third* of these donors own homes worth over a million dollars (see Figure 1). To put this in perspective, the US Census Bureau estimates that just 0.6% of American households own homes worth that much. Donors who make mega-contributions bear little resemblance to the average American—after all, their average aggregate contribution of $91,000 was nearly twice the median annual income of American households.

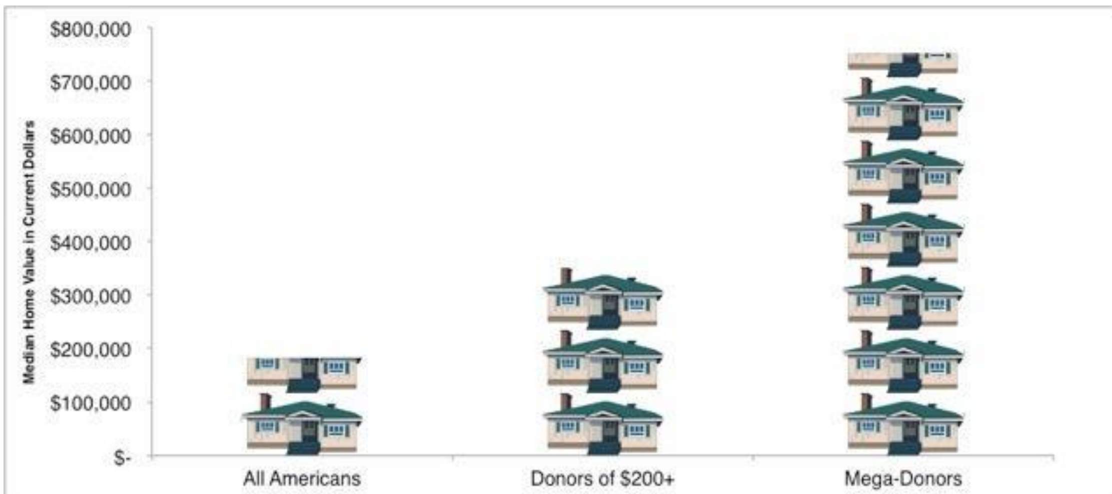

Figure 1: Median Home Value of All American Homeowners, Donors of $200+, and Mega-Donors in Federal Elections

These stark differences between the characteristics of wealthy donors and average Americans might be important for at least two reasons. For one, the characteristics of donors suggest that wealthy donors may have different *interests* and *needs* than average Americans.[3] It's probably fair to speculate that average Americans are concerned with financing their children's education and paying their mortgages, while these concerns matter little, if at all, to the top 1% wealthiest Americans.

Second, social scientists have recently analyzed decades' worth of public opinion surveys to evaluate differences in the *policy preferences* of wealthy Americans. It turns out that not only do super-wealthy Americans have different interests and needs—they also demand different kinds of public policies from elected officials. To take just one example, the wealthiest Americans are generally more supportive of economic policies to cut capital gains taxes, reduce top income tax rates, and lower the estate tax than lower- and middle-income Americans. They also tend to take slightly more liberal views on social issues like abortion and gay rights than do lower- and middle-income Americans.[4]

Concluding Thoughts

McCutcheon v. FEC will be the Court's most significant campaign finance decision since *Citizens United*. The *McCutcheon* decision could strike down the aggregate contribution limits that have been a staple of our campaign finance regulations since the 1970s. And in doing so, the decision may have far-reaching consequences for how our nation's elections are financed. Without adequate additional safeguards, the decision has the potential to further undermine the transparency of our elections, and to exacerbate the dependence of our elected officials on the nation's super-wealthy elites.

Notes:

[1] For an extensive discussion on the dependence of elected officials on wealthy donors, see *Republic, Lost: How Money Corrupts Congress—and a Plan to Stop it* by Lawrence Lessig (2011).

[2] The housing value estimate for the American population comes from the 2010 Survey of Consumer Finances, converted to current dollars using Bureau of Labor Statistics CPI Inflation Calculator. To measure the housing wealth of donors, we utilized a random sample of all itemized donors in the 2004 and 2008 federal elections. "Mega-donors" refers to all donors who contributed 50% or more of the legal aggregate limit in each election cycle. In 2004, the aggregate limit was $95,000; in 2008, it was $108,200.

[3] For more on representational distortion in American politics, see *Voice and Equality: Civic Voluntarism in American Politics* by Sidney Verba, Kay Lehman Schlozman, & Henry Brady (1995) and *The Unheavenly Chorus: Unequal Political Voice and the Broken Promise of American Democracy* by Schlozman, Verba, & Brady (2012).

[4] These findings come from political scientist Martin Gilens' *Affluence and Influence: Economic Inequality and Political Power in America* (2012).

October 8, 2013

Companies Capture

Mariano Mosquera

Weak public procurement processes in some Latin American countries are undermined in order to fund party politics. This situation presents new methodologies of, and a wide scope for, institutional corruption because it involves, among other things, the creation of ad hoc corporations to establish corrupt relationships with the government.

The classic definition of corruption indicates that it is pollution of the public by the private. This idea of corruption has promoted the study of a "corporate state," co-opted by corporations that distort the public interest and address collective goals and resources to private interests. Academic development of this view has led researchers to identify specific strategies like corporate lobbies, or even the notion of "state capture,"[1] in which people related to private interests are placed in key positions of the state to implement corruption from inside of it. However, this focus on corruption is not entirely successful for some countries in Latin America, where economic power appears subordinate to political power.

In the region, the government extends ties to co-opt the private sector in order to finance politics. That is, the government looks for corporate partners or directly creates some corporations to divert public resources and objectives toward partisanship. So the pollution of the public by the party interest is a strong component of the definition of corruption.

In this sense, the public procurement process appears to be a clear example of institutional corruption,[2] and in particular of the extension in the definition of corruption.

How it Works

Institutional corruption in public procurement begins when government officials request money from already co-opted suppliers. These companies promise to give that money (usually a percentage of the contract awarded) to the officials once the contract is awarded to the company. Officials or institutions receive a political advantage with this money that allows them to lead the political system. Thus, they look for political and social support through dirty fundraising strategies used to improve political organization and visibility. In exchange, the government systematically grants contracts to allied suppliers, without respecting the competitive rules of public procurement processes.

Some general conditions cause the officials' requests for money to operate differently than individual corruption with the incentive of personal gain. These conditions include the large number of people who can participate in the bidding process and the high economic amounts involved. This creates a special interest of the "political class" (party leaders in government) in strengthening mechanisms of political financing through the public procurement process, involving extensive networks of political allies and the quest for major economic amounts. In modern democracies with competitive elections, taking advantage is part of the political struggle, but the problem is the use of inappropriate processes to achieve this advantage. The pressure of competitive democracy on political financing, in this case, affects the processes and purpose of the state.

In addition to this, there exists confusion about the purpose of the state, the purposes of the government, and the intent of the party.

Corruption Processes

Fundraising for political parties by soliciting private contributions is not corruption. But it is an offer from the government to some of the providers who are bidding for a public works contract, in exchange for the promise of money and through the alteration of the bidding process. In this case, money is diverted to party politics. The inappropriate public procurement process undermines the competition among providers through the distortion of the principles of maximum diffusion, better quality and lower price.

Another distinguishing factor of this form of institutional corruption is not only characterized by the pursuit of corporate partners by the government, but also by the creation of ad hoc companies. Many times the government creates ad hoc firms that only serve the purpose of a corrupt relationship with it. In these companies, conversely to Kaufmann's notion of "state capture," people with partisan loyalty are put into place, with the objective of diverting public resources obtained to finance politics.

Two recent cases at the sub-national level in Argentina demonstrated this methodology of institutional corruption. Both cases, reported journalistically, reflected the creation of companies with people related to partisan political power.

In the government of Cordoba Province a provider of road cleaning services, created to establish a corrupt relationship with the government, was led by party allies placed into power directly by the Minister of Transport. The case finally ended up with the resignation of the Minister. Another case in the municipality of Villa Carlos Paz showed how a newly formed company with no experience obtained contracts for major tourist events in the city, while at the same time the company made "donations" to local government.

Conflict of Purposes and Devastating Effects

On the one hand, the purpose of the state is the promise of a level playing field that is equally restrictive and empowering for all its inhabitants[3]; this contrasts, at least in this case, with the idea of mobilizing political support.

In an ideal sense, the competitive public procurement process secures the purpose of the State (as in Held's definition). But in many cases in Latin American contexts, undermining the public procurement process is necessary for fundraising party support.

Thus, corruption is the election of a wrong process (by leaders of the party working in key positions in the government) to achieve the objectives of party politics, affecting the purpose of the State. This is the primordial conflict of interests between government and party. This is a practice of corruption without any possibility of justification, because collective resources are used for partisan objectives and by improper means.

On the other hand, it is important to clarify at another level of analysis that the existence of multiple and complex governmental purposes are used to mobilize partisan support in some governments in the region. This increases the confusion of purposes, where officials and institutions are interested in receiving money and political benefits to achieve these purposes of government. Here, the purpose of the party is not in conflict with the purpose of government, but the purpose of the state is affected by the use of improper means. This kind of corruption has more possibilities for artificial justification, and is excused (in our regional culture) because collective resources are used for collective purposes. Furthermore, it is clear that the effects of this institutional corruption are so devastating because of the high economic amounts that exist in public procurement processes.

A negative consequence, with a wide territorial and temporal scope, is the lack of quality in public investment. This kind of institutional corruption also produces the inability to use public works as a Keynesian tool for economic and productive mobilization through the development of strategic sectors. This point is very important in emerging economies.

Successful Practices in the Region

A comprehensive and robust framework of rules applied to the public procurement process may be an appropriate remedy against such institutional corruption. The successful experience of Chile-Purchase proves it. The Chilean system is based on institutional arrangements that combine the professionalization of public administration, public procurement courts, and enforcement authorities with functional autonomy. In addition to this, the active and passive public information processes are relevant, as well as the social participation in councils of integrity and transparency, and the continuous innovation in technology tools.[4]

Moreover, the civil organization Poder Ciudadano in Argentina has implemented an integrity pact methodology, between providers, to avoid paying bribes. This initiative is still very limited, only focusing on building a transparent scenario for public procurement. This methodology is accomplished by defining the exact scope of the specific pact, access to certain information, and civil monitoring.

The author wishes to extend special gratitude to David Johnson for corrections, and to Alejandro Barbeito, who created the artwork in this blog.

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October 15, 2013

Seeing What Isn't There: Resolving Failed Banks after Dodd-Frank

Gregg Fields

The American writer Gertrude Stein, in describing a visit to her childhood home of Oakland, would later write, "There is no there there." Were she still alive, she might say the same about aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Most of Dodd-Frank's mandated rules, for instance, haven't been written. The idea that the law spelled the end of "too big to fail" runs counter to the fact that many major banks are actually getting larger. And episodes like JPMorgan Chase's derivatives scandal—nicknamed the London Whale—suggest that practices that brought the world economy to the brink of ruin are still running full throttle even though Dodd-Frank was designed to rein them in.

If all that weren't evidence enough, a recent spate of filings by the country's major financial institutions once again suggests that the allegedly great and powerful Dodd-Frank is less like the omnipotent Wizard of Oz and more like the weak-willed man behind the curtain.

The filings at issue are "resolution plans" of major banks. They're nicknamed "living wills" because they require institutions to outline how their affairs are to be handled should they experience a life-threatening shock like the one in 2008. The plans must be filed annually, under Dodd-Frank's 165(d) rule adopted by the Federal Reserve and FDIC.

Tougher Rules?

The regulatory goal of the living wills is to prevent a repeat of the wildly unpopular bailouts of 2008. "Under the Dodd-Frank Act, bankruptcy is the preferred resolution framework in the event of a systemic financial company's failure," James R. Wigand, then-director (now retired) of the FDIC's Office of Complex Financial Institutions, testified to Congress earlier this year. "Ensuring that any institution, regardless of size or complexity, can be effectively resolved through the bankruptcy process will contribute to the stability of our financial system and will avoid many of the difficult choices regulators faced in dealing with systemic institutions during the last crisis," Wigand said.

The living wills were first required in 2012, although they were somewhat incomplete. In fact, regulators found them to be so flimsy that earlier this year they outlined a lengthy list of details that banks had to include in 2013 plans. They also extended the deadline for plan submissions by three months, to October 1.

"The Plan's strategic analysis should be presented in a concise Narrative form that discusses the Covered Company's overall resolution strategy under the U.S. Bankruptcy Code and/or other appropriate insolvency regimes. The Narrative should discuss the critical steps of the resolution process and how identified weaknesses or impediments may be addressed," the regulatory guidance said.

Regulators have now released the public portions of the 2013 plans, in which banks were to take into account "adverse" and "severely adverse" economic conditions and consider issues like international cooperation as distressed global banks deal with regulators and assets in other countries. Yet, despite the tougher regulatory guidance, the new living wills read less like final wishes and more like wishful thinking.

"We believe that the resolution planning process, as required by our supervisors, is a critical building block in the development of orderly resolution plans for major financial institutions that will address the 'too big to fail' problem, an objective we fully support," Goldman Sachs says in its plan. "We also support the goal that all financial institutions, regardless of size or complexity, should be able to be resolved without cost to the taxpayer."

Regulators and, by extension, taxpayers, have no need to worry, Goldman Sachs assures us. "The plan does not rely on the provision of extraordinary support by the U.S. or any other government to the firm or its subsidiaries and would result in no loss to the FDIC Deposit Insurance Fund," contends Goldman Sachs.

For this article, the resolution plans of Goldman Sachs, JPMorgan Chase, Citicorp and Bank of America were reviewed. What's striking isn't how complicated the resolution plans are but, rather, how simply they describe the envisioned orderly liquidation, if it comes to that, of global institutions that have trillions of dollars in assets, with operations around the world.

JPMorgan Chase, for instance, believes "that our resolution plan would effectively resolve the firm within a reasonable timeframe, without systemic disruption and without exposing taxpayers to the risk of loss," its resolution plan reads. It later adds: "The resolution plan would not require extraordinary government support, and would not result in losses being borne by the U.S. government."

While those are certainly laudable goals, firm details in the resolution plans are tough to find. Admittedly, the public plans aren't a full accounting, but rather summaries. Presumably, the full plans filed with examiners contain greater detail.

Theories of Reality

Nevertheless, students of institutional corruption might question whether these theoretical plans can withstand inevitable economic, political and ethical realities that a collapse like 2008's would undoubtedly unleash.

Indeed, an analysis might begin with the concept of regulatory capture. Regulatory capture occurs when industry holds powerful influence over the regulatory rules it lives by. Regulatory capture is often a symptom of institutional corruption.

Regulatory capture has often been blamed, at least in part, for the banking collapse of 2008. Oversight agencies had a hands-off policy toward risky practices like derivatives trading, for instance, in part because Congress had expressed deregulated derivatives with the Commodity Futures Modernization Act of 2000. Similarly, regulators sat idly by as banks took massive risks in products like subprime mortgages in the years leading up to the collapse.

Yet, while Dodd-Frank is touted as a "reform" law, it's worth asking if it changes that laissez-faire regulatory environment. Specifically, why are banks outlining how their problems will be resolved in the next crisis? Shouldn't it be regulators calling the shots?

"I believe the entire concept is flawed, and it is just another piece of paper from the Beltway that is supposed to give comfort and assurance to everyone, especially the regulators, that the too big to fail problem has been resolved," Ken Thomas, a Miami-based banking analyst and longtime Wharton lecturer told me. "With all due respect to Marx, I consider living wills The Opiate of the Regulators."

Global Reach

Another frequent contributor to institutional corruption is conflicting constituencies. That is, an institution beholden to more than one constituency must inevitably prioritize one over another. That becomes an institutional corruption issue if the preferred constituency doesn't serve the public interest.

It's particularly relevant regarding banks, because their very structure requires them to serve multiple constituencies. Most notably, they aren't regulated by Washington alone. Many if not most of their assets are going held in foreign countries, who may or may not go along with U.S.-approved resolution plans. In its guidance, the FDIC asked banks to "identify and quantify, among other things, the actions . . . to avoid the adverse consequences of ring-fencing by host jurisdictions."

Citigroup, for instance, derives more than half of its revenue and income from operations outside North America, according to its resolution plan. Citigroup says its resolution plan "addresses how Citi's non-U.S. operations would be impacted in the event of failure at the Citigroup parent." Details, however, are not forthcoming.

The problem, to some observers, is that the resolution plans aren't pre-emptive. They don't actually require banks to significantly restructure their balance sheets and abstain from riskier practices. Rather, the plans are their best guess about how they'll respond should a disaster occur.

Among other things, they presume they'll be able to orderly liquidate their assets in a timely manner at reasonable prices, even though the history of financial panics suggest that won't be the case.

"Today's markets trade on seconds and milliseconds of new data, and any hint of a serious problem at a (too big to fail bank) means that it must be immediately dealt with by the regulators," Thomas, the banking analyst, told me.

In a recent speech, Martin Gruenberg, chairman of the FDIC, acknowledged that institutional challenges remain on the issue of resolving failed financial institutions. And until regulators actually are tested by a failure, "there will no doubt continue to be skepticism about the capability and will of regulatory authorities to impose the consequences of failure on the shareholders, unsecured creditors, and managers of these firms," he said in a speech earlier this month to the Volcker Alliance, a public policy organization founded by former Federal Reserve Chairman Paul Volcker.

With that in mind, the FDIC plans to release a fuller description of the resolution process later this year, Gruenberg said. Time will tell if there's a there, there.

October 16, 2013

Informal Business Practices in the Russian Pharmaceutical Sector

Elena Denisova-Schmidt

In spite of the financial crisis and its consequences, Russia still remains a potentially attractive market, presenting some promising investment opportunities with the potential for dynamic growth in sales and profits. But foreign investors might be faced with several significant challenges while working in Russia, because informal practices—the spoken and unspoken understandings that complement or sometimes even contradict official procedures—often prevail over formal rules and laws.

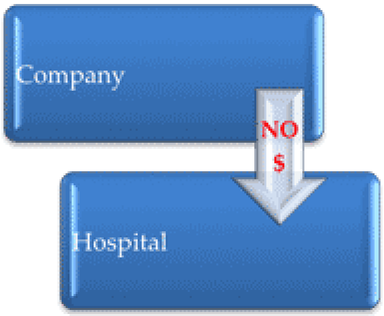
Using one pharmaceutical company as an example, this contribution shows what informal practices foreign companies might expect in Russia and how they could manage them.[1]

Cooperation with the State

Like other pharmaceutical companies operating in Russia, one particular company has spent much time dealing with the country's antiquated and often business-unfriendly regulations and laws. For example, Russian hospitals have a quota on the medication they prescribe: 30% should be of domestic origin. The company produces its medication abroad, but packs it in Russia—so according to Russian law, the company produces domestic medication. Many physicians and patients alike are not satisfied with this protectionism, however; the quality of Russian drugs needs improvement. Domestic insulin produced in one Russian region, for example, is actually provided free of charge to patients, but it is completely ineffective. Foreign insulin is available on the market, but it must be bought by patients directly and most of them cannot afford it.

Cooperation with Hospitals

Russian law prohibits pharmaceutical companies from providing direct financial support to a hospital. An indirect donation through a third party (e.g. a charity organization) is still a possibility, however. Consider the example of a hospital undergoing renovation: its budget is unfortunately not sufficient to modernize its own infrastructure, so a charity organization might make an offer of new furniture, new equipment and other consumables on the condition that the hospital buys and distributes a certain amount of drugs from one of the organization's sponsors (Figure 1 and Figure 2).



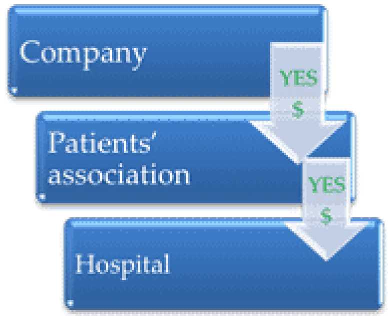


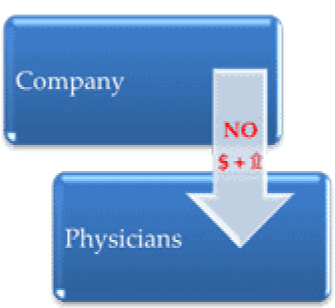
Figure 1 Figure 2

Cooperation with Physicians

The company cooperates with local physicians. Physicians are an important link in the product distribution chain, but they are also an important channel for professional discussions and feedback. There are some regulations that restrict such cooperation, however.

Federal law No. 323,[2] covering the health protection of citizens—effective since January 1, 2012—makes this relationship more complicated. For example, representatives of a pharmaceutical company are no longer allowed to meet with physicians during their working hours—but the law does not stipulate if lunch time counts. Physicians are not allowed to accept any gifts from pharmaceutical companies, including office supplies and medical uniforms. Many hospitals in Russia have a very poor budget, however; they are not even able to provide their employees with pens or coveralls.

Before the introduction of this new law, pharmaceutical companies used to invite physicians for various events, including different types of entertainment and trips abroad. The new law prohibits this, although educational events, such as roundtables and trips for educational purposes—including coveted trips abroad—are still permissible (Figure 3 and Figure 4).



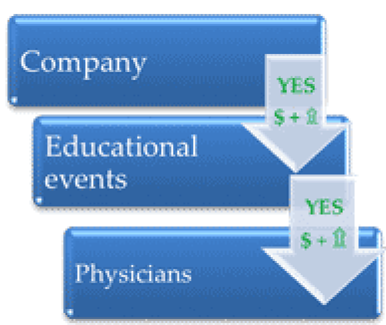


Figure 3 Figure 4

So, for example, a physician researching his or her Ph.D. thesis might undertake a study on the use of a company's drugs. To comply with the degree requirements in Russia, a Ph.D. student must have published a certain number of articles in academic journals before submitting a thesis. The pharmaceutical company sponsors these publications,[3] which explicitly contain information on this company's products. Usually these are publications in recognized Russian academic journals. The company might also cover travel costs and provide a small honorarium for a physician talking about its products at an academic conference or during continuing education for practicing physicians.[4]

This pharmaceutical company, like the other foreign pharmaceutical companies operating in Russia, seems to use the same business practices in Russia as they do at home. The difference is in the starting point: under-financed Russian state hospitals that lack some basic instruments such as thermometers and blood pressure devices, and underpaid Russian physicians, as well as the lack of effective government control to verify that the regulations are being followed. This situation gives foreign pharmaceutical companies more latitude than they have at home.

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1. The results of this project were presented at the 11th Annual International Young Researchers Conference, Post-Communist Corruption: Causes, Manifestations, Consequences, Havighurst Center, Miami University, Oxford (USA), March 29-31, 2012, and at the Research Centre for East European Studies (Forschungsstelle Osteuropa) at the University of Bremen, Germany, April 27, 2012. The author would like to thank the participants for all of the feedback received during both events.

2. A full version can be found at http://www.rg.ru/2011/11/23/zdorovie-dok.html, last visited September 28, 2013.

3. An author usually pays for a publication in Russia. Medical journals charge about 10 USD per page at least.

4. Practicing physicians in Russia have to take special courses (continuing education) every five years to be eligible to work.

October 23, 2013

Reversal of Fortune

Sheila Kaplan

For years, Stephen Sayle worked as a lobbyist for oil and gas interests, helping them to secure the best deals possible on Capitol Hill. To critics, he still works for the industry—but now he's on the payroll of the U.S. House of Representatives.

In a political maneuver known as the "Reverse Revolving Door," Sayle left his job as CEO of Dow Lohnes Government Strategies LLC, and landed as chief of staff of the House Committee on Science, Space and Technology's Subcommittee on Energy. The full committee oversees federally-funded, non-military research and development. The subcommittee watches over energy research and development; Department of Energy laboratories; nuclear, solar and renewable energy; pipeline studies and other areas critical to Sayle's recent clients. In the past few years, according to federal disclosure records, Sayle has lobbied for no less than six energy businesses or trade groups, among them: Chevron Corp., Calpine Corp., National Grid plc, Tenaska Energy, ITC Holdings and the Electric Power Supply Association. Last year, he was named one of Capitol Hill's top lobbyists by *The Hill* newspaper.

Can a lobbyist shift his outlook from protecting business interests to protecting the nation's interest so quickly? Former Democratic Rep. Brad Miller, of North Carolina, doesn't think so.

"It's undoubtedly true that the Republicans on the subcommittee are very, very sympathetic to the views of the energy industry," wrote Miller in an email. "It still would be nice just for the sake of appearances to pretend that they think the public interest and the energy industry's interests might not always be identical." Miller, who served as ranking Democrat on the Subcommittee on Energy and Environment before it was divided into separate panels, said he is also concerned about congressional staffers who, while serving in government jobs, set their sights on their next, higher-paying post.

"The problem with the revolving door is that members and staffers sometimes start work for their potential future employers when they're still supposed to be doing the people's business," he said. "Even if they're not consciously betraying the public interest to promote their own future employment prospects, it's got to be in the back of their mind. It won't be hard for Sayle to figure out who his potential future employers are—they're almost certainly his past employers."

Miller has a point. Sayle declined to comment, as did a spokesman for science committee chairman, Rep. Lamar Smith (R-Texas.) But this is not Sayle's first turn through the revolving door. The profile listed on his LinkedIn page notes his early career: a few years serving on the staff of Rep. Joe Barton (R- Texas), followed by several years as counsel to Republican members of the powerful House Energy and Commerce Committee. [Public records allude to a lobbying job between his positions with Barton and the Energy and

Commerce committee.] From there, Sayle deployed to Dutko Worldwide, a lobby firm, where his portfolio included the American Chemistry Council, and the National Petrochemical & Refiners Association (which has since become the American Fuel & Petrochemical Manufacturers); as well as other businesses. From Dutko, according to his LinkedIn profile, Sayle moved to Dow Lohnes Government Strategies. Sayle was generous to the GOP, with more than 97 percent of his total $66,822 in campaign contributions, reported through 2012, going to Republican candidates, according to Influence Explorer, a project of the Sunlight Foundation, a Washington, D.C. research group devoted to government transparency.

Although less common than moving from government to industry, the reverse revolving door is not so rare, according to the Center for Responsive Politics (CRP), a D.C.-based nonprofit organization, which tracks the impact of money and lobbying on elections and public policy. CPR's website lists dozens of former lobbyists now ensconced in offices of lawmakers of both parties. Another employee of the House Science, Space and Technology Committee is former National Mining Association lobbyist Todd Johnson, who did a stint in the Senate before becoming staff director of the Subcommittee on the Environment. Gary Andres, majority staff director of the Energy and Commerce Committee, was a longtime lobbyist at Dutko Worldwide.

Viveca Novak, CRP's editorial and communications director, said Sayle "brings a certain expertise in energy and some of the other industries he's had clients from, which is the plus side for the committee in getting someone like him."

But, she added, "The downside is that it seems like it would be very hard for him to take an even-handed approach, to a lot of the issues that will be before the committee. Clearly he can't recuse himself from these issues, because they are central to the committee's work."

Ethics rules governing the reverse revolving door are vague. Robert Kelner, chair of Covington & Burling's election and political law practice group, who has also worked with GOP political committees, said, "It's fair to say that the reverse revolving door rules are fairly relaxed, certainly compared to the usual revolving door rules for people leaving the Hill." "There are no explicit rules, it's more, there are some rules you can infer from other rules. First, of all, there are Bar [Association] rules, so if the lobbyist is coming from a law firm, then the lobbyist, depending on which Bar or Bars they are a member of, may be under some restrictions working on the same matters they worked on before."

Kelner thinks the rules are fine the way they are. "While I can understand the point of view that would suggest we need stricter rules for lobbyists going to the Hill, I also think that Washington suffers from what I like to call ethics sclerosis, an over-abundance of ethics rules to the extent that it's very difficult for anyone to comply," he said.

November 1, 2013

Obamacare's Unhealthy Relationship: A Cautionary Tale of Public-Private Partnerships

Gregg Fields

The HealthCare.gov website isn't exactly a government creation, but rather the product of partnerships with private contractors. In that sense, it's a variation of an increasingly popular form of governance known as public-private partnerships, or PPPs. And it's not working.

The crowd could be forgiven if it seemed distracted when President Obama visited Faneuil Hall this week, just hours before the beloved Red Sox would take the field at Fenway Park and win the World Series. "I am well aware a presidential visit is not the biggest thing going on today in Boston," Obama quipped.

Obama was in Massachusetts to address the continuing crippling technical problems that have botched the debut of the Affordable Care Act's insurance exchanges. "The website hasn't worked the way it's supposed to over these last couple of weeks," he told the crowd. The site "is too slow, too many people have gotten stuck. And I am not happy about it." But perhaps he shouldn't have been surprised.

Though frequently touted as a way to stretch tax dollars and bypass burdensome bureaucracy—a veritable "win-win-win" for taxpayers, governments and corporations—two researchers at the Edmond J. Safra Center for Ethics this week presented findings that persuasively challenged that view, at least in some cases.

The joint presentation was by Jonathan Marks, a network fellow at the Edmond J. Safra Center for Ethics and director of the bioethics program at Penn State, and William English, a former fellow and current research fellow at the Harvard Initiative for Learning and Teaching.

Based on their extensive research, and most relevant to the Edmond J. Safra Center for Ethics, Marks and English have found that PPPs have the potential to lay the groundwork for institutional corruption, distorting a public agency's mission into activities that don't serve the public interest.

For example, there is the possibility of creating rent-seeking opportunities for favored partners. Also, a government unit could develop a form of dependence corruption, becoming so reliant on a single partner that it erects barriers to entry for more innovative competitors. And in some cases the private partner may provide resources to a virtuous public cause as a springboard toward a larger agenda that is more economically lucrative.

More broadly, PPPs also run the risk of diminishing accountability, as they don't answer to the public in the way, for instance, that elected officials do. That, Marks said, can in turn undermine confidence in government agencies, crimping their ability to serve the public in other endeavors. "It's hard for partnerships not to attribute great weight to those parties that bring money to the table," Marks said.

By the Slice

Marks used several real-world examples in his presentation, some of them drawn from "What's the Big Deal? The Ethics of Public-Private Partnerships Related to Food and Health," a working paper he produced for the Edmond J. Safra Center for Ethics earlier this year.

In one case, he pointed to an organization called Dairy Management Inc., created by federal statute and funded by farmers and agribusiness interests. Over time, Dairy Management worked, with formal approval of the U.S. Department of Agriculture, to increase the amount of cheese in fast food items. The results included a stuffed pizza crust, which upped the amount of cheese eight-fold.

The problem: the USDA is also committed to promoting good nutrition. As a 2010 New York Times article revealed: "While Warning About Fat, U.S. Pushes Cheese Sales."

In another case, a foundation provided the Children's Hospital of Philadelphia $10 million to address childhood obesity. But the foundation had been established by the American Beverage Association, with funding dominated by Coca-Cola, Pepsi and the Dr. Pepper/Snapple Group. At the time, Philadelphia's city council was considering a tax on sugar-sweetened beverages, which it didn't pass.

As Marks wrote in his working paper, the issue was about much more than money. "The donation threatens to undermine trust and confidence in the City Council, in light of its subsequent decision not to approve the soda tax, and in the hospital that accepted the donation," he wrote.

Team Efforts

The PPP concept isn't exactly new. In a sense, Christopher Columbus's voyage to the New World might qualify as a PPP. And English noted that the early colonies relied on private partners to construct infrastructure like municipal water systems. Marks added that there is no universal definition of a PPP, precisely because they come in innumerable shapes and sizes.

But while the idea may be old, PPPs are gaining new relevance because in recent years cash-strapped governments across the country have turned to them. "It's an ever-expanding category, in my view," Marks said.

From a social standpoint, English suggested that PPPs may run counter to systemic frameworks that have served Western democracies well. Specifically, in his working paper "Institutional Corruption and the Crisis of Liberal Democracy," English contends Western democracies' ascendance in the last century was rooted in their success at separating the domains of economics and politics.

PPPs, by contrast, turn that model on its head—forcefully merging government and business. This can in turn produce "types of public-private partnerships that are going to be problematic," English said.

An example might be publicly funded sports venues. For instance, English noted that Harvard urban planning professor Judith Grant Long found taxpayers have had to cover $10 billion in cost overruns on stadiums and arenas for professional sports teams. Long's study was the basis for her 2012 book, *Public/Private Partnerships for Major League Sports Facilities*.

To be sure, PPPs have their supporters. As English noted in his presentation, the theory behind them is that "PPPs enable the public sector to harness the expertise and efficiencies that the private sector can bring to the delivery of certain facilities and services traditionally procured and delivered by the public sector." Historically, they appear to be particularly useful in cases of natural monopolies, like utilities, or when a government outsources tasks that are easy to monitor.

"The use of partnerships is increasing because they provide an effective tool in meeting public needs, maintaining a high level of public control, improving the quality of services, and are more cost effective than traditional delivery methods," according to the National Council of Public-Private Partnerships, an advocacy group.

A Glitch in Time

But examining the government's experience with the development of the HealthCare.gov website reveals, in microcosm, some of the trends Marks and English identified. In an opening statement before a House committee this week, Kathleen Sebelius, secretary of Health and Human Services, said her agency relied on "private sector contractors" to develop the site. She added: "Unfortunately, a subset of those contracts for HealthCare.gov have not met expectations."

A primary contractor which has come under withering criticism is CGI Federal, a subsidiary of CGI Group, a Canadian concern that describes itself as the fifth largest information technologies and business process services company in the world.

In 2011 the government's Centers for Medicare and Medicaid Services (CMS) partnered with CGI to develop Obamacare's so-called federally facilitated marketplace, or FFM. "I want to state unequivocally that our partnership with CMS for the successful implementation of the FFM . . . remains a top priority," Cheryl Campbell, CGI's senior vice president, told a House committee in testimony on October 24.

The record shows healthcare reform has been a windfall for CGI. Michael Roach, its CEO, said in a July 31 conference call that revenue for the firm's global healthcare sector was up 90 percent "largely driven by the impact of U.S. healthcare reform." In dollar terms, U.S. quarterly revenue was up nearly $92 million from the same period last year. Said Roach: "We continue to see more extensions and ceiling increases on our existing work while we further leverage our position on contract vehicles." Roach concluded: "Accordingly, we continue to view U.S. federal government as a significant growth opportunity."

To explain what Roach means by "ceiling increase": CGI has what is known as an ID/IQ contract, for indefinite delivery/indefinite quantity. In essence, the contract can be expanded without soliciting new bids. According to Reuters, the CGI contract for the health care website has swelled from the original projected $93.7 million to nearly $196 million. "They just blew through the original ceiling," Scott Amey, general counsel at the Project on Government Oversight, a Washington-based watchdog group, fumed to Reuters.

Not much about this partnership, perhaps even the cost overruns, would be especially bothersome if in fact it had delivered on its promises. But as millions of Americans who need health insurance now know, this partnership failed to serve the public interest, at least so far.

If there is cause for optimism, it's that Obama pledged in Boston that the glitches will be fixed. "And I take full responsibility for making sure it gets fixed ASAP," he said. "We are working overtime to improve it every day."

November 4, 2013

Watch, Listen, Worry

Paula Lyons

In this post, award-winning journalist Paula Lyons reflects on how our news industry has changed, and what it means for democracy.

It was 1984. I was a consumer/investigative reporter at WCVB-TV, Boston's ABC affiliate, working on an expose of how industry-supported changes in the federal chicken inspection system were contributing to rising rates of salmonella food poisoning.

In the midst of our editing process, Perdue phoned our general manager, raging, saying they heard we were doing a "hatchet job" on their industry. They threatened to remove their ads.

A considerable amount of money was involved. But undeterred, our GM called their bluff. "Go ahead!" he reportedly said. "And see if we ever let you back on the air of the most successful TV station in New England!"

Ah, those were the days!

My career had started at the locally owned WCVB in 1978. It was an extraordinary place to work, known then for its serious news department, program risk-taking, and creativity. In fact, in 1981, the New York Times ran a story headlined "Some Say This is America's Best TV Station."

The news department operated under highly ethical, strict, news directors. They insisted on fairness and balance in every story, to the extent that that was humanly possible; and also gave us the time to tell a story completely. Their standards were high. My facts were checked and double checked. It was stressful, but worth it. We were riding high.

In the early '80s, my General Manager could afford to "blow off" an advertiser. There were, after all, only 3 network stations in most big cities. Where else were advertisers going to go? CNN was still in its infancy, there just wasn't a lot of competition. He could afford to be brave.

It's just about impossible to imagine such a scenario today. Advertisers have tens of choices of where to advertise and viewers of where to watch so-called "news."

And we have lost so much more than we have gained.

When there were just three broadcast networks and their affiliates, Americans seemed to be more or less "on the same page." It felt like we at least agreed on the facts of what was happening in the United States, whether our opinions of them varied or not. Today we can't seem to agree on anything.

I first noticed trouble abrewing when I left WCVB in 1989 to work at ABC's Good Morning America.

Bosses in local TV were getting nervous as competition from cable was challenging their cherished position. We were even losing some of our news colleagues to the now maturing CNN and a new upstart, called Fox.

At ABC, the old values were still in place. The news of the day was reported with a determined effort not to take a side, give an opinion. And with few exceptions, reporters kept themselves and their personal views out of their stories. Were there some exceptions? Of course! Geraldo Rivera worked there then! But even he was fact-checked.

Of course, in broadcast television, we were required to be as objective as humanly possible. Broadcasters operated under the federal government's 1949 "Fairness Doctrine," a late, lamented regulation that seems quaint today.

It required that we be fair to all sides, and if any persons were attacked on air, they had the right to respond on that same channel.

That rule never applied to cable television, and soon opinion stories—then whole opinion channels—were off and running.

Are we really better off than when we had just the "Lame Stream Media"? Many of us had hoped that new choices in news would democratize information, add more voices, texture, context, and yes, diversity to the public conversation.

Instead, cable channels were hijacked by extremes of the left and right, and we ended up with ideological TV filled with misinformation, shouting fests, extremes of thought, and downright lies . . . all permitted with no oversight at all.

Americans started to tune in and listen only to channels representing their own points of view, and demonizing all who represented "the opposition." Positions hardened, compromise became a filthy epithet. And majority rule? Forgetaboutit!

The result? According to Michael Kranish writing in the Boston Globe recently, "an explosion in the availability of information has coincided with historic levels of political polarization—the starkest divide since the early 1900's according to a Duke University study released this year."

I can't watch any of the cable news "validation" channels or, for that matter, listen to talk radio. During a presidential election year, I have to turn the machines off.

Call me old-fashioned, but I believe ideological media outlets have destroyed respect for many of our institutions, especially that of the presidency, and completely corrupted public discourse.

If you need an example of how that has changed for the worse, consider the following two quotes . . . spoken 50 years apart.

The first is from the actor John Wayne, who on the election of John F. Kennedy in 1960 said, "I didn't vote for him, but he's my president and I hope he does a good job."

The second is from talk radio host Rush Limbaugh, who on the inauguration of Barack Obama in 2009 *said*, "I hope he fails."

I am not naïve. I know we have been here before. Highly partisan, downright "yellow" journalism has been the rule rather than the exception in our nation's history. Fairness, after all, is a mid-19th century phenomenon. It has come and gone many times since then.

But that doesn't mean I don't long for its return.

And I am relieved to no longer be a part of what local television news has become. After 5 years at Good Morning America, I returned to television in Boston at the highly respected WBZ-TV, a CBS affiliate.

The differences wrought by macro changes in the industry were obvious—less time to tell a complete story, direction from above on what stories you could and could not tell, a reduced focus on serious news, including coverage of local politics, greater emphasis on celebrity news (Lindsay Lohan, really?) and on any story, no matter where it was from, that simply had great video.

My 25 year journalism career ended ten years ago. I don't miss it a bit. But oh, how I worry about the country.

November 12, 2013

Yellen Takes the Stand: Institutional Corruption's Formidable Foe?

Gregg Fields

When theorizing on regulatory reforms that might reduce institutional corruption, an enticing thought is this: Wouldn't it be nice to wipe the slate clean and start over? While that may not sound terribly realistic, America may get the chance should Janet Yellen be confirmed as the next chief of the Federal Reserve.

Yellen is President Obama's nominee to succeed Ben Bernanke, whose term as Fed chairman is up on January 31. She is a highly regarded economist, a current vice chairman of the Fed and would be the first woman to run the nation's central bank. (She also happens to be married to Nobel laureate economist George Akerlof.)

Yellen's confirmation hearing before the Senate Banking Committee is scheduled for Thursday. It comes at a pivotal time for the Fed, which happens to turn 100 this year. As it enters its second century, the formerly lofty reputation of the Fed has lost a great deal of altitude following the financial collapse. An agency once viewed as rising above the fray of Washington's guerilla politics came to be seen as the ultimate Beltway insider. A legacy of independent leadership symbolized by former Fed Chairman Paul Volcker—who deployed Fed powers to tame inflation in the 1980s—was tarnished by ties to titans of Wall Street.

The Fed has been a lightning rod for controversy since its founding. And that continues, with some conservative members of the Senate announcing they intend to put a hold on Yellen's nomination.

"As the Senate debates the nomination of the next head of the Federal Reserve, there is no more appropriate time to provide Congress with additional oversight and scrutiny of the actions and decisions of the central bank," Sen. Rand Paul, the Kentucky Republican, wrote to Senate Majority Leader Harry Reid in late October.

Part of the challenge for any Fed chairman is the agency's so-called dual mandate. In 1977, Congress amended the original Federal Reserve Act. The change called on the Fed to enact policies that maximize job creation and minimize inflationary risks. The problem is that those two goals are often at conflict. The Fed, through its open market committee (FOMC) can help generate jobs with lower interest rates and stimulate the economy. Conversely, it can fight inflation by raising rates and tamping down demand.

That historically meant that the Fed is in the position of either pleasing Wall Street, which favors inflation vigilance, or Main Street, which benefits when more potential customers have jobs. Analysts frequently refer to Fed members as "hawks" or "doves" on fighting inflation.

The record suggests that Yellen is more of a dove, at least at the moment. "The large shortfall of employment relative to its maximum level has imposed huge burdens on all too many American households and represents a substantial social cost," she said in a speech to the National Association for Business Economics earlier this year. With inflation currently running below 2 percent, "I believe it's appropriate for progress in the labor market to take center stage in the conduct of monetary policy," she added.

Yellen's view may signal a shift in the priorities of the Fed. She was nominated for the job when Larry Summers, the former Harvard president and former Treasury secretary, who was a well-known advocate for Wall Street deregulation, withdrew his name from consideration. Yellen, who lives in California, was chair of the White House Council of Economic Advisers in the Clinton administration, but relative to Summers is a comparative outsider to Washington.

The Bernanke Fed

Certainly, the outgoing Bernanke has earned a reputation as a highly regarded reformer since taking the helm of the Fed in 2006. For instance, he ushered in an era of transparency that was unprecedented for the Fed, whose penchant for privacy was reflected in the 1987 book *Secrets of the Temple* by William Greider. Former Fed Chairman Alan Greenspan rarely spoke in public, and usually in Congressional testimony. Bernanke, in contrast, has held press conferences and any number of public speeches.

Similarly, Greenspan was an ardent cheerleader for the deregulation of financial markets. Bernanke, in a Chicago speech I attended last spring, elaborated on how banking practices demanded pro-active regulation.

"The step-up in our monitoring is motivated importantly by a shift in financial regulation and supervision toward a more macro-prudential, or systemic, approach, supplementing our traditional micro-prudential perspective focused primarily on the health of individual institutions and markets," Bernanke said.

For students of institutional corruption, Bernanke's "systemic" emphasis has been significant. Institutional corruption is characterized not so much by bad actors as by bad systems—influences that together form an economy of influences that ultimately don't serve the public interest. Rather, they lead to phenomena such as regulatory capture, revolving door syndrome and cultural capture, where the values of an industry are adopted by government overseers.

These patterns are often indicators of underlying institutional corruption. And, as Bernanke said, it is often difficult to detect the damage until it's too late. "After all, neither the Federal Reserve nor economists in general predicted the past crisis," he said in Chicago.

Return to Normalcy

Despite his unquestionable achievements, the reality is that Bernanke didn't have the luxury of presiding in normal times. The world was in turmoil. The priority was rescuing banks rather than regulating them.

Yellen, should she be confirmed, will take office in an economy that is fragile but increasingly stable. The financial markets are at all-time highs, and the U.S. added more than 200,000 jobs last month, despite the economic anchor of a federal government shutdown.

How might Yellen re-direct the institutional mission of the Fed? How will her policies and those of the FOMC, which sets the direction of interest rates, address the systemic regulatory risks that Bernanke referred to? Can Yellen restore the frayed public trust that, in the long run, is a cornerstone of the Fed's foundation of influence?

(Yellen's ascendance happens to coincide with regime change at another crucial regulatory agency, the Commodity Futures Trading Commission, or CFTC. The CFTC regulates trading in those risky financial contracts known as derivatives. President Obama is nominating senior Treasury official Timothy Massad to replace the outgoing Gary Gensler.)

Winged Combat

Advance copies of Yellen's expected Senate testimony weren't available. But a careful reading of her record does suggest that a Fed under her guidance will differ markedly in tone and attitude from historic norms.

At a speech of hers I attended last spring in Washington, for instance, Yellen made clear that she was a firm supporter of the greater transparency ushered in by Bernanke. "It is hard to imagine now, but only two decades ago, the Federal Reserve and other central banks provided the public with very little information about such monetary policy moves—the spirit of 'never explain' was very much alive," she said, speaking to the Society of American Business Editors and Writers (SABEW).

Yellen was actually the architect of the greater transparency policy. In 2010, Bernanke asked her to lead a new subcommittee on FOMC communications, leading to many of the new outreach initiatives. There's still room for improvement, she conceded. "But I hope and trust that the days of 'never explain, never excuse' are gone for good, and that the Federal Reserve continues to reap the benefits of clearly explaining its actions to the public," she said.

Transparency, of course, is considered a potent antidote to institutional corruption. But in the case of the Fed it isn't a complete solution. With banking reform, an equal problem has been regulatory capture—where an industry largely dictates the rules it must live by.

This regulatory capture was in full swing in the years prior to the banking crisis, as evidenced by the repeal in 1999 of the Glass-Steagall Act, which separated Wall Street investment banks and Main Street commercial lenders. Also, the Commodity Futures Modernization Act of 2000 essentially exempted regulatory oversight of derivatives, leading to rampant speculating that ultimately swamped banks that had to be bailed out.

That backdrop forms what is likely to be Yellen's biggest challenge: enacting actual banking reform. Although the Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in 2010, it is far from being a mission accomplished. The problem is that Dodd-Frank requires hundreds of rules to be written by regulatory agencies. An easy majority of the deadlines have been missed for writing these rules, according to the Davis Polk law firm, which tracks the progress. Furthermore, in some cases rules that have been written are taken to court by powerful industry interests, with courts in some cases overturning them or, at best, prolonging the process.

In 2010 testimony to the Financial Crisis Inquiry Commission, created by Congress, Yellen, who was then president of the Federal Reserve Bank of San Francisco, acknowledged that pre-crisis oversight simply fell short of what was needed.

"I think that we would have needed to go into a particular institution and impose standards that were tougher than were generally being applied by the Fed and other regulators," she told the FCIC.

At the SABEW conference last spring, I asked her about the slow pace of creating new standards under Dodd-Frank. "It has been an enormous challenge to implement all that is in Dodd-Frank," she said. "We're working with regulators all around the globe to see if we can move together jointly."

Forward Together

Whether that kind of outlook will help Yellen restore the public's trust in the Fed remains unknown. What's clear is that, as she moves toward what is surely one of the most important jobs in the world, perhaps Yellen's greatest asset isn't her government-granted powers, but rather the high regard that those who know her have for her.

In September, 500 of the country's leading economists wrote a letter to President Obama urging her nomination. "All of us understand full well that the nomination is yours to make," the letter said. "In making that decision we would like you to have the benefit of our professional opinion that Janet Yellen is the person who would serve the nation best in this important role at a critical time for our country."

November 13, 2013

Preferences of Types of Corruption: A Rational Choice Model

Mariano Mosquera

By arranging the types of relational corruption most frequently found in Latin American countries from a rational agent perspective, it is possible to identify the corrupt practices that cause considerable damage to institutions as well as to society.

A Rational Choice Scenario

Every decision requires three components: a decision agent, a set of decision alternatives, and finally, a valuation criterion to help the decision-maker choose one alternative over another. The decision agent is a selfish actor who seeks to maximize personal gain by increasing benefits and reducing costs. The agent is also a political actor who is interested in the political benefits, and not only in the economic benefits.[1] Finally, the rational and political agent is a public official who is capable of making decisions that affect the purpose of the public institutions by abusing the public power entrusted to them.

On the other hand, a hypothetical scenario with complete information and lack of restrictions is assumed (what-if analysis).[2] In this scenario, completeness and transitivity properties are applied to alternatives (incomparable options are discarded).[3] This ensures that the valuation criterion for the agent will be comprehensive and systematic.[4]

In our case, the set of alternatives is made up of types of relational corruption. Corruption is defined as the abuse of the entrusted power for private gain, but the gain may also be political. The valuation criterion within a framework of the rational choice theory takes the form of costs and benefits; in particular, the costs and benefits associated with the types of relational corruption. In other words, the types of corruption involve a series of costs and benefits that the rational agent can assess in order to choose one over another.

Cost-Benefit Analysis of the Corrupt Relationship

Costs are assessed as a risk before making a decision. The cost risk is defined as the consequence of the costs based on the likelihood of occurrence. The main cost risk of each type of relational corruption is associated with the possibility of being invisible; that is, the likelihood that the type of corruption is maintained in secrecy.

The lower the cost of being invisible, the greater the opportunity for a certain type of corruption. The higher the cost of being invisible—for example, when it is necessary to develop strategies to cover a defect inherent in the type of corruption—the lesser the opportunity for said type of corruption. That is why the assessment of the cost risk of a type of corruption is determined by two factors. The first factor is the number of actors involved in corruption. If there are two actors involved in corruption it is easier (less costly) to maintain secrecy than if there are more than two participants. The second factor is the method of corrupt relationship, which is assessed on the basis of the likelihood of keeping corruption invisible, and not on its effectiveness.

The three main methods are influence, agreement, and threat, in this order of priority for the rational actor. Influence is not as explicit as an agreement, hence the cost of being invisible is lower. An agreement is consented to, while a threat is more costly, since it can be visibly resisted by the actor that receives the violence of the threat. The definition of institutional corruption is centered on this inappropriate method of conducting a relationship, which undermines legitimate procedures.[5]

On the other hand, the main benefit of these types of corruption is associated with the level of monetary gain. This level of gain is interesting to the political system and its funding only if it is high. The monetary gain depends on the economic position of the related actor. Companies, beneficiaries of policies, civil servants and citizens: this is the order of priority for the agent. Companies have more economic potential than citizens. Also, in Latin American countries, the increase in public expenditure on transfers, as well as the growth of public bureaucracy, are attractive for the corrupting agent.

Thus, the rational analysis of the corrupt relationship depends on the number of actors involved and the method of corrupt relationship chosen (cost risk of being invisible) and on the economic position of the related actor (economic and political benefit).

Analysis Matrix of Types of Corruption (With Scoring)

Number of actors	Method of corrupt relationship	Related actor according to economic position
• Two (1) • More than two (2)	• Influence (1) • Agreement (2) • Threat (3)	• Companies (1) • Beneficiaries (2) • Public servants (3) • Citizens (4)

Regarding costs, the higher the score, the higher the cost of being invisible. As for benefits, the lower the score, the higher the economic and political benefit.

The main types of corruption can be found within the possible combinations of this matrix. Now we have the strategic advantage of being able to arrange the preferences of a rational agent. As a preliminary exercise to apply this model,[6] we will analyze the following types of corruption which are frequently found in Latin American countries: bribery, clientelism, sale of offices, traffic of influence, political hiring, extortion, and association with suppliers.

Preferences of Types of Corruption

From a rational economic and political point of view, the traffic of influence is the first form of corruption. Only two actors can be involved in this practice: the agent and a company that acts as a lobby group or finances electoral campaigns to obtain favors (3 points).

The association with suppliers is the second form of corruption. The two actors involved in this practice, the agent and a company, enter into a secret agreement to award contracts (4 points). The monetary gain is used to finance political activities.

Clientelism, the third form of corruption, is a widespread practice in Latin American countries. This practice involves many actors who benefit from public policies through influence (5 points).

Political hiring, without meritocratic processes or performance management, occupies the fourth place. This practice connects many civil servants by means of influence (6 points).

These last two types, unlike other practices in which the agent receives money that is later used to finance political activities, are a "direct political investment" since the service provided on a discretionary basis is what influences political loyalty.

The sale of offices, which occupies the fifth place, involves monetary compensation for the appointment to a public office, and connects two actors, agent and employee, by means of an agreement (6 points). This practice does not involve large amounts of money and is not used to finance political activities.

Ordinary bribery involving citizens, although only two actors are connected by means of an agreement, occupies the sixth place (7 points).

Extortion can also involve two actors by means of a threat, and if the actors are citizens, it reaches eight (8) points. This practice is not used to finance political activities.

Identifying the types of corruption with greater opportunity of maximizing the agent's utility entails identifying the forms that are causing more damage to institutions as well as to society. The higher the economic utility is for the corrupting agent, the more distorted the public investment is, and the higher the increase of the transaction costs that affect the market. The higher the political utility, the more distorted the equitable purpose of the state and the representation of public officials.

In order to discourage corruption, it is necessary to develop better legal frameworks and control institutions that increase the cost of being invisible for the various types of corruption. This is accomplished through schemes of visibility into the agendas of public officials, transparency mechanisms for public acquisitions, and evidence-based public policies, among others.

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1. Political benefit as acknowledgement in a group of people with common interests. Mancur Olson, *The Logic of Collective Action* (Harvard University Press, 1965).

2. Pau Marí-Klose, *Elección Racional (Rational Choice)* (CIS, 2000). It is important to note that there are institutional conditions of the competitive democracy that promote corruption, but the "what-if analysis" requirements are applied to the selection of types of corruption.

3. Norman Schofield, "Rational Choice and Political Economy" in *The Rational Choice Controversy* (Yale University Press, 1996).

4. Antonio Villar, *Decisiones Sociales* (McGraw Hill, 2006).

5. Dennis Thompson, "Two Concepts of Corruption," Edmond J. Safra Research Lab Working Papers, No. 16 (2013).

6. While this model can be combined with other theoretical perspectives, the starting hypothesis is that as far as decisions on corruption are concerned, the agent's rationality becomes more pronounced. This model is developed extensively in this author's postdoctoral fellowship at the National University of Cordoba (Secretary of Science and Technology, National University of Cordoba).

November 18, 2013

Spiraling Prices for Cancer and Specialty Drugs

Donald W. Light

Pharmaceutical companies sometimes charge so much for cancer drugs that even *insured* patients cannot afford their 20 percent co-payments—on what can be $100,000/year medicines. Sometimes, in order to pay for cancer drugs, patients stop taking other vital drugs, or cut back on food. This is a major concern for Hagop Kantarjian, Chief of Leukemia and full professor at the MD Anderson Cancer Center in Houston, Texas.

In a remarkable campaign, Kantarjian recruited over 100 cancer specialists to describe how exorbitant prices keep them from giving good clinical care because their patients cannot afford to take their medicines. The New York Times made this front-page news.

The synergies of being at the Safra Center include calls or emails out of the blue from creative and productive people, like Kantarjian, who asked if we could "write something together." We talked about medicine's mission to help and heal those who are ill, injured, or at serious risk. Pharmaceutical companies also embrace this goal in their mission statements. Yet their pricing of cancer and other specialty drugs undermines that mission. We explain how in a new policy analysis, published in *Cancer* and titled "Market Spiral Pricing of Cancer Drugs."

Our policy analysis points out that drug companies keep raising the prices on even older cancer drugs, by an average of 20-25 percent a year, up to ten times the rate of inflation—and then setting the prices of new drugs above that ever-spiraling baseline for older drugs. We call this the "market spiral pricing strategy" of pharmaceutical companies. It undermines the mission of medicine and harms patients.

Prices are doubling every five years. Yet most new cancer drugs offer few advantages over older ones. Thus pricing cannot be based on added value, as companies and their allies claim. Nor, we show, can it be based on recovering the inflated estimates of companies' research costs, especially given the free ride they get from publicly funded research and taxpayer subsidies. We conclude that net, median research costs for companies are about one-tenth the amount they claim. Marcia Angell made a similar analysis in her famous book, as did Public Citizen, a consumer advocacy organization, in a 2001 policy paper.

Companies are developing hundreds of new drugs for cancer and other life-threatening diseases, because they arranged a provision that prevents Medicare from negotiating volume discount prices and requires it to pay whatever the companies decide to charge. The popular misconception that high-priced medicines must be highly effective keeps companies prospecting for cancer-drug gold. Most of the drugs they develop, however, fail to meet the minimal criteria for FDA approval, but even those approved are usually little or no better than existing drugs. This reflects FDA policy and criteria, as explained in a recent overview in the Safra special issue of the *Journal of Law, Medicine and Ethics*. Cancer drugs are also unusually toxic, making patients suffer miserably. That might be worthwhile if the new drugs reduced mortality, but they usually do not.

Drug companies also use gross profits in at least four ways to bias market forces. First, they fund and "educate" patient groups so that they act as pressure groups that make it difficult for insurers or other payers to object to prices of $100,000 and up. Second, they retain leading experts who get new drugs into clinical guidelines that insurers and Medicare have to observe. In these ways, they have the payers surrounded. Third, they retain leading specialists to promote their new drugs. Fourth and finally, they fund large clinical trials that have no scientific goal, but pay hundreds of specialists, as members of the "research team," to recruit and monitor their patients as "subjects." These are known as "seeding trials" because they seed the market and sprout more sales. Unlike many countries, the U.S. lacks an official, arms-length evaluator that would assess the added clinical value of new drugs. In other affluent countries with advanced health care, insurers work with government to negotiate prices for cancer drugs and pay about one third of U.S. prices. The American "free market" is a free market of high prices and misinformation, protected by government regulations and laws, in a sellers' market which FDA practices promote. Then U.S. insurance companies "control the cost of cancer drugs" by passing on 20 percent to patients in the form of a co-payment. Co-payments are dis-insurance, an insurer's cop-out for not bargaining for an affordable price. Sick patients become impoverished in a unique American set of practices that serve special interests and contribute to about half the personal bankruptcies in the United States. Perhaps "market spiral pricing" will get the attention it deserves.

Acknowledgements: I am grateful to Jonathan Darrow for his critical reading and valuable comments on earlier drafts of this blog.

November 18, 2013

Volcker Overruled

Brooke Williams

What do banking giants Citigroup and Barclays have in common with the nonprofit Bipartisan Policy Center, a think tank in Washington, D.C.? It depends where you look.

Two weeks after the Bipartisan Policy Center (BPC) launched an initiative to "analyze, assess, and recommend ways to improve financial regulatory policy," one of Wall Street's top lobbying firms, Rich Feuer Anderson, added the think tank to its list of clients—alongside Citigroup, PricewaterhouseCoopers, Barclays and others.

Mitchell Feuer, former counsel to the Senate Banking committee, and John Anderson, previously an executive of the too-big-to-fail Credit Suisse, have been simultaneously lobbying on behalf of the think tank's advocacy arm and big banks (including one donor to the think tank) to influence implementation of the Dodd-Frank financial reform legislation, according to disclosure reports filed in October.

Some of their lobbying has focused on the Volcker rule, a part of Dodd-Frank that bans federally backed banks from gambling with their own money—a practice that contributed to the economic crisis in 2008. Five federal agencies responsible for writing the rule have faced a lobbying blitz, and yesterday, the *New York Times* reported they are debating how stringent to make it and whether to close loopholes.

Last month, scholars with the BPC's financial regulatory initiative released a paper, "A Better Path Forward on the Volcker Rule and the Lincoln Amendment," which largely echoes the position of big banks and Wall Street. Slow down, phase in and provide ample opportunity for input (and regulatory capture) along the way.

A bipartisan group of former Senate majority leaders created BPC in 2007 to do "rigorous analysis" and combine "politically balanced policymaking with strong proactive advocacy and outreach." On its website, BPC is upfront about industry's involvement, saying business leaders are part of deliberations that produce policy recommendations.

But what about the money they donate?

BPC accepts undisclosed amounts of money from big banks, natural gas interests and medical companies while its scholars publish papers on Wall Street reform, the future of fracking and affordable health care. Meanwhile, BPC's advocacy arm collects millions in donations from undisclosed sources and pays to lobby on all of the above.

BPC and its lobbying arm, BPC Advocacy Network, share a suite on the 10th floor of an office building a block from K Street. The think tank created the lobbying shop because "ideas, roundtables, and reports go only so far." As a tax-exempt "social welfare" group known as a 501(c)4 organization, BPC Advocacy Network doesn't have to disclose its donors and can influence public policy with little accountability.

Donations to BPC Advocacy Network have increased from $1 million in 2008 to $4.1 million in 2011, according to tax filings. So far this year, lobbying records show, it has hired five outside lobbying firms and employed seven in-house lobbyists.

Lobbying interests aligned

A cross-examination of disclosure reports shows the BPC think tank's corporate donors and its advocacy arm lobby on many of the same issues, including the Volcker rule.

Citigroup is one of the think tank's top corporate donors, and along with the American Bankers Association, is listed as a member of its 2012 Leaders Council, which provides opportunities to "engage with the founders, policy project members and staff" and "help guide BPC activities." (BPC recently removed that language from its website.)

James Cox, a professor at Duke University who co-authored the position paper on the Volcker Rule, said he had no idea big banks were funders of the think tank. There was no evidence of "any hidden hand" in their research, he said, so he isn't sure why it matters. Plus, he said, the report wasn't all that friendly to Wall Street.

"They may actually be looking at the report, thinking my god what bastard did this?" he said. "When you're putting sophisticated people in a room and asking them to draft a position, it's hard to understand why it would matter who paid for that room."

The paper included a disclaimer stating it didn't necessarily "represent the views or opinions of the Bipartisan Policy Center, its founders, or its board of directors." Co-authors Jonathan Macey, a professor at Yale, and Annette Nazareth, a former commissioner for the Securities Exchange Commission, did not return phone calls requesting interviews.

Rosemarie Calabro Tully, spokeswoman for BPC, didn't respond to questions about how it handles situations in which donors have a financial interest in the outcome of policy research. She pointed to a chart in the think tank's 2012 annual report showing that about 19 percent ($4 million) of its contributions come from corporations and individuals.

"The merit and integrity of our work rests on the transparency of our consensus-based process, and the diversity of our funding and participants," she said in an email.

Tully said there is no minimum required to join the Leaders Council and didn't respond to a request for amounts contributed. Tax filings show another 2012 Leaders Council member, America's Natural Gas Alliance, donated $250,000 in 2011.[1]

Industry ties run deep

Last month, former Lab Fellow Ken Silverstein wrote a blog about BPC's deep ties to energy companies and how it "routinely advocates, under the guise of independent scholarship, for policies that benefit its donors." In July, Lee Fang wrote in The Nation about BPC's ties to retailers it helped as they refused to sign a plan to improve worker conditions after garment factory disasters in Bangladesh.

In August, consumer advocacy and lobbying group Public Citizen published a report finding BPC had launched its financial regulatory initiative only "after Citigroup and ABA became substantial funders" and that "the experts it recruited disproportionately bring pro-big-bank credentials."

ABA's president, Frank Keating, who earned more than $1.7 million in that position in 2011, is also on BPC's board of directors and was a member of its "Debt Reduction Task Force." Candida Wolff, head of global government affairs for Citigroup, is on the board of the BPC Advocacy Network, according to her bio.

In October, Keating testified at a Senate Banking, Housing and Urban Affairs committee hearing on financial stability and growth. He cited a BPC figure and disclosed his positions with the think tank, but he didn't mention ABA had financed its work.

The BPC Advocacy Network has spent about $1.25 million in-house and $610,000 on outside firms this year to lobby federal lawmakers on dozens of issues, including the implementation of Dodd-Frank, according to the most recent disclosure reports.

As BPC describes its system, the think tank "impacts the public dialogue" and its lobbying arm "influences the policy outcomes." Their goal is big: "influencing legislative language, changing minds, changing laws, and even changing the nation."

But the portrayal is missing important players: the think tank's corporate donors that have a financial interest in these public policies, and anonymous donors to its advocacy arm that just might have a stake in them, too.

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1. The ANGA 2012 Form 990 filing wasn't available as of publication.

November 20, 2013

Should We Trust the New Cholesterol Guidelines?

Christopher Robertson, re-blogged from the Petrie-Flom Center

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The new American Heart Association and American College of Cardiology guidelines on how patients should manage their cholesterol are likely to dramatically increase the sales of statins. (E.g., check out the bump to Pfizer's stock price.) Yet, the new guidelines have become instantly controversial, with prominent cardiologists calling them into doubt.

In addition to the substantive scientific dispute, there are also questions about whether the guidelines panel may have suffered from biases, due to conflicting interests. As PharmaLot reports:

Of the 15 panelists that authored these new guidelines, six reported having recent or current ties to drugmakers that already sell or are developing cholesterol medications. And among the half dozen who disclosed these relationships was one of the two panel co-chairs, which contradicts an Institute of Medicine suggestion about managing conflicts on such panels. Each of the six panelists disclosed they worked as a consultant and received funding for personal research. And among the 10 expert reviewers, half listed consulting relationships.

I, of course, do not know the right answer about statins on the merits. As a layperson, I must use proxies and heuristics to decide, and to some extent busy non-specialist physicians must do the same. That is the whole point of the guidelines — so that each individual physician does not have to review the science himself or herself. They are supposed to be able to simply rely on the guidelines, as the state of the art. Yet, the conflicts of interests undermine our confidence in the AHA/ACC guidelines, making them less impactful on our prior beliefs. (My own research has documented this sort of discounting, among both physicians and laypersons). That sort of discounting is perfectly rational.

Some have argued that it is unrealistic to find experts who do not suffer from such conflicting interests. But what if the AHA/ACC had just proceeded with the nine unconflicted panelists, and the five unconflicted reviewers? Regardless of whether the panel reached the same outcome, it might have then better served the bona fide interests of the AHA and ACC, as well as the interests of public health. If that panel did reach the same pro-statin outcome, which boosted Pfizer's stock price, all the better.

November 20, 2013

J.P. Morgan and the Lessons of Memory Failure

Justin O'Brien

It is somewhat ironic that Steve Cutler, a former head of enforcement at the Securities and Exchange Commission, should serve as the general counsel for J.P. Morgan, a corporation that has just negotiated the largest single penalty in history. Less ironic and more serious for Wall Street are the signals the $13 billion settlement provides of likely future enforcement trajectories.

The severity of the fine, the forced admission of wrongdoing, and the requirement that J.P. Morgan cooperate in an ongoing criminal investigation suggest the settlement is merely the end of the prologue. It sets the stage for a denouement next year that has huge implications for the governance of Wall Street.

As the United States gears up to the 2014 mid-term congressional elections, the financial sector is the crosshairs of an exceptionally divisive battle that eerily replicates the lead up to the passage of Sarbanes-Oxley in 2002, which was the last serious but failed attempt to reform the structure of financial regulation.

Then, emboldened by the combative, innovative, and dubious litigation strategies of the New York State Attorney General, Elliot Spitzer, both the SEC and Department of Justice began using deferred prosecutions to enforce cultural change and combined this with aggressive criminal prosecutions. It was an era that brought major fines and the imposition of tough prison sentences. It saw the chief executive officers of WorldCom, Enron and Tyco, among others, in prison.

In large part the strategy worked because of Spitzer's prior predilection for taking morally wrong but legally weak cases on the calculation that the corporation involved would settle rather than suffer the consequences of the disclosure of damaging testimony. His relentless campaign forced a fundamental change in the politics of enforcement.

As Director of Enforcement at the SEC, Cutler played a pivotal role in the Corporate Crime Task Force, a multi-agency group that temporarily at least brought a sense of accountability to Wall Street, most notably by building alliances with elected State Attorneys General, who increasing saw the position as a route to the gubernatorial mansion, most notably Spitzer himself along with his successor Andrew Cuomo.

"I think this place [the SEC] has been well served by some of the traditions and protocols that it has maintained but it does cause angst and consternation," Cutler told me in an interview in 2005 as he was packing up his office in Washington DC to return to private practice. "The frustration for some of my soon-to-be former colleagues here is that some of those traditions mean we are going to end up looking like we are not doing something when in fact we are."

In 2005, Cutler advanced two principal strategic and tactical reasons for this state of affairs. Citing philosophical differences with his client, the SEC itself, as a barrier to more aggressive enforcement, Cutler made it clear in 2005 that enforcement, at heart, is a political decision.

"The chairman and the commission set the tone for this place. I would like to think that I was making recommendations that made sense, and sometimes lawyers make recommendations that at first blush might be beyond where a client would want to go," he surmised. Decoded, the SEC was at the mercy of the political predilections of its appointed commissioners, who in turn were constrained by wider political forces. Those constraining factors disintegrated in 2002 in the aftermath of scandal, just as they have today.

The second identified tactical problem was the fact that while the SEC had developed relationships with the Department of Justice, the SEC was initially unprepared as to whether and how to deal with ambitious State Attorneys General, in large part because of what Cutler termed the 'lack of a shared memory' about how to broker compromises to advance collective as well as self-interest. That too has changed fundamentally.

The re-alignment of the tactical and the strategic means that once again, the politics of enforcement returns centre-stage at a crucial time in the electoral calendar.

In sharp contrast to even the recent past, prosecuting Wall Street has once again become a priority for both the SEC and the Department of Justice, as well as critical State Attorneys General in New York and California, each of which is facing re-election next year.

It is indicative that in announcing the settlement with J.P. Morgan, the Department of Justice shared the limelight with the states, noting the importance of the cooperation of the State Attorneys General of New York, California, Delaware, Illinois and Massachusetts. It is further telling that the taskforce that brokered settlement, the Residential Mortgage Securities Working Group, is co-chaired by New York's State Attorney General, Eric Schneiderman.

The failure to remember this combination is what makes this stage of the crisis exceptionally problematic for both Cutler and J.P. Morgan, and indeed for Wall Street itself, not least because of the nascent but exceptionally toxic Libor and currency manipulation probes, which senior officials in the Department of Justice have already signaled will be the biggest white collar crime investigation in history.

The price of settlement has exponentially increased in direct proportion to the failure of institutional memory. The politics of enforcement has returned with a vengeance.

December 6, 2013

Rate Manipulation: Largest Cartel Fine in History

Justin O'Brien re-blogged from the Centre for Law, Markets & Regulation

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SYDNEY: 5 December 2013 - The European Union investigation into rate manipulation of critical financial benchmarks has generated the largest cartel fine in history. Six global banks—JP Morgan Chase, Citigroup, Société Générale, UBS, RBS and Barclays—have paid a total of €1.71billion ($2.3 billion) in an attempt to put the scandal behind them. The settlement, however, marks the beginning rather than the end of a process.

As it unfolds, the scandal is likely to prove exceptionally destabilizing to national, regional and global regulatory reform agendas. Here are five reasons why.

First, the settlement covers only two currency trading platforms, the setting of the Euro Interbank Offered Rate (Euribor), and Yen denominated trading based on the London Interbank Offered Rate (Libor) and the Tokyo Interbank Offered Rate (Tibor). Given the range of financial benchmarks including, critically, sterling and US dollar Libor, the settlement opens up, therefore, rather than covers the waterfront.

Figure 1: Euro Interest Rate Derivative Cartel

Participant	Duration of participation per infringement	Reduction under the Leniency Notice (%)	Fine (€)
Barclays	32 months	100	
Deutsche Bank	32 months	30	465 861 000
Société Générale	28 months	5	445 884 000
RBS	8 months	50	131 004 000

Source: European Union Competition Directorate

Second, if it has not already happened, the settlement is likely to change the dynamics of corporate whistleblowing. UBS and Barclays received total immunity for reporting the misconduct to the European competition authorities on the Yen and Euro cases, respectively. Citigroup received partial immunity in relation to one of its three attempts to rig the Yen derivative market (see Figure 2).

Figure 2: Yen Interest Rate Derivative Cartel

Participant	Duration of participation per infringement(s)	Reduction under the Leniency Notice (%)	Fine (€)
UBS (5 infringements)	1 month, 8 months, 5 months, 10 months, 1 month	100% for all infringements	0
RBS (3 infringements)	8 months, 5 months, 3 months	25% for one infringement	260 056 000
Deutsche Bank (2 infringements)	10 months, 2 months	35%, 30%	259 499 000
JPMorgan (1 infringement)	1 month		79 897 000
Citigroup (3 infringements)	1 month, 2 months, 3 months	35%, 100%, 40%	70 020 000
RP Martin (1 infringement)	1 month	25%	247 000

Source: European Union Competition Directorate

The gains for Barclays and UBS in turning state witness were substantial. In the EIRD case, the British bank avoided a fine of €690 million. In the YIRD cartel, UBS would have faced a financial punishment of €2.5 billion but for its cooperation, which mirrored the global Libor investigation. In a classic example of the prisoner's dilemma, cooperating with regulatory authorities has now become an imperative at every stage in the process.

Third, in calculating the fines, the European Union "took into account the banks' value of sales for the products concerned within the European Economic Area, the very serious nature of the infringements, their geographic scope and respective durations."

Holding out is an exceptionally risky proposition unless the bank can demonstrate that control systems were in place. It is notable in this regard that the Competition Directorate took the deliberate step of naming the banks that refused to settle, include HSBC and Crédit Agricole. The settlement, therefore, sets the stage for ongoing litigation that at the very least can have damaging reputational effects. For HSBC, in particular, this is problematic, given the imposition of a $1.9 billion settlement in relation to the failure of controls in its US and Mexican operations, which facilitated industrial-scale money-laundering by Mexican and Columbian cartels.

Fourth, the involvement of major French and German banks demonstrates all too clearly that domicile is no bulwark for effective risk management. It will be recalled that last month the Dutch bank Rabobank was separately fined $1.1 billion in relation to Libor manipulation. The revelation forced its chief executive, Piet Moerland, to resign. Suggesting that he was unaware of and shocked by the behaviour of his traders, Mr. Moerland took responsibility for a flawed culture. "Such behaviour is entirely contrary to our core values, of which integrity is the most important," he said.

Deutsche Bank, the recipient of the largest fine in the Euro cartel and the second highest in the Yen cartel, has taken a starkly different approach. On its global portal, which operates with the strapline "passion to perform," one struggles to see any responsibility.

The bank headlines the fine "an agreement with the European Commission as part of a collective settlement on interbank offered rates." The language is telling. "The settlement amount reflects, in particular, the high market share held by Deutsche Bank in the markets investigated," it says in a press release, and the conduct, which is nowhere spelt out, is presented as a "legacy issue."

Deutsche Bank's co-chief executive officers noted solemnly that "acting with integrity is a core value at Deutsche Bank, and we expect every employee to adhere to it. We are attaching the highest institutional importance to ensuring that this type of misconduct does not happen again." It may be clever PR but it suggests, given Deutsche's global dominance in derivative trading, that the litigation reserves set aside may not be enough should the European Union Competition Directorate adopt a systematic approach to unraveling the extent to which all financial benchmarks have been susceptible to cartel behavior.

Fifth, two major US banks have accepted wrongdoing in relation to yen trading manipulation—Citigroup and JP Morgan. The relatively small fines imposed do not provide much comfort for the US banks. It follows similar acceptance of wrongdoing in Singapore by Bank of America and JP Morgan Chase. This suggests that pressure will mount for an investigation of their role in the more critical dollar and sterling denominated Libor trading. This pressure comes at a pivotal time in the electoral calendar in the United States. With President Obama under increasing pressure to leave a legacy, Wall Street could find itself exceptionally exposed in the lead-up to the crucial mid-term elections next November.

The European Union settlement has demonstrated conclusively the corrupted nature of financial benchmarks. Given that national regulatory authorities have to report progress towards compliance with IOSCO principles on financial benchmark governance by next June, it is more likely than not that the issue will move centre-stage during Australia's stewardship of the G20 and IOSCO itself. Managing it will define the credibility of each. Legacy, it appears, matters to everybody.

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December 9, 2013

Volcker's Tall Order: How Institutional Corruption Delays Banking Reform

Gregg Fields

After some three years of regulatory wrangling, the Volcker Rule is set for its official unveiling. The nation's top banking oversight agencies have indicated they will vote this week to approve the directive, part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

What's in the rule? Well, no one wants to say for certain. How will it work? Again, that's a detail that hasn't been disclosed.

About the best that can be said is that, if reports are correct, simplicity isn't one of the Volcker Rule's virtues: according to some news reports, the rule during the drafting process swelled to nearly 1,000 pages—or nearly half as long as the Dodd-Frank Act that mandated the creation of the rule.

Nevertheless, expectations are riding high on the Volcker Rule, which is perhaps appropriate since it's the namesake of former Fed Chairman Paul Volcker who, at six-foot-seven, was both literally and figuratively a towering figure in the history of banking regulation.

From an institutional corruption standpoint, the anticipated Tuesday vote by five agencies is an opportune time to take inventory of financial reform efforts since the crash that preceded the Great Recession. Has reform been shaped—for better or worse—by common symptoms of institutional corruption such as conflicts of interest, regulatory capture, and dependence between regulators and industry?

This institutional corruption inquiry will focus on three broad areas. One, did institutional corruption make a Volcker Rule necessary? Two, has institutional corruption delayed, or diluted, the rule that will be adopted? Finally, how might institutional corruption neutralize the Volcker Rule's effectiveness once it is officially the financial sector's rule of engagement?

In remarks last week, Treasury Secretary Jack Lew said the Volcker Rule will be a watershed moment in regulatory restructuring. "Rule-writers will soon put forward a tough Volcker Rule that I expect to be true to President Obama's vision and the statute's intent," Lew said at a program hosted by Pew Charitable Trusts. "The rule now before regulators for a vote is the product of much intensive work and analysis—and, needless to say, years of effort."

On that last point, there's little doubt. Dodd-Frank was passed in 2010, and the Volcker Rule was originally floated in 2011, but essentially withdrawn after an avalanche of industry outcry.

After The Fall

By way of background, it is helpful to start with a simple question: why is the Volcker Rule needed at all? The answer lies at the heart of the causes of the financial crisis, when markets plunged, banks collapsed and the economy fell into the steepest decline since the Great Depression.

Much of the carnage was rooted in Wall Street's slavish marketing of subprime mortgages, or home loans made to borrowers of unusually high credit risk. Numerous lawsuits—which resulted in some gigantic settlements—have alleged the investment risks were misrepresented and the deals were rife with conflicts of interest. For instance, the mortgages became the basis for residential mortgage-backed securities, or RMBS, that imploded when homeowners couldn't keep up with their payments and defaulted. Yet, at the same time institutions were selling securities to investors, they were allegedly privately placing bets that the securities were going to tank.

Beyond that, banks had attempted to hedge their risks by purchasing a form of insurance commonly called "credit default swaps," or CDS. CDS products are part of a financial category generally known as "derivatives."

Over time, a wild secondary market in derivatives developed as banks traded them "over the counter," or among themselves. The difficulty was that the underlying credit risks—and actual market value—were virtually impossible to determine. The trading itself morphed from a defensive strategy to a highly profitable playmaker. Regulators were unable to stop the clock, since derivatives were specifically exempted from oversight by the Commodity Futures Modernization Act of 2000.

The result was that, when everything collapsed, the entire financial industry was sitting on untold hundreds of billions of dollars in losses. Banks and some non-bank companies, like AIG, which had sold some $400 billion of CDS, had to be bailed out lest the financial system fail. The Wall Street bailouts remain highly controversial. As Nobel Laureate economist Joseph Stiglitz wrote in 2011: "The financial sector's inexcusable recklessness, given free rein by mindless deregulation, was the obvious precipitating factor of the crisis."

Note the language used by Stiglitz: the finance sector may have been guilty of "inexcusable recklessness," but that's not the same thing as calculated corruption. Rather, it suggests the culprit was institutional corruption—influences and conflicts, such as "mindless deregulation"—that are perfectly legal. So in that sense, it seems perfectly fair to argue that institutional corruption did make the Volcker Rule necessary.

Delay In Game

How is the Volcker Rule supposed to work? And more importantly, is institutional corruption at least part of the reason why it is years behind schedule?

The Volcker Rule would sharply limit "proprietary trading," where a bank trades in derivatives with its own capital. Banks could still engage in "market making," or trading in derivatives and similar products on behalf of clients. But in theory the Volcker Rule would sharply curtail their ability to place taxpayer-backed banking funds at risk.

From an institutional corruption standpoint, the problem isn't that there should be a line drawn, but rather where to draw it. Sometimes, for instance, a bank may need to take a position in a client's securities and act as an intermediary, particularly because derivatives often are illiquid. Is that market-making or a proprietary trade? And shouldn't banks be allowed to secure legitimate hedges against possible losses?

"In adopting the Volcker rule, Congress prohibited banking entities from proprietary trading while at the same time permitting banking entities to engage in certain activities, such as market making and risk mitigating hedging," Gary Gensler, the outgoing chairman of the Commodity Futures Trading Commission, which plays a central role in regulating derivatives, said last year. "One of the challenges in finalizing this rule is achieving these multiple objectives."

That challenge has created the years-long delay in writing and adopting the Volcker Rule. And during that delay the banking system was vulnerable to the kinds of losses that presaged the 2008 bailouts. A leading example is the $6 billion "London Whale" trading loss incurred by JPMorgan Chase.

That leads to the second point of our analysis: has institutional corruption played a role in the delay of the Volcker Rule? As Lawrence Lessig, Director of the Edmond J. Safra Center for Ethics, has written, institutional corruption is often the result of influences that cumulatively create an economy of influence that ultimately doesn't serve the public interest.

Rarely has a piece of legislation been subject to more influences than the Volcker Rule. To begin with, five regulatory agencies had to agree to terms: the Securities and Exchange Commission, the U.S. Commodity Futures Trading Commission, the Fed, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corp. Each agency has its own constituencies and its own policy goals. And the organizations aren't known, generally, for always acting collegially. The Fed and the OCC are reportedly leaning toward a lenient rule for banks, while the CFTC, at least under Gensler, who is soon leaving, has advocated for a stricter standard.

A further influence has been the banking industry, which has lobbied relentlessly as the Volcker Rule was shaped. (The so-called FIRE sector, for finance, insurance, and real estate, spent an estimated $488 million on lobbying in 2012, according to opensecrets.org, and $358 million as of Oct. 31 of this year.)

A 298-page draft Volcker Rule in 2011 drew a withering 18,000 comment letters, some from entities such as the Red Lobster restaurant chain, which said its concerns were that strict regulations could sap economic vitality and therefore reduce its business.

Even after all these years, some powerful business institutions maintain there's no rush. The "process to date has created a 'black box' of rule writing that could result in an unbridled exercise of regulatory power that can harm the economy," David Hirschmann, president of the Center for Capital Markets Competitiveness, formed by the U.S. Chamber of Commerce, wrote in a letter to regulators late last month. He added: "Therefore, we once again urge the Agencies to re-propose the Volcker Rule."

In that context, it's worth asking: at what point does a perpetual delay in policy become a policy? And in this particular case, does it serve the public interest or, rather, the economy of influence that is producing the delay?

Malcolm Salter, Senior Faculty Advisor to the Edmond J. Safra Center for Ethics and Harvard's James J. Hill Professor of Business Administration, Emeritus, refers to this type of problem as gaming. "It is one of the most corrosive forms of institutional corruption in business," Salter wrote in a 2010 working paper. Institutional corruption, he added, "refers to company-sanctioned behavior and relationships that may be lawful but either harm the public interest or weaken the capacity of the institution to achieve its primary purposes."

From Here On

It's a pertinent point because the reality is that, even if the Volcker Rule is adopted this week, it won't immediately become official policy.

The rule will still be subject to, at minimum, months of legal interpretations by the various agencies. That historically has often meant legal challenges by industry interests, which in turn could mean aspects of the Volcker Rule are put on hold until the litigation is final.

Finally, there is the simple fact that agencies can't possibly oversee all activities undertaken by financial institutions. JPMorgan, as one example, has $2.4 trillion in assets and operates in 60 countries.

"How supervision and enforcement of the Volcker provisions are handled among the five agencies is one of the most important and potentially complicated practical aspects of implementation," Julie Williams, former general counsel for the Office of the Comptroller of the Currency, told Bloomberg News last week.

In other words, the game continues.

December 11, 2013

Taking the "Citizen" in "Corporate Citizenship" Seriously

Dieter Zinnbauer

The following letter to a company presents some of the key points put forward by lab fellow Dieter Zinnbauer, of Transparency International, in a new working paper that advocates for a major overhaul of how corporate citizenship is conceptualized and practiced.

Dear [Apple, Google, Exxon, Ford, GE—insert your favourite Fortune 500 company],

Thanks so much for sharing with me your [annual report/sustainability report]. I am very impressed by your achievements as a good corporate citizen and I think you have every reason to celebrate your successes.

Your section on "giving back to the community" contains a truly impressive list of good deeds. I deeply appreciate that you support the local philharmonic orchestra and encourage your employees to engage in some pro-bono charity work. Only one little nibble: how about letting me know, on top, how much you contribute—like every citizen, corporate and individual—to the public purse to cover all these investments and expenditures, from education to roads to high speed internet, that we have all democratically agreed upon as a community and that your enterprise also greatly benefits from. So a bit more information on how much in taxes you pay, to communities, to countries, would be incredibly helpful and a great way to showcase a core part of your corporate responsibility.

I could not agree more with your impassioned pledge to put people and their well-being first, to act and excel as a responsible steward for future generations and a sustainable future. I learn from your numbers that your water consumption has gone down. Bravo! But why this understatement? I presume you are doing so much more for us and our future with all the money, influence and professional lobbying power that you deploy for shaping public policies. So why not celebrate how you exercise your responsible engagement in this probably even more important area? How about giving us a good run through of what values and policy aims you stand for, how you push for them, why, and with what resources? Your rhetorical resolve leaves no doubt that you put your lobbying power where your mouth is. I would just like to be sure. And given the power you wield, which dwarfs the resources of persuasion that other citizens can enlist to put their points across, I think it is actually fair to ask and get the numbers—not as some rather cryptic filings to lobby registers, but as plain language statements and key figures in your annual report.

Finally, I truly applaud your tireless efforts to ensure that you not only set an ethical tone from and for the top, but strive towards turning integrity, accountability and zero tolerance for corruption into real values that are practiced in every fibre of your company and far-flung network of affiliates and partners. But what systems have you put in place to make this actually happen? How do you ensure that deviance is effectively prevented, and effectively detected and sanctioned if it occurs? To give us the confidence that all of your subsidiaries, affiliates and employees will abide by the laws of the land, a key pillar of responsible citizenship.

Now let me emphasize again that I am not trying to be difficult. I really am not in the blaming-and-shaming business of judging whether you pay enough taxes, stand for the right policies, or have sufficient safeguards in place against breaking the law. I just think it would be great if you made this information available in plain words and figures, so that communities can actually begin to truly evaluate your claims about corporate citizenship in a substantive way and have an informed discussion about them.

Taxes, law abidance and policy engagement are the three most fundamental pillars of citizenship, from its original conception to today. Show us that you are serious about corporate citizenship and tell the world about your conduct, and people can give credit where credit is due.

Dieter Zinnbauer, "Getting Serious About Corporate Citizenship—The Essential, Yet Missing Building Blocks for Responsible Corporate Behaviour," November 4, 2013. Available at: http://ssrn.com/abstract=2349616 or http://dx.doi.org/10.2139/ssrn.2349616.

December 12, 2013

Credibility of Evidence and Affiliation in the Quest for Proper Science

Bart Penders and Kim Hendrickx

Lorry drivers who regularly visited South and Eastern Europe were struck by the beauty and shapeliness of local women. This observation give rise to the "Edric Original" breast growth pill, filled with *hop*, the apparent key dietary difference between well-endowed Southern and Eastern European and everyone else (Scholtens, 1997). The full treatment will set you back €540—a bargain.

What is it about this offer that makes us doubt its credibility? Why do we evaluate some claims as more credible than others? Kim Hendrickx is currently finalizing a PhD thesis on the credibility of claims on food products. Bart Penders and Kim Hendrickx give a commented preview of the argument:

The European Union has set up an infrastructure to rid itself of ill-supported claims associated with foods. One type of health claim that fell victim to this is that associated with pre- and probiotic foods.

But what is the proper foundation for a health claim? Who is going to decide upon this? And what effects does such an infrastructure have on nutrition science? This debate has become prominent since the European Food Safety Authority (EFSA) was charged with the evaluation of health claims, resulting in a list of permitted claims for the EU in 2012.

In December 2012, a list of permitted claims was approved based upon a scientific opinion from EFSA. It contained 222 general function health claims, 30 nutrition claims, and 21 health claims referring to the reduction of disease risk factors or child development. A whopping 1631 health claims were not approved (included the breast growth claim at the top of this post) and needed to be gradually removed from the public domain; 2303 health claims remain under consideration, awaiting more data (Mathioudakis, 2013).

That list was disappointing to both industry and academics. Most allowed claims dealt with vitamins and minerals, while pre- and probiotic claims were rejected. They are considered one of the most promising segments in the functional foods market and the discussions between industry, academics and EFSA have led to the creation of interest groups on pre- and probiotics. They have written letters to scientific journals and to the Commission, and a new scientific community emerged under the name *gut health scientists*, with a website to defend their cause and their right to contribute to the definition of proper nutrition science.

There are currently two "fault lines" running through the nutrition research community with respect to the health claims debate and the underlying struggle to define proper nutrition science as the rightful referee. First, there is an *institutional* fault line that discursively positions scientists with industry involvement in a seeming opposition to those who are not.

Second, there is an *epistemological* one, distinguishing between the different logics of evaluating, valuing and working with evidence.

Today, most academic researchers in nutrition come to collaborate with food companies at some point in their career, either through collaboration in concrete research projects or through increased involvement in public-private research consortia. Lesser et al. (2007) point at a relationship between funding source and study result, while Katan (2007) notes that this need not reflect the quality of science but may rather reflect the subset of science that is actually done. Nevertheless, industrial relationships and perceived breaches of integrity influence public trust in researchers and institutions (Marks, 2013), and professional evaluations of credibility (Kesselheim et al., 2012).

Industrial science suffers from credibility problems—about which industrial scientists utter their discontent: "[I]t is unscientific, as well as unfair, to discard or discount a study based solely on which investigator or institution conducted or funded it" (Barrow and Conrad, 2006). However, during their assessment, EFSA panelists do not reserve a separate treatment for health claim dossiers provided by companies, simply because such dossiers are almost by definition provided by such companies. Industry being the default applicant, all that can be taken into account as a variable in the judgment of dossiers is the scientific content. The idea is that scientists recognise sound science when they see it, and that it is thus possible to make consensus-based judgments.

Deciding which type and which amount of evidence is sufficient to support any scientific claim is a question generally settled through consensus. *Evidence based medicine* (EBM) is such a consensus: a logic of gathering, interpreting and weighing evidence. It includes a hierarchy of evidence, with the randomized controlled trial (RCT) at the top. EBM has, for all intents and purposes, become the dominant perspective in biomedicine, prescribing what type of evidence is most important, most credible and most sought after. However, in 2011, a group of nutrition scientists challenged the EBM consensus with reference to the European health claims debate (Biesalski et al., 2011). They made a plea for more methodological diversity, and for a different conceptualisation of health, and propose to replace EBM with "evidence based nutrition" (EBN) in the context of nutrition science.

EBN can be considered a strategic programme that serves both academic and industry-related nutrition science. EBN is politically analogous to EBM, in that it identifies its own experts and methods to reach consensus and formalise scientific judgment. The most important distinction EBN proponents forward between EBN and EBM deals with a line drawn between what pertains to "the medical" and "the nutritional." "The medical" is *actively externalised* from nutritional research.

The RCT has become emblematic of EBM. The RCT is also the preferred form of evidence for EFSA's NDA panel, if available. When adherents of EBN propose an alternative to EBM, they are questioning the role of the RCT for research into the diet-health relationship, and they are questioning the hierarchy of evidence for the assessment of health claims. Their arguments range from pragmatic ones (ethical permissibility, cost and duration of RCTs) to fundamental questions about the suitability of RCTs. They argue that RCTs are not suitable to identify subtle effects and synergies amongst nutrients that are fundamental to human health, but not measurable in a single-point clinical outcome.

This leads to a situation where nutrition scientists in the EFSA panels are being reproached by peers for "wrongly" adhering to the EBM paradigm. To some, EBN is the only valid way of weighing nutritional evidence—the only conceptualisation of proper science, able to get to the dietary "truth."

The insistence on a singular "proper science," however, can lead to conflating two different scientific practices and types of knowledge: experimental practice and regulatory practice. Experimental practice ideally creates new knowledge by posing further questions and by changing experimental setups. In contrast, regulatory practice proposes a *fixed* setup in order to make judgments and put further questions (temporarily) to a halt. In both cases, "knowledge" does not refer to the same thing, and it does not fulfil the same function. Both EBM and EBN propose a set of criteria to make *judgments*, rather than scientific hypotheses, meaning that both are *regulatory instruments*, and thus political.

The singular notion of "proper science" makes it impossible to accommodate the different meanings and roles that knowledge, evidence, and "truth" represent in an arena where actors with different agendas and different practices meet. A possible consequence is that one is left with the impression that there is only good science and bad science, both morally and methodologically. Under such circumstances, the question "where does the good science come from?" resurfaces over and over again.

Instead, proper nutrition science it is about conceptualisations of origin, knowledge, evidence, and truth that fit the local context. The challenge lies in the continuous evaluation of that fit, and all the inclusions and exclusions it may invoke.

Note: A full length version has been submitted for publication.

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December 13, 2013

Prato Fire Aftermath - Solutions Don't Come Easily

[Heather White](#)

A smell of smoke still hangs in the air and the two banners hung by visitors paying their respects last week read "These Seven Dead Deserve to be Remembered With Dignity. We Must Give Them the Utmost Respect" and “Grief Knows No Color”.

The factory, which is actually a combination storage space with truck bay, sat abandoned with piles of burned debris outside. The neighboring factories continued business as usual on Monday, a day after the fire ripped through the workshop, killing seven workers as they slept inside.

In the world of the fast fashion, production cannot stop until the goods are finished. When a factory has only 15 employees in order to avoid the watchful eyes of the authorities, the shifts will be 18 to 24 hours long, seven days a week.

The authorities believe that a portable cookstove is the source of the fire, which would make sense because in Prato, Italy the Chinese factory owners (of which there may be as many as 5,000) disable the central heating in their factories. They refuse to pay for heat for their workers. They also disable the heat in the apartment buildings they have bought from cash-strapped Italians over the last ten years. At a recent gathering in a three-bedroom apartment, shared by at least seven workers and four children, we kept our winter coats on the entire evening, like we used to do in China in the early 1980's before central heating. Was I in Italy or China? I asked myself several times.

At an emergency meeting of the Prato city council last Wednesday the scene was somber in the wood-paneled meeting room, where an incredibly ornate ceiling and hand-sewn silk tapestries decorate the walls, reminding visitors of Prato's long history as a textile center from medieval times. The meeting began with two minutes of silence while the city's bells rang in memory of the dead.

The building where the city council meets dates to the 13th century, and Prato's leaders are well aware of what is at stake.

"This could be the future of Italy," Edoardo Nesi, the culture commissioner of Prato has said. "Italy should pay attention to the risks."

The Chinese consul general from nearby Florence put in an appearance, shedding a tear as she proclaimed the Chinese government's newfound desire to change the brutal exploitation of workers that has been Chinese factories' *modus operandi* in Prato for the last 15 years. Were this to happen, it would mark a fundamental shift in policy.

However, in conversation later with a few workers, none of them expressed hope that the consul's words will come will become reality. When they call the Chinese Consulate on the phone for assistance they are usually hung up on. They described the "bad attitude" of the government bureaucrats they've dealt with. "It's not like the warm relationship you have with your embassies and consulates in the West. Our government offices here don't want to hear from us and don't want to help."

Workers I've interviewed in Prato over the last two years have said that the Chinese government is unhelpful regarding their plight, and is more interested in the approximately $1 million a day wired to China from Prato's 5,000 registered and unregistered factories.

Specifically to Zhejiang and Fujian provinces, resulting in an economic boom in both provinces.

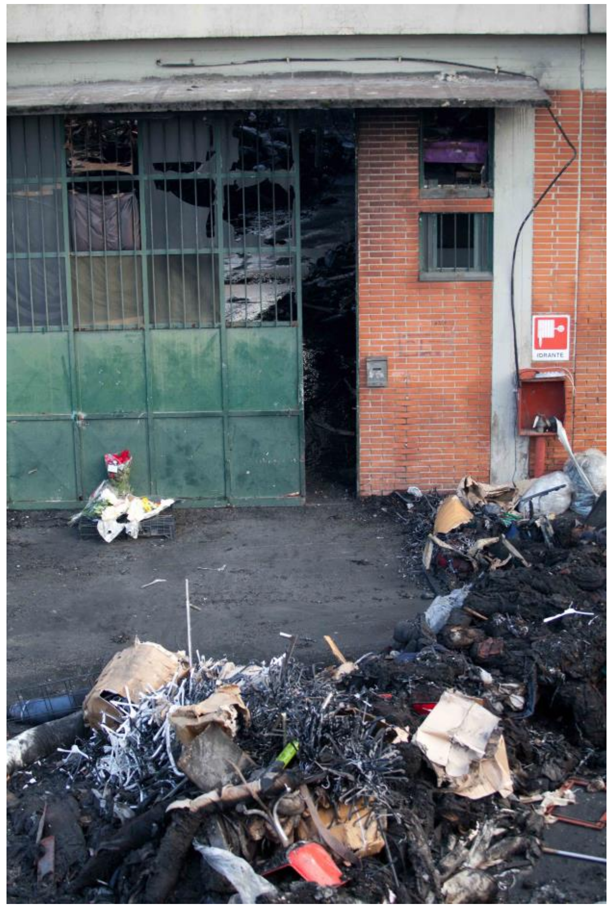
"How can China leave a mark like this in the E.U.?" the mayor, Roberto Cenni, has asked in frustration, his efforts to engage with the Chinese consul fruitless over the years.

"Noise, bad habits, prostitution. People can't live anymore. They're sick of it."

Local journalist and expert on Prato's Chinese business community Silvia Pieraccini has written about Italian officials' inability to persuade the Chinese government to address the growing crime problem, the unsafe factories, and the trafficking network that brings workers overland from China and into Italy illegally. Estimates range from 15,000 - 30,000 illegal Chinese workers living in Prato today.

Despite the undocumented status, they hide in plain sight once they have purchased forged residence documents, courtesy of a corrupt local bureaucracy. The permits take approximately two years to earn. This is two years at a minimum of 16 hours a day, seven days a week, which is only possible after they've paid off their €10,000-30,000 debt for the transport from China to Italy. I overhead a permit broker offer to prepare two permits for a woman for €8,000 (for her husband and third daughter, born in China, where the one-child policy has been widely ignored over the past fifteen years. The discussion of China's underreported census numbers is a topic for another day).

The initial trafficking debt takes from one to three years to re-pay, according to every worker I have spoken to. Once the Chinese immigrants have their residence permits, which do not get challenged by the authorities because they are indistinguishable from valid documents, they continue to avoid interacting with Italian society, often to their detriment. They are (under)paid in cash and do not call the police when robbed, which happens frequently on Prato's unsafe streets. The Chinese underworld has come to Prato, running gambling and prostitution businesses, and serves as muscle in disputes between rival factory owners. I met a man who said he'd trashed a factory, as retaliation in a feud, and spent two years in an Italian jail. Western Union and other wiring services have absconded with workers' funds, never wiring the money to China as promised, disappearing overnight. Reports to the authorities are not made, of course.



Occasionally a dead body has been found on the streets, with no clue as to how the young men died. Most people think they died of exhaustion from working more than 30 hours at a stretch (which many I spoke to said they have done in the past), but no one knows for sure, including the authorities who sometimes cannot even find out the names of the dead. One former worker I spoke to said at her factory the owner put workers in the dumpster wrapped in a plastic bag when they died. Dead workers' residence permits are quickly taken and used by others, no death reported. Hence the saying, "No Chinese ever die in Italy."

Anything is possible in the Prato factories, so the news that there was a very young child in the factory during the fire who escaped with his parents comes as no surprise, just a shake of the head. The children live in the factories with their parents and in many cases do not go to school. Of the more than 20 workers I have interviewed on this topic, none said their child attended school in Italy. That isn't universal, however, and I do see Chinese and Italian school children together on the streets of Prato. It is one of the positive signs that things will be better in the future.

One of the powerful local unions, the Italian General Confederation of Labour (CGIL), held a vigil and march in Chinatown late last week. Unfortunately, none of the Chinese knew it was a union carrying the banner, or what it said. They said they assumed the banner said something to the effect of "We express our condolences for what happened."

In fact the union is trying to get Chinese workers to join them and organize the factories: an obvious solution. One worker did go to the union last week after the fire, but she left without giving her name or following through with her complaint, when told she would need to give full identification details which would be made available to her employer.

Italian law requires that workers give their names and their factories name when denouncing their employers, a deal-breaker in this Chinese community. Without anonymity and the promise of instant residence permits, getting Chinese workers to ally with CGIL is unlikely.

Photo credit: Luigi Casentini (fire trucks at factory image, fireman with flower image)

December 17, 2013

Progress is Possible in the Institutional Corruption of Healthcare

Christopher Robertson, re-blogged from the Petrie-Flom Center

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Today, there are two big stories that relate to the "institutional corruption" of medicine (aka conflicts of interests). For those who have been working long and hard on these issues, they are cause for hope. The needle does move.

First, one of the biggest pharmaceutical companies, GlaxoSmithKline, has decided that it will stop paying doctors to promote their drugs. My prior work has shown that such payments are quite common (e.g., 61% of urologists and 57% of gastroenterologists taking money), and that they likely influence the prescribing decisions of the doctors who take such money. In recent months, Glaxo has made several such moves towards greater transparency and integrity, often as a result of threatened or actual criminal prosecutions. (See their newfound commitment to opening up their clinical trial data too.)

The NYT story quotes an industry consultant suggesting that the move to stop paying physicians is a result of the Affordable Care Act's "sunshine" requirement that such payments will be disclosed, and that several other drugmakers are considering similar moves. I am a bit skeptical that the disclosure mandate had such an effect, since the disclosures were already required by Massachusetts and other states, and as part of the "corporate integrity agreements" that came of several federal prosecutions. My sense is that such disclosures are not likely to reach patients in a useable way, so it's hard to understand how the transparency could really impose much of a disincentive on the companies. Yet, something has caused Glaxo to change course.

Second, the National Football League has decided to give the National Institute of Health $100 million to study brain injuries. The counterfactual is that the NFL could have kept the money, of course. But the more interesting alternative is that the NFL could have just spent the money itself, hand-picking the researchers and carefully specifying how the research should be performed, in order to buy the scientific conclusions that it preferred. This has been the classic strategy of industries facing litigation risk, from tobacco, to asbestos, and now the paper industry, whose law firm actually commissions scientific studies on its behalf. The NFL's move instead proves that it is possible for a self-interested party to nonetheless fund independent, credible, gold-standard research, by using an intermediary, such as the NIH.

This is exactly the sort of reform that I have called for, as an alternative to the false dichotomy between public funding and private interest. For companies that have a bona fide interest in discovering and publicizing the scientific truth, a credible intermediary like the NIH can reassure consumers of scientific information that it is valid. Now, if only we can get big pharmaceutical companies to make the same move for their clinical trials and other scientific research studies. Perhaps the first-movers will be the most innovative companies who have bona fide products and are tired of them being lost in the cheap talk? If physicians making prescribing decisions continue to give greater credence towards NIH-funded research, such integrity could be rewarded.

December 19, 2013

Brookings New Year's Resolution: Reveal More about Foreign Government Funding

Brooke Williams

The Brookings Institution, one of the most influential think tanks in the world, plans to publicly disclose more details in 2014 about money it receives from foreign governments.

The move is in response to a letter the Lab at the Edmond J. Safra Center for Ethics sent to Brookings and 11 other think tanks in August 2013, signed by this author and the Lab's director, Larry Lessig, asking them to voluntarily disclose the amounts and purposes of donations from foreign governments.

David Nassar, vice president of communications for Brookings, said the think tank is conducting an internal review of its disclosure policies and will begin discussions with its 19 foreign government donors next year about new policies it would like to put in place.

With the exception of the relatively few who ask to remain anonymous--none of which are foreign governments--Brookings already publishes donors' names in its annual report, grouped by funding ranges. The ranges are fairly broad, with a top tier of $1 million or more, leaving a lot to the imagination.

In the most recent report, the United Arab Emirates is the only foreign government named in the top tier. Others include Qatar, Norway, Switzerland, Taiwan, the Netherlands, Korea, Canada and France.

Nassar said that the Edmond J. Safra Ethics Lab's letter was the first time anyone had requested specific amounts and purposes of foreign government donations, and it prompted a series of internal discussions. While Brookings wants to take immediate steps to become more transparent, it also needs to consider contracts and agreements with donors.

So far, Brookings is the only think tank to respond affirmatively to the request. This is despite the fact that some foreign government donors already deem the information public. Take Norway, which upon request quickly supplied a detailed budget of its $1 million grant to Brookings for a project on climate change.

Among other things, the budget shows more than half the grant paid for salaries and benefits of specific scholars at the think tank. In some cases, scholars are aware of the funding relationship, Nassar said, but Brookings has strict policies in place to prevent donors from influencing research.

"Brookings research is published whether a donor agrees with it or not, and there are no exceptions to this," he said. "We don't sign agreements where the research is subject to the donors' discretion."

Nassar provided a copy of Brookings' internal "Donor Recognition Guidelines," which outline specific policies meant to ensure donors have no real or perceived influence over scholars' work. The first item in a list of "guiding principles" states that Brookings "will at all times maintain an independent position on policy issues its scholars are researching."

"To protect the quality of the work of the Institution, its donors, policymakers and the public, Brookings does not accept gifts from donors who seek to undermine the independence of its scholars' research or to otherwise predetermine or influence recommendations or final direction," the guidelines state.

At the same time, Brookings permits its scholars to participate in fundraising and interact privately with donors.

Any donor who gives $50,000 or more is entitled to "private briefings with Brookings scholars." And in its Conflict of Interest Policy, Brookings provides a hypothetical situation in which it would be acceptable for a scholar to vacation with a donor:

"A Brookings Senior Fellow is invited to join a $100,000 donor at the donor's vacation home in Telluride to ski during the Christmas holidays. The Institution is cultivating the donor to make an eight-figure endowment gift. The donor makes it clear to the scholar that she has invited "a few friends" to a dinner on Christmas Eve and that she hopes the scholar will "say a few words" about his latest manuscript. The scholar informs the relevant Development and Executive Office personnel who provide additional information to the scholar about the donor's interests and affiliations. Because the scholar is engaging in legitimate donor cultivation, he does not have a conflict of interest."

Nassar said Brookings' reports are peer-reviewed internally, and scholars must document and report interactions with donors.

December 20, 2013

The SDNY Bench is the Crucible for Debate on Financial Regulation

[Justin O'Brien] re-blogged from the [Centre for Law, Markets & Regulation]

The Southern District of New York federal courthouse on Pearl Street in Lower Manhattan has emerged as the crucible for an increasingly pointed debate on the future of financial regulation. It is here that the intersection between law and morality, prosecutorial and regulatory purpose and acumen, personal conduct and the financial services industry's commitment to market integrity is being played out.

Without question, the highest profile facilitator of this debate is Judge Jed Rakoff. Faced with an invidious choice of providing court approval for regulatory strategies he views as demonstrably failing, Judge Rakoff drew a line in the sand earlier this year, refusing to endorse a settlement with Citigroup, an institution he dismissed as a 'recidivist' offender (page 11).

Given that the 'Court has not been provided with any proven or admitted facts upon which to exercise even a modest degree of independent judgment' (page 4) he argued the court had no choice. That decision is on appeal to the Second Circuit, with a decision imminent.

Reprising arguments first made here at a visit to the CLMR in Sydney that the stated reasons given by the Department of Justice for not bringing senior executives or institutions to account are implausible excuses, Judge Rakoff has now taken to the stage in New York itself, most notably in a major essay in the latest issue of the New York Review of Books. The timing appears deliberate. Recent court cases in the Southern District, however, suggest Judge Rakoff is not the only iconoclast on the bench.

Judicial skepticism in the United States is demonstrably on the rise. Earlier this month in sentencing Mathew Taylor, a former Goldman Sachs to nine months imprisonment for hiding a loss-making $8.3bn position that cost the bank $118m to unwind, Judge William Pauley evoked Bonfire of the Vanities, a biting satire of 1980s greed that indicted not only Wall Street but the wider culture its triumph celebrated and legitimated.

'In short, Mr Taylor you were in Tom Wolfe's words a 'Master of the Universe," he told the defendant. Taylor, who graduated from MIT and owned a house in the Hamptons by the time he was 28 now works as a swimming pool cleaner in Florida. 'This case presents a paradigm of everything that is wrong with Wall Street and the regulators that are charged with protecting the public,' the judge said, caustically adding 'so much for Goldman's concern about the financial markets.'

Thomas C. Rotko, a lawyer for Mr. Taylor, told reporters outside of the courtroom that 'we are pleased that the judge saw this matter as we did as an indictment in part of the regulatory system itself.'

Last month another member of the bench, Judge Alvin K. Hellerstein, used a sentencing hearing to ask a deceptively simple but enormously complex question, 'Why do good people do bad things.' This, he said was 'a deepening mystery in my work.' That case, involving a mid-level Credit Suisse executive, Kareem Serageldin, who inflated the value of mortgage-backed securities as the market imploded in 2007. A graduate of Yale, Serageldin 'was in a place where there was a climate for him to do what he did,' the judge said. 'It was a small piece of an overall evil climate inside that bank and many other banks.'

Nonetheless, a custodial sentence was necessary. 'Each person has to look within himself and ask himself what is right, what is wrong,' the judge said. 'Even in the worst of times, what is right cannot be sacrificed.'

This leaves unresolved how and why the misconduct flourishes. One explanation is as Peter Henning has persuasively argued, that 'perhaps misconduct by some groups can be ascribed to the belief that so long as everyone else seems to be doing something, it cannot actually be wrong.' under pressure to produce profits for a hedge fund or a bank, traders are often on the lookout for an "edge" on the market that can slowly take them closer to crossing the line into illegality. Add to that the vagueness of the insider trading laws in determining when information is "material," and it can be easy to cross into illegality without necessarily noticing it.'

This argument of slippage could be seen in another of Judge Rakoff's rulings. In imposing a two-year prison sentence on Rajat Gupta a former board member of Goldman Sachs for insider trading, Judge Rakoff said he had 'never encountered a defendant whose prior history suggests such an extraordinary devotion, not only to humanity writ large, but also to individual human beings in their times of need.'

What the stories being played out in the Southern District suggest is that how to regulate culture has become both pressing and exceptionally problematic. It is a question of epic and global proportions.

The Financial Conduct Authority in the United Kingdom has argued that 'it is only through establishing the right culture that senior management can convert their good intentions into actual fair outcomes for consumers and ensure that delivery of these outcomes is sustainable'. This is an obligation that the financial services industry has recognized as essential but has also signally failed to introduce. That failure is most manifest a high profile formal pledge to embed integrity in 2010 that was organised by the Barclays chairman, forced to step down as a result of the bank's cultural problems associated with the Libor investigation.

Given that failure there can no longer be reliance on stated commitment to cultural renewal. Instead it must be warranted, if necessary through the introduction of external monitoring of how commitment extends beyond a mechanistic approach to compliance, an approach that starts at the level of the board but through a negotiated process extends throughout the organization through an ongoing and verifiable deliberative process.

This gives greater confidence that the appropriate risks have been identified and are being actively managed. The ongoing component of this risk is essential. It makes culture a tangible risk management metric, which can, as Michael Cowan helpfully suggests, in turn be assessed according to leadership, strategy, decision-making and challenge, controls, performance management and incentives.

Critically, to be effective the strategy must be consistent with commitment to wider social values that goes beyond legal obligation and lies at the heart of the professional model. This approach is designed to be an exercise in experimental governance.

Industry has, correctly, complained for some time that it is laboring within a regulatory framework over which it has no ownership. If it wants this to change it must take a degree of responsibility. It is in its interests and that of society that it does. If not expect the Southern District to take a punitive approach to those who are eventually held to account. 2014 is shaping up to be a pivotal year for regulatory enforcement and legitimacy.

December 20, 2013

A Moral Dilemma (Magarich)

Meri Avetisyan

Issues of integrity in education are in the focus of many international and national organizations. In 2011 Transparency International reported that 35% of the world population considered education in their respective countries to be extremely corrupt (Transparency International, 2011). Reports usually indicate high level of corruption in a number of Central Asian and East European countries' educational systems and Armenia is not an exemption in this regard.

According to Transparency International's household sector survey, education is the 3rd most corrupt institution in Armenia.[1] Apart from reports of various organizations, there are numerous accounts of school teachers' integrity violations in media.[2] However, in Armenia tips or thank you gifts, popularly known as 'magarich,' have been so common and wide-spread in all sectors of public service, including education, that they are often not perceived as reprehensible.[3]

For measuring and subsequently tackling corrupt behavior in schools, it is very important to understand how school teachers perceive and interpret their professional integrity. Therefore we contacted school teachers from urban and rural parts of Armenia, and asked them to write anonymous stories from school life which, in their opinion, involve teacher integrity issues. As the majority of research projects that involve sensitive subjects, we also faced various difficulties in participant recruitment. Many teachers refused to participate in our study, offering various justifications for refusing to do so. In our opinion, the reasons for refusing to participate could also explain the current state of affairs in schools. Therefore we would like to briefly introduce these reasons.

Teachers who refused to participate feared for their jobs. We assured them of the confidentiality of their personal data, and explained that there is no possibility of identifying the writer of a particular story. However, teachers were too afraid of school principals, local authorities, and authorities in general who would reprimand or dismiss them from their jobs, if they wrote about sensitive issues concerning schools. Moreover, they have a general distrust towards both governmental and non-governmental organizations, media, and surveys in general. Further reasons of refusal to participate were the lack of hope for any positive change, and distrust towards confidentiality of surveys.

Although we were aware of integrity violations at schools from reports of various organizations and media stories, we were very much surprised by the collected stories. Our participants indeed wrote striking stories. Before we finalize our research and write up a scientific report, we would like to share a remarkable story from our research. Our respondent in this case is a 24-year-old female with 2 years' experience working as a school teacher at a village school.

A Story of a Rural School Teacher

"I live in a town which is the regional center, but I work in a rural school where the standards of education are pretty low, because teachers do not make efforts to properly teach their respective subjects. However, they give students undeservedly high grades: all villagers are interconnected via family ties, close friendship, or are neighbors. Everybody is happy with the situation, because all parties get what they want; students receive high grades without much efforts, teachers do not have to spend much energy on teaching, but they receive various agricultural goods in exchange for generous grades.

I refused to follow the mainstream culture in this school from the beginning, and contrary to the majority of my colleagues, graded fairly. Thus, most of the students who were getting highest grades before I started to teach at the school, received lower than usual, but fair grades for my classes. I was doing my best to teach them, but was not gifting grades. My approach has made the school principal, my colleagues, students and their families unhappy: the principal and my colleagues were not able to ensure high grades for the children of their friends, neighbors, and relatives for the classes that I taught. My opposition to the mainstream organizational culture was received with angry criticism. I received several warnings from the principal, my colleagues were blackmailing me, and the students were making fun of me. Although the situation was very humiliating, I refused to give up and continued to follow my principles.

The situation became more hostile when at the end of the semester the nephew of the head of the village administration failed my exam. The principal and the majority of my colleagues tried to convince me to change the grade, but I told them that until the student is ready for the exam on a satisfactory level, he will not get a pass. After unsuccessful efforts to break my resistance by putting pressure on me, they found another way. The head of administration via his contacts in the office where my father worked threatened to fire my father from his job, if I will not give a pass grade to the nephew of the head of the village administration.

At the end I gave up and had to give a satisfactory grade to this student. I could not allow my family members to suffer because of my position. I was degraded in the eyes of the students and colleagues, and could not talk about honesty and moral principles. As a teacher I was supposed not only to teach students traditional school subjects, but also moral principles and integrity. However, what would be the value of my words, if I cannot follow the principles that I teach. I know that I violated principles of professional integrity, but did I have a choice? Should I have allowed my father to lose his job? Maybe I have chosen the wrong side by trying to keep high professional standards in a rural school, and the people who tried to teach me how things are done in their village are right. If cover-up and patronage are the norms in the society, what can I do against it? What would have you done in my place?"

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[1] UNDP & Transparency International Armenia, 2006, CRRC, 2011

[2] "For Non-Learners "Romano" is an Expensive Pleasure, "Aravot" daily newspaper, March 13, p. 5.; "Diploma With and Without Flowers, "Haikakan Jamanak" daily newspaper, June 29, p. 6.;"There is a Corruption in Armenia's Schools-Parliament Vice Chair", http://news.am/eng/news/122451.html

[3] Transparency International, Armenia 2003

December 20, 2013

"Think Tank and Foreign Agent?"

Brooke Williams

"In Washington, it is difficult for a small country to gain access to powerful politicians, bureaucrats and experts. Funding powerful think tanks is one way to gain such access, and some think tanks in Washington are openly conveying that they can service only those foreign governments that provide funding."

That's an excerpt from a study intended for "internal use" at the Norwegian Ministry of Foreign Affairs (MFA) and later released publicly. It provides a window into how the government views its donations to think tanks in the United States as mechanisms for access and influence.

While this perspective might not raise an eyebrow of those following a largely pay-to-play think tank industry in Washington, D.C, it does raise the question of whether or not the activities fall under the Foreign Agents Registration Act (FARA).

The May 2012 report titled "From Contributor to Partner?" says the MFA donates to think tanks "to advance the priorities of Norwegian foreign policy."

"Some diplomats interviewed for this report even emphasize that the level of funding a government such as Norway's provides will determine what level of access it gets."

Enacted in 1938, FARA was in response to an influx of German propaganda agents leading up to World War II. The law is meant to make public the identity of those acting in a "political or quasi-political capacity" on behalf of foreign governments to influence public opinion, policies and laws.

Joseph Sandler, a FARA expert and former counsel for the Democratic National Committee, said language in the Norwegian report suggests some think tanks might need to register as foreign agents.

"That's awfully close, if not over the line," he said. "This is what these guys are going to be thinking about over the holidays."

Norway has given money to "some 45 U.S. think tanks and research institutions as well as a number of policy implementing non-governmental organisations," according to the study, which the Norwegian Peacebuilding Resource Centre conducted for the MFA. In 2011, Norway donated about $250 million NOK to think tanks and foreign policy shops in the U.S., according to the report. Among the think tanks are the Brookings Institution, the Center for Strategic and International Studies, the Center for American Progress, and the World Resources Institute.

The report states that Norway's funding of Brookings "is the clearest example" of how the amount of money it gives determines the amount of access it gets.

"Norway is, after Qatar and the UAE, the largest foreign government contributor to Brookings, and Norwegian funding is less restricted than that of the two Arab partner countries," it says. "This is of great benefit to Norwegian delegations visiting Washington, and the flexibility of the framework agreement makes it possible to have Norway influence policy on many levels."

David Nassar, vice president of communications for Brookings, said in an email that Brookings routinely meets with diplomatic delegations regardless of whether or not they are donors, and its scholars often reach out to government officials.

"Many of them have served at various levels of government and bring with them insights and experiences that lead to high quality and policy relevant results," he stated. "We also invite senior policymakers and leading public figures to speak at various public and private meetings and conferences and convene dialogues among experts and policymakers to discuss policy issues."

Brookings publishes a list of foreign government donors in its annual report with fairly broad funding ranges and plans to increase the level of transparency in 2014 in response to a letter from the Lab at Edmond J. Safra Center for Ethics requesting voluntary disclosure.

Nassar provided copies of Brookings' donor recognition guidelines and conflict of interest policies, which he said are meant to ensure donors, including foreign governments, do not interfere with or determine the "final direction, conclusions or recommendations" of its work.

He said, "Given the independence of our research, we do not now nor have we ever believed that Brookings needed to register with FARA."

The Department of Justice, which oversees FARA, declined to comment on specific organizations.

Martin Torbergsen, adviser to the MFA's Section for Human Rights and Democracy, said in an email that the ministry is preparing to "make public and regularly update information online about support to foreign policy research at think tanks outside Norway." He said the details should be available on the Norwegian embassy's website in January 2014.

December 26, 2013

Monitoring Corporate Money in Brazilian Elections

Gustavo H. M. de Oliveira

Following the recent push for more transparency and civic engagement in the Brazilian government, and the increased concerns regarding corporate money in elections, we are developing a website to monitor corporate donations to political campaigns in Brazil and some possible effects of these donations.

In its first phase, to be launched next month, the website will make use of two datasets: corporate donations to political campaigns and the amount of public money that these corporations receive through public contracts. The website will present the data in a user-friendly interface, allowing any citizen to visualize the magnitude of corporate money in Brazilian politics.

The recent years have been transformative in Brazil's quest to remedy corruption. First, because after many years, the Supreme Court finally issued the first arrest warrants regarding the biggest corruption case in Brazilian history. Thirty-eight people, most of whom are from the high echelons of Lula's presidency (2002-2010), were accused of having participated in a scheme to buy votes in Brazil's Congress. The Supreme Court found 25 of them guilty. Many of them are already in jail. This is unprecedented in a country where people believe the rich are never punished for their crimes and where the Judiciary is seen as too inefficient and complacent with power to bring politicians to trial. The arrests bring about renewed hope in Brazilian political institutions.[1]

A second move in the effort to remedy corruption has been the fact that the federal, state and local governments in Brazil are increasingly emphasizing transparency and civic participation in their operations, to improve public service as well as to enable social control of government. Many initiatives—such as the federal Transparency Portal—collect many datasets that concern government operations. The recent Access to Information Law—the Brazilian FOIA—signed two years ago, is another landmark initiative of this new era. Governments are also working with civil society to build websites and apps that improve the quality of the services offered to citizens. Two recent examples are the City of Rio de Janeiro's recent hackathon and the Planning Ministry's Open Data Contest.

Third, the use of private money in elections, through corporate donations to political campaigns, has been extensively discussed in the media and in the political sphere this year. In fact, the Supreme Court is currently considering a lawsuit that challenges the constitutionality of corporate donations to elections—and a decision is expected to be announced in 2014.

Following this movement of increased hope in institutions and the use of open data to enable civic control and participation, we are currently developing the Open Politics website

("Política Aberta" in Portuguese), which combines data from different public agencies to enable the monitoring of the influence of private money in Brazilian politics. In its first phase, to be launched next month, the website makes use of two datasets: corporate donations to political campaigns; and the public contracts these corporations have received. As this is meant to be a civic app, it will be released as open source, so others can participate in the project or build upon it for future applications.[2]

Rather than providing an academic analysis of the data, the website is targeted to the general public, providing a user-friendly interface whereby any citizen can quickly visualize and understand the information. The website will also have some blog posts focusing on specific analyses, so that people can easily access some of the highlights of the data. In the recent push for better institutions and more transparency in Brazil, we hope this website will help Brazilian citizens understand—and perhaps work for the change of—the undue influence of private money in Brazilian politics.

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1. The Economist. *Jailed at Last*. November 23rd, 2013. Available at: http://www.economist.com/news/americas/21590560-landmark-justice-jailed-last

2 You can find me on GitHub at https://github.com/gustavohmo

January 3, 2014

Desperate Half-Measures

Jim Morris

The nation's enforcer of workplace safety and health all but admitted defeat in October when it issued a press release urging employers to voluntarily crack down on chemical hazards.

The Occupational Safety and Health Administration (OSHA), part of the U.S. Department of Labor, has set exposure limits for nearly 500 chemicals, from arsenic to zinc oxide. Workplaces that exceed these limits can be cited and fined. The aim: to prevent exposures that cause or contribute to an estimated 53,000 deaths from work-related illnesses each year.

Trouble is, many of the standards are, by OSHA's own description, "out of date and inadequately protective." Hence the October press release, in which agency chief David Michaels asked employers to adopt stricter limits—like those in effect in California or recommended by the National Institute for Occupational Safety and Health (NIOSH)—"since simply complying with OSHA's antiquated [limits] will not guarantee that workers will be safe." Unfavorable court decisions, dogged industry lobbying and anti-regulatory forces in Congress have made it nearly impossible for OSHA to update the numbers, many of which were calculated prior to the agency's creation in 1970.

Even as OSHA was pleading with businesses to protect their workers (the carrot), it was trying another approach (the stick). In September, it cited Fiberdome Inc., a fiberglass manufacturing plant in Lake Mills, Wis., for allegedly overexposing workers to styrene, a chemical that can wreak havoc on the central nervous system and may cause cancer. OSHA proposed $49,500 in penalties; Fiberdome contested the citations.

Here's where an otherwise pedestrian case gets interesting. It turns out that airborne styrene levels in the plant didn't violate the OSHA limit of 100 parts per million. They did, however, exceed the NIOSH recommended limit of 50 ppm. So, OSHA invoked the general duty clause of the Occupational Safety and Health Act, which states that employers must provide workplaces "free from recognized hazards that are causing or are likely to cause death or serious physical harm to…employees."

An OSHA spokesman told Bloomberg BNA the move didn't signal a new enforcement strategy. But some in industry aren't so sure. "Industry lawyers say they will vigorously fight back against any attempts to use the general-duty clause to make an end run around existing rules," *The Wall Street Journal* reported. A court decision in the Fiberdome case looms large.

"I would like to see [OSHA] win, but I don't see it happening," John Newquist, a retired assistant regional administrator for the agency in Chicago, told me in an email. "What are the consequences of losing? OSHA might find [its ability to use] the general duty clause…severely curtailed in the future."

Instead of trying to circumvent its archaic exposure limits, OSHA should seek to update a "large group" of standards at once using the best science from the world's premier health authorities, Newquist maintains.

It's been tried before. In 1989, the agency issued a gutsy rule setting 164 new standards and updating another 212. It calculated that these standards collectively would "eliminate 55,000 occupational illnesses and 683 deaths each year," at an annual cost of $150 per worker and $6,000 per affected plant.

An industry court challenge thwarted the effort. In 1992, the 11th Circuit Court of Appeals vacated the new limits, having found that OSHA had failed to demonstrate that they were necessary or feasible. Chastened, OSHA has moved gingerly ever since, to the dismay of worker advocates.

Last year, the agency did propose a new exposure ceiling for silica, a toxic mineral linked to lung cancer and the deadly lung disease silicosis. But Michaels told reporters he expected the rule—opposed by trade associations whose representatives have dominated meetings with the White House Office of Management and Budget in recent years—would take "many months" to become final. Some observers question whether it will come out before the end of the Obama administration.

January 6, 2013

50 Years After the War on Poverty, Poor People Still Silent in Politics: Continuing Johnson's legacy requires sweeping democratic reforms to ensure a voice and vote for all

Daniel Weeks

Fifty years ago this week, President Lyndon Johnson declared a national War on Poverty in his State of the Union Address. Speaking to a joint session of Congress just six weeks after President Kennedy's assassination, he promised to "strike at the causes, not just the consequence" of persistent poverty in America and "strike away the barriers to full participation in our society."

The programs which comprised the War on Poverty and broader Great Society legislation—from Food Stamps, Head Start, and Job Corps to Medicare, Medicaid, and expanded Social Security—were primarily focused on meeting short-term economic needs and expanding long-term economic opportunity for the tens of millions of Americans living in poverty in the early 1960s. Few question its contribution to reducing the poverty rate in the 1960s.

Yet half a century later, the war has not been won. Close to 50 million Americans are currently living in poverty on less than $24,000 per year for a typical family of four. At fifteen percent of the total population, that is scant improvement over the late 1960s. Close to half of them live in deep and persistent poverty on less than $12,000 per year for a family of four, the highest rate since record-keeping began in 1975. When you include the 100 million Americans who are struggling to stay a few paychecks above the poverty line, fully half the population of the United States is poor or "near poor," according to the Census Bureau.

There are many reasons why poverty persists in America today. Poverty is partly an economic concern: a lack of decent-paying jobs, housing, health, and economic opportunity. It is also a social concern: a space apart from mainstream society, lacking many of the educational and cultural tools needed to get ahead. But first and foremost, poverty is political: it is embedded in the very structures of our society and maintained by an unjust distribution of political power. Put differently, American poverty is a democracy problem.

Take Darius, for example. The 22 year-old from South Los Angeles freely admits to making mistakes of his own. But his first and most defining "mistake" was beyond his control: Darius did a bad job picking parents. His mother—seventeen and single when he was born—worked two jobs to support her habit and her home, in that order. His father, a jobless high school dropout, received his third strike and an automatic life sentence when Darius was four, end of story. In his neighborhood in Los Angeles, the best way out of poverty for a young black man was to break the law selling drugs. So Darius broke the law, made some money, and got sent to juvenile hall. His uncle broke the law, made some money, and got shot—while Darius, who considered him a dad, watched him die.

A few years later, after serving time, Darius himself became a dad. "That made me stop and think," he says. He ditched his guns and found a public charter school that would take him in at the age of 20. Now, one semester away from earning his high school diploma at 22, Darius dreams of landing a regular job so that he can support his family without having to break the law. His dreams don't stop there. Somewhere along the way, Darius got political and decided that being a man meant fighting for childcare centers in impoverished neighborhoods like his, so that young kids growing up can get a better start. But with many of his peers behind bars and countless more barred from voting because of past offenses, and without an extra dollar to his name to fund a politician's campaign, he doubts whether those in power will ever "give people like me the time of day."

Sadly, the social science research bears him out. As this series will show, socioeconomic status is arguably the most important factor determining the amount of political influence a citizen, or would-be citizen, commands. This is true with regard to both inputs of political voice—registering to vote and voting; participating in political causes and campaigns; funding elections; and lobbying the federal government—and public policy outputs, the real-life responsiveness of elected officials to a given set of needs.

In concrete terms, American democracy in poverty translates into ten million voting-age citizens being denied the right to vote or voting representation in Congress on account of a prior conviction or the (non-state) in which they live; sixteen million immigrants of voting age having no formal stake in the political process; and tens of millions more law-abiding citizens being excluded from voting by a variety of informal means. Most of the modern-day disenfranchised have poverty as their common credential. Making matters worse, the politicians on whom they rely do not rely on them: a tiny fraction of wealthy Americans lobbies the federal government and fewer than one percent provides the lion's share of campaign funds.

However you slice and dice the numbers, people on low incomes and with limited education are found to be at a serious, structural disadvantage when it comes to making their voices heard and having their interests represented in Washington. They are far from equal citizens in the public square.

A democracy problem requires a democracy solution. Just as the gains made during the first decade of the War on Poverty cannot be separated from another pair of bills that President Johnson signed into law—the Civil Rights Act of 1964 and Voting Rights Act of 1965—so too must the work to combat poverty today include concerted action to preserve America's founding promise of political equality for all.

Dan's photographs from his journey are accessible at:
http://flickr.com/gp/99682116@N03/5UR28N

January 7, 2014

Bernanke Takes a Bow, Yellen Takes Center Stage: Will Fed Transparency Get a Second Act?

Gregg Fields

Without question, steering America through the Great Recession was a massive responsibility for outgoing Federal Reserve Chairman Ben Bernanke. But in a de facto farewell address last week, Bernanke suggested that, in addition to plunging markets and teetering banks, he faced an equally complex policy challenge: restoring the public's trust in one of Washington's most important regulatory institutions.

"We took extraordinary measures to meet extraordinary economic challenges, and we had to explain those measures to earn the public's support and confidence," Bernanke said, in a speech at the annual meeting, held in Philadelphia, of the American Economic Association.

With Janet Yellen's 56-26 confirmation vote by the Senate on Monday, and the country's economy perceptibly if unevenly on the mend, it's worth assessing Bernanke's legacy. While much will be made of Bernanke's role in the recovery, for the purposes of studying institutional corruption, his efforts to restore public support of, and confidence in, the Fed merit special scrutiny.

Looking forward, there is also the question of whether the extraordinary measures to gain the public's confidence will outlive the extraordinary challenges that created the need for them. Put another way, will the issue of public confidence lose its urgency, and become less of an institutional priority, at the Fed?

Worth noting, Yellen helped design many of the Fed's communications strategies at Bernanke's behest. Yet the recent history of some leading women financial regulators—Brooksley Born of the Commodity Futures Trading Commission and Mary Schapiro at the Securities and Exchange Commission, for example—indicates that Washington isn't always comfortable with female leadership. (A case in point: In November, the Capitol Hill publication Roll Call criticized Yellen's fashion sense, saying she wore the same outfit to her Senate confirmation hearing as when President Obama nominated her. "At least we know her mind won't be preoccupied with haute couture," wrote the columnist, Warren Rojas.)

Finally, even if one can accept that Bernanke, and now Yellen, have the right idea, there's the bedeviling issue of whether the problem of institutional corruption is too big for one agency to tackle. As Lawrence Lessig, director of the Edmond J. Safra Center for Ethics, wrote recently: "Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness."

That raises the question: if a problem is systemic, doesn't the solution have to be systemic, too? The Fed doesn't operate in a vacuum. Congress, innumerable agencies, and a very powerful industry also are part of the system that regulates economic policy.

A Tarnished Reputation

Bernanke's recent speech implied—he didn't explicitly say—that there is little doubt the reputation of financial regulators took a debilitating drubbing during the economic crisis.

As banks' reckless practices came to light, regulators were seen as clueless enablers—or even worse, perhaps not so clueless. Former Fed Chairman Alan Greenspan, whom Bernanke succeeded in 2006, was a tightlipped guru whose wildly industry-friendly policies were never seriously challenged in Washington.

His iconic status crumpled when Wall Street had to be bailed out. Greenspan "more than any other individual, bears personal responsibility" for the financial crisis, Nobel laureate Paul Krugman wrote in 2011. The Economist magazine concurred, in a review of Greenspan's recent book, The Map and the Territory. "America is fortunate his job passed to a scholar of the Depression before the crisis of 2008 struck," it opined.

Bernanke is, in fact, a self-described student of the Depression. And his economic responses to the crisis were rooted in perceived Fed failures in the 1930s. His greatest policy innovation was the "quantitative easing" programs that flooded banks with capital in an effort to jump-start a moribund economy.

But equal to his fiscal innovation were his upheaval of the Fed's mystical communication practices. Under Bernanke, transparency and accountability became standard practice—and were transformed into policy tools.

"Fostering transparency and accountability at the Federal Reserve was one of my principal objectives when I became chairman in February 2006," Bernanke said. "As it happened, during the crisis and its aftermath the Federal Reserve's transparency and accountability proved critical in a quite different sphere—namely, in supporting the institution's democratic legitimacy."

A Break with Tradition

Of course, since its creation in 1913, neither transparency nor accountability was a priority for the Fed, thanks to its special status in the Washington power pantheon. Its actions don't have to be approved by the White House or the legislative branch, for instance. It doesn't depend on Congressional funding. Aside from a legally mandated Monetary Policy Report, presented semiannually to Congress, during which the Fed chair testifies, the nation's central bank isn't required to say much about its operations at all.

In contrast, the Bernanke era will be remembered as a time when the Fed threw open the curtains. In 2007, for instance, the Federal Open Market Committee, the Fed panel tasked with setting interest rates, began disclosing a summary of economic projections of its members. Over time, the FOMC also told the public what its long-term policy goals were.

As one example, it explicitly stated it was aiming for inflation of around 2 percent and unemployment somewhere between 5.2 percent and 6 percent. (It currently is at 7 percent.) In April 2011, Bernanke fielded questions from reporters at a press conference—a first.

"What types of transparency are needed to preserve public confidence?" Bernanke asked rhetorically. "At the most basic level, a central bank must be clear and open about its actions and operations, particularly when they involve the deployment of public funds."

Confidence Renewed?

For the purposes of the Edmond J. Safra Center for Ethics, the emphasis on public confidence is especially noteworthy. That's because one of institutional corruption's more serious side effects, as Lessig wrote, is a loss of public trust. This in turn undermines the institution's ability to achieve its goals.

"Talking only to the Congress and to market participants would not have been enough," Bernanke said. "The effort to inform the public engaged the whole institution."

Can that momentum continue, now that Bernanke is leaving the scene? One potentially positive sign is that Yellen was actually the architect of many transparency initiatives. In 2010, Bernanke asked her to lead a new FOMC subcommittee on communications.

In a speech to the Society of American Business Editors and Writers last spring, Yellen said the transparency effort was driven in part by the capabilities of emerging media. Bernanke's press conferences, for instances, are streamed live over the Internet.

"The revolution in the FOMC's communication, however, isn't about technology or speed," Yellen added. "It's a revolution in our understanding of how communication can influence the effectiveness of monetary policy."

Splicing Bernanke and Yellen's comments, then analyzing them through the prism of institutional corruption metrics, yields the following pattern: greater transparency enhances public trust, and this public trust in turn produces more effective monetary policy.

The Path Forward

Transparency, of course, isn't necessarily a cure for institutional corruption, though it can be an effective treatment. And even if one views Fed accountability as a noble experiment, the concept may not prove popular on Capitol Hill, where the financial sector has already contributed $87 million to mid-term races, according to opensecrets.org, ranking first.

Nevertheless, as the Fed enters its second century, Bernanke said the simple truth is that there's no going back to historic patterns when it comes to transparency and accountability.

"The crisis has passed, but I think the Fed's need to educate and explain will only grow," he said. When Paul Volcker became Fed chair in 1979, he noted, there was no CNBC, no Bloomberg terminals, and tweeting was for the birds. "The Fed must continue to find ways to navigate this changing environment while providing clear, objective, and reliable information to the public."

January 16, 2014

Prisoner's Escape

Mariano Mosquera

When governments ask companies for bribes, it leads to a prisoner's dilemma situation in public procurement processes. However, companies can manage to escape through collusion.

The Game

The prisoner's dilemma is a strategic game between two actors. Each actor has two choices, to cooperate or to defect: "C." and "D." for player I; "c." and "d." for player II.

↓I-II→	c.	d.
C.	2 / 2	0 / 3
D.	3 / 0	1 / 1

Payoffs are defined according to the simultaneous combination of choices made by the players. When both choose cooperation, each player receives a payoff of 2, while when both choose defection, each player receives a payoff of 1. The combination (C., d.) entails that player I cooperates and player II defects, which results in a payoff of 0 for player I and a payoff of 3 for player II. The combination (D., c.) entails that player I defects and player II cooperates, which results in a payoff of 3 for player I and a payoff of 0 for player II. Defection is the dominant strategy in the prisoner's dilemma.

The players' decisions are the result of the various analyses they carried out. In the first place, a trust or distrust-based analysis (strategic and cultural) can be used to anticipate the other actor's movement. In the second place, the players can make an analysis (more rational and individual) of the benefit sum of the payoff options. Finally, a Rawlsian analysis. The ban on communication between prisoners acts as the veil of ignorance; that is, the lack of knowledge about one's relative position with respect to the other actor's decision. This tips the balance in favor of low-risk decisions, since actors would rather not suffer too much damage once the veil is lifted. Therefore, they rule out the option with the worst outcome. According to these three analyses, the best choice is defection.

The prisoner's dilemma is based on distrust towards the other actor; defection brings a higher benefit sum than cooperation (3+1=4>2=2+0), and the worst possible outcome is that one of the actors cooperates (0) and the other one does not. Mutual defection is a Nash equilibrium, since once both players have stated their decision, neither will have any incentive to change it. Mutual cooperation is a Pareto optimality since it brings the highest collective benefit sum (2+2=4), and it is a situation that cannot be changed without damaging any player.

The Public Procurement Jailer

This game is played in public procurement processes when the government favors institutional corruption. In the original prisoner's dilemma, the jailer establishes the rules of the game through the payoff system. In this case, there are (formal and informal) rules defined by the government (the jailer) for two companies (prisoners) that want to sell their goods or services to the government. The government offers or promotes, or the companies just know of, the following two possible choices: cooperate with the other actor in a competitive bidding process, or defect from the competitive process and try to win a government contract in return for bribes.

If both actors defect (in this latter sense), the bidding cannot be performed, since another actor's cooperation is necessary to "disguise" a corrupt hiring as a competitive and legal process. The government can make a corrupt agreement with only one actor. If the other actor also decides to offer a bribe but cannot do it, he will not bid (a second decision is not made).

In this game we will not consider the possibility that the government could make a corrupt agreement with both players. For example, the government could make an agreement with one actor so that he wins the contract and also enter into an agreement with the other actor so that he legitimizes the process (which is unlikely in a non-iterated game, since the promise of changing roles in the next bidding process is lost). The combination in which both players defect is spawned by distrust and the logic that another player defects and agrees to pay a bribe to the government. This leads the actor to defect as well, either by offering a bribe or by deciding not to participate in the bidding process. As a result of the combination resulting in the defection of both players, no tenders are submitted. If both players cooperate, a legal and competitive bidding process takes place. If one player cooperates and the other one defects, the cooperating player legitimizes a bidding process that is not actually competitive; it is a charade. Clearly, the cooperating player does not know that the other one has defected. The defecting player wins the contract in return for a bribe.

Complex Payoffs

In this public procurement game, payoffs are defined in connection with two variables: the amount of the contract and the probability of winning the contract. Also, in the case of mutual defection, the variable "time gained" should be considered, since neither player makes any effort to submit tenders.

↓Combination-Variable→	$	Probability	Time gained
Both cooperate	A	b.	0
Both defect	0	0	C
Solitary cooperator	0	0	0
Solitary defector	A^{-}	B	0

With regard to the amount, A is defined as the actual value of the contract. It is also stated that A^{-} is the value A of the contract less the bribe (A^{-}=A-bribe). In this regard, A^{-} reduces the appeal of the contract for the company. "B" is the complete certainty of winning the contract.

On the other hand, participating in a competitive bidding process involves winning or losing. With two players, the probability is 0.5, assuming that both of them assume an even competition (b.=B/2). If both players defect, neither has a chance of winning the contract, but none of them made an effort to submit tenders (C). If one player cooperates and the other one defects, the cooperating player submits a tender but has no chance of winning the contract. The defecting player will surely win the contract.

↓I-II→	c.	d.
C.	Ab.0. Ab.0.	A¯B0. 000.
D.	000. A¯B0.	00C. 00C.

This scenario maintains the prisoner's dilemma structure: A¯ B0.>Ab.0.>00C.>000.

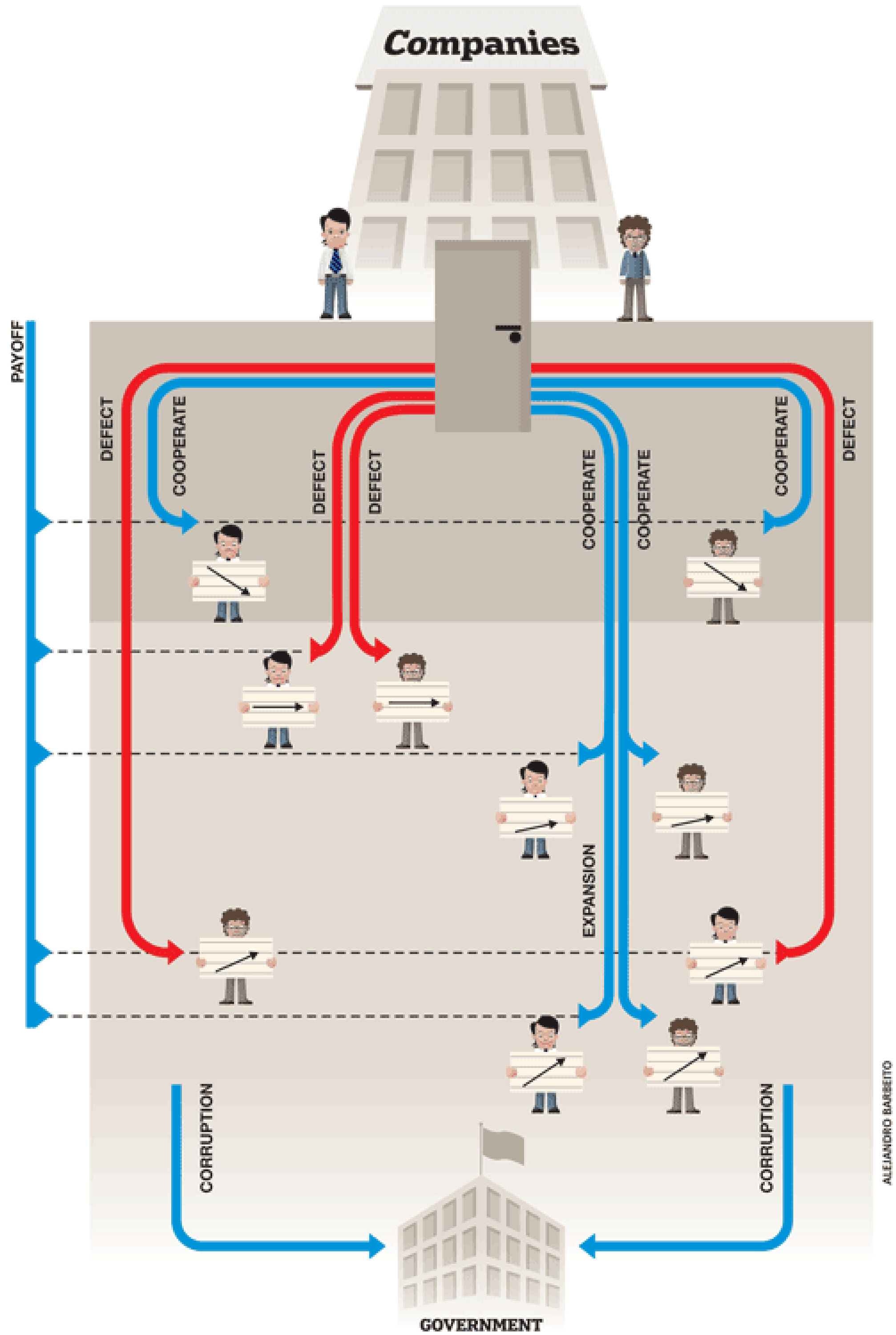
A general assumption in this payoff system is that actors view the risk of participating in illegal activities as very low. That is why the risk variable will not be considered. In real life, the equilibrium in a game with more than two players is achieved with the combination of defection (D.) and legitimization (c.). This is the combination desired by the corrupt government. With more than two players, the probabilities of finding a legitimizing actor increase.

Expanded Cooperation

Collusion is the means by which the prisoners can escape the dilemma. Collusion refers to the expansion of cooperation between prisoners against the jailer; in this case, the government. That is to say, the cooperation between prisoners goes beyond the pre-established rules of the game and its payoff system.

This requires an option of expanded cooperation for the actors. If they make this decision, the actors increase the payoffs in two variables: an increase in price (due to an agreement between suppliers) and an increase in the probability of winning (due to a subcontracting agreement with the loser.[1]) Only by means of expanded cooperation can the actors change the rules and the payoff system imposed by the jailer.

Acting on their own, the players are condemned to the jailer's payoffs. If only one of them cooperates, the cooperator does not get any payoff. If only one of them defects, the defector will be conditioned to the bribe demanded by the government.



Collusion can increase significantly the contract value (A+). In addition, with a subcontracting agreement between two actors, the probability of winning the contract is B. In this scenario, the payoff structure is changed: A+B0.(collusion)>A¯B0.(solitary defector)>Ab.0.(simple cooperation)>00C.(mutual defection)>000.(solitary cooperator). It is assumed that even with subcontracting, the increased amount is very attractive to the actors.

Rawls Obstacle

In this new scenario, two of the three analyses carried out by the actors are modified. This enables the prisoner's escape. The culture of distrust is not eliminated in this scheme; however, it is transferred to the jailer. Companies trust more in themselves than in the government, since the latter is the source of the initial corruption.

The benefit sum is modified as well. Cooperating now entails: A+B0.=A+B0.+000. Defecting entails: A¯BC.=A¯B0.+00C. Being: A+B0.>A¯BC. This is the case as long as the amount of the increase is higher than the time-money relationship assigned to a tender submission process. These two criteria outweigh the Rawlsian analysis of preventing the worst of all evils. The actor may consider that the other actor will also add benefits and choose expanded cooperation. Any actor who does not cooperate in an expanded way and defects is not doing it due to the lack of good payoffs, but merely because he thinks the other actor will defect or try to hurt the other actor.

The Rawlsian analysis continues to be the worst obstacle, since cooperating could still be the worst outcome if the other actor defects. However, in this public procurement scenario, it is the jailer who is distrusted.

The original prisoner's dilemma has two players but also has rules based on the ban on communication, the payoff system, and a jailer who imposes its authority. Therefore, the prisoner's escape entails:
1. A set of rules and a payoff system that do not favor cooperation.
2. A jailer without the legitimacy to demand obedience, who is favored by the defection/legitimization combination.
3. A payoff system that can be increased with cooperation between prisoners.
These conditions will lead to expanded cooperation.

Changes

By examining how to cooperate beyond pre-established rules, we can rethink institutions and their incentives.[2] Expanded cooperation shows better payoffs, which are useful for the players' individual analyses. Through the increase of cooperation payoffs, it is possible to switch from the prisoner's dilemma rules to Rousseau's stag hunt incentives. Also, a new payoff structure could enable a Nash equilibrium with a dominant reward (Pareto optimality) in expanded mutual cooperation.

Offering bribes is possible in a prisoner's dilemma scheme. However, the offer of bribes is reduced by the improvement of incentives for cooperation (stag hunt), even with a corrupt government. In this case, legally favoring the subcontracting of the losing companies that cooperated in the competitive process could be considered.

Distrust in government makes it necessary to look more deeply into corporative transparency methodologies and integrity agreements under the coordination of third parties, such as universities and civil organizations. On the other hand, in an iterated game, additional scores could be assigned during the bidding process to losing companies from previous processes, whenever they face the same competitors. This entails generating advantages in other games; incentives for cooperation and not only applying sanctions in new games, as the classic way out of the iterated game.

*The author would like to thank Dr. José María Rodriguez, Economist, for reviewing this article.

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1. The iterated game usually includes the promise of changing roles in the next bidding process. In this game, repetition is not considered.

2. This framework can be used for the purpose of investigating other expanded cooperation processes, such as social uprisings triggered by inefficient institutions and governments that promote the combination of no participation/legitimization.

January 24, 2014

Happy Birthday, Citizens United! San Diego Has a Present for You

Carla Miller

January 21, 2010 was a watershed day in U.S. political history—it was the day the Supreme Court decided *Citizens United*. For four years we have witnessed and studied the effects of the Court's blessing of unlimited independent campaign expenditures by corporations.

On January 21, 2014, exactly four years later, the Justice Department announced a major indictment in the Southern District of California that illustrates how *Citizens United* has filtered down to shape and potentially corrupt local elections.

Is the timing of this indictment a coincidence? I think not. Kudos to the prosecutors for their subtle message.

The indictment alleges a conspiracy to channel $500,000 in illegal foreign funds into the 2012 local elections in San Diego, California. Shell companies were created, SuperPACs were funded and money flowed into the Mayoral, District Attorney, and congressional campaigns in the Wild West atmosphere of *Citizens*. Those charged include a local lobbyist and a former police detective who were working with the Washington, D.C. based "Campaign Guru"—Ravneet Singh. Also named as a defendant was Mr. Singh's company, the Election Mall. This company touts a focus on technology solutions for campaigns, including a "Cloud Campaign," the "*ultimate technology solution for campaigns of all sizes and budgets*." The indictment paints a picture of how "ultimate technology" and a "Mall" approach to elections marries with the loose campaign spending restrictions of *Citizens* to influence local elections. An appropriate birthday gift.

In the *Citizens United* opinion, the Supreme Court famously stated that "this Court now concludes that independent expenditures, including those made by corporations, do not give rise to corruption or the appearance of corruption." After the events of this week, the citizens of San Diego most likely disagree with the Court.

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January 27, 2014

Defining a Defining Challenge: Linking Institutional Corruption and Income Inequality in America

Gregg Fields

As the 2014 mid-term elections draw closer, income inequality has emerged as perhaps the leading issue driving campaign debates. Perceptions about the severity of income disparity and blunted social mobility in America by millions of middle-class citizens—and voters—will make the subject a prickly political reality for those seeking to be sent, or returned, to Congress on November 4th.

For evidence of the issue's political potency, look no further than the elevation of Bill de Blasio, who was elected mayor of New York after telling his fellow Gothamites, "In so many ways, New York has become a Tale of Two Cities." The rising political fortunes of the populistic Senator Elizabeth Warren, co-author of *The Two-Income Trap: Why Middle-Class Parents Are Going Broke*, is another telling example.

In a major address in early December, President Obama framed the income inequality issue, along with the resulting decline in mobility, as impacting more than just household budgets, however. Rather, it weakens American social cohesion "*not just because we trust our institutions less*, but studies show we actually tend to trust each other less when there's greater inequality," Obama said (italics added).

And with that, the president immediately seized upon a pattern that is familiar to researchers at the Edmond J. Safra Center for Ethics. As Larry Lessig, director of the center, noted last year, one of institutional corruption's consequences is "weakening either the public's trust in that institution or the institution's inherent trustworthiness."

In this piece, we will explore similarities, and possible linkages, between income inequality, which Obama declared to be "the defining challenge of our time," and institutional corruption.

Challenging Assumptions

While it may be a defining challenge, simply defining income inequality is one of the greatest challenges to studying it.

Against the backdrop of a dysfunctional and polarized Washington, it's perhaps not surprising that bruising battles have erupted over income inequality's meaning, as well as its causes and remedies. Furthermore, it can be tough to define the size of the problem, with, inevitably, one side claiming the other side's statistics are skewed or its analysis misguided. Two major schools of thought might be characterized this way: there are those who view income inequality as a societal failure, versus those who see it as the result of bad personal choices.

As Jonah Goldberg, the conservative columnist for the National Review, recently put it in a column titled "Define Income Inequality," "liberals tend to see income inequality as the disease, and conservatives tend to see it as a symptom." Specifically, as a symptom of other economic and social dysfunctions like poor public education systems, a slack economy, and the decline of families headed by a married couple. (But Goldberg's clear implication is that there's an across-the-aisle consensus that income inequality is an issue.)

Nevertheless, there have been a number of impressive attempts to quantify income inequality. And though the actual numerical conclusions often vary, the clear trendline is toward widening gaps in much of the developed world, but particularly in the United States.

The most widely cited measure of income inequality is the Gini coefficient, often referred to as the Gini index. It is named for an Italian statistician, Corrado Gini, who developed it as a measure of income distribution within countries in the early 1900s.

The Gini index ranks income distribution on a scale that begins at 0, a theoretical place where all citizens have the same income, and rises to 1, an equally fictional location where a single person receives all the income.

According to the Census Bureau, the 2010 Gini coefficient for the U.S. was .469. That would definitely be at the high end among developed countries. More alarmingly, in 2011 it rose again, to .475, a statistically significant jump. "This suggests more income inequality across the country," the Census Bureau noted. It climbed again in 2012, though only to .477. Nevertheless, since 1993, the earliest year for which meaningful comparisons can be made, the Gini index for the U.S. has risen 5 percent, according to the Census Bureau.

In contrast, the rich-world average is a much lower .31, according a 2011 analysis by the Organisation for Economic Cooperation and Development. The Scandinavian countries were even more equal, with the Gini coefficient for Sweden, for example, at .24, although even there it has been rising.

To be sure, there are valid criticisms of the Gini index. One, it only measures distribution of income within a country, not overall social well-being. The U.S. may have a problem with income inequality, for instance, but it'd be hard to argue that its quality of life is less than that of the Philippines, Cameroon, Guyana and Iran, nations that rank slightly better by the Gini gauge, according to the World Factbook, published by the CIA.

Furthermore, poverty and income inequality can be very tough to measure across cultures. In the U.S., for instance, there are forms of aid such as food stamps and housing assistance, and every developed country has some form of income transfer programs. But global comparisons aren't easy, because no two countries have the exact same social safety net or economic profile.

"The inequality debate should focus more on the sources and reasons for inequality, and less on how much inequality there is, or how much it has changed; more on explaining inequality, and less on deploring it," Charles Wolf Jr., who has research positions with both the RAND Corp. and the Hoover Institution, wrote in 2012. "This is what the debate should be about, but isn't."

Easy Solutions?

Indeed, dispassionate debate is a rare commodity in the national discussion on income inequality. Globalization, the decline of unions, the number of unwed mothers, and the levels of immigration have all been, at times, mentioned as culprits, or at least contributors, to rising income inequality in America. But economic studies seem to have reached as many conclusions as there are points of view.

With so much conflict as to the cause, it's not surprising that proposed solutions are often at loggerheads as well. Glenn Hubbard, dean of the Columbia Business School, who chaired George W. Bush's Council of Economic Advisers, believes the problem could be relieved with relatively simple modifications to tax codes. In layman's terms, Hubbard proposes a solution he called "a rising tide lifts all boats," in a recent op-ed for the Washington Post titled "Tax reform is the best way to tackle income inequality."

"Bold action is needed—and is best taken through tax reform rather than an expansion of the welfare state," Hubbard said. His ideas included education vouchers and other support for low-income individuals, and spurring employment by reducing payroll taxes paid by employers and raising "consumption" taxes on what households spend "and/or progressive reductions in the growth of Social Security and Medicare benefits."

These ideas would produce greater "inclusion" of lower-income households in a growing economy, Hubbard argued. In that sense, ideas such as a higher minimum wage are aiming at the wrong targets. A higher minimum wage "almost surely reduces employment," he wrote.

Even if Hubbard is correct—there are many studies that suggest his conclusions aren't quite so clear cut—it's questionable how much political traction that ideas like reining in Social Security and Medicare might gain, given the existing economic insecurities of the American middle class.

Furthermore, as of January 1, 2014, 19 states have minimum wages above the federally mandated $7.25 per hour. Also, since the early 1990s more than 120 cities have passed their own "living wage" laws, according to the National Employment Law Project.

A Nobel View

Hubbard's views are at ideological odds with his Columbia University counterpart, Nobel laureate economist Joseph Stiglitz, author of the 2012 book *The Price of Inequality: How Today's Divided Society Endangers Our Future.*

Stiglitz expounded on the book's themes last October in the New York Times. "American inequality began its upswing 30 years ago, along with tax decreases for the rich and the easing of regulations on the financial sector," he said. "Rising inequality reinforces itself by corroding our political system and our democratic governance."

Indeed, perhaps the greatest social injury is to the public's trust, Stiglitz added in a second Times column published in December. "We do not measure trust in our national income accounts, but investments in trust are no less important than those in human capital or machines," he said. "Unfortunately, however, trust is becoming yet another casualty of our country's staggering inequality: As the gap between Americans widens, the bonds that hold society together weaken."

In essence, President Obama and Stiglitz have each argued that diminished public trust is one of the greatest casualties of income inequality, and Lessig has argued that the fallout of institutional corruption is, in fact, often reduced public trust.

The correlation between institutional corruption and income inequality is strengthened by another observation by Stiglitz: In 2012, the top 1 percent of Americans took home 22 percent of the nation's income. The top 0.1 percent took home 11 percent.

That lopsidedness is mirrored in how campaigns are financed in America, according to Lessig. "In the new America, the tiniest fraction of the 1 percent controls that first step in the election," he said in a speech at the University of California-Berkeley last fall. In the 2012 election cycle, for instance, 132 Americans—0.000042 percent of the country—gave 60 percent of the money super PACs received.

"My claim is in a system where candidates are spending 30-70% of their time dialing for dollars from this tiny, tiny fraction of America, they have manifested a dependence upon this tiny, tiny fraction of America," Lessig said last October, in an event sponsored by the Harvard Law School's Federalist Society. "And that dependence … is a corruption of Madison's design."

In essence, concentrations of vast wealth produce not just income inequality but also institutional corruption. And each poses the longer term danger of undercutting the effectiveness of democratic institutions.

In the words of President Obama, "people get the bad taste that the system is rigged, and that increases cynicism and polarization, and it decreases the political participation that is a requisite part of our system of self-government."

January 29, 2014

Jefferson's Dream

Matthew Kozlark

How the issue of campaign finance reform in New Hampshire could be used to jump-start the spirit of democracy in the United States, at the local level.

Jefferson's Letters

In 1816, Thomas Jefferson wrote from Monticello a series of letters to his friends, in which he outlined what he took to be the only way to salvage the revolutionary spirit and vitality of generations to come in the United States. Jefferson perceived that, because the machinery of the government at the state and federal levels, as it had been designed during the Constitutional Convention of 1787, failed to allow for direct participation in public affairs by the people of the United States, this revolutionary spirit, unexercised by any political action of consequence, would soon be lost. The people needed to be given something political to do at a local level that contributed in a direct way to the vitality of the nation.

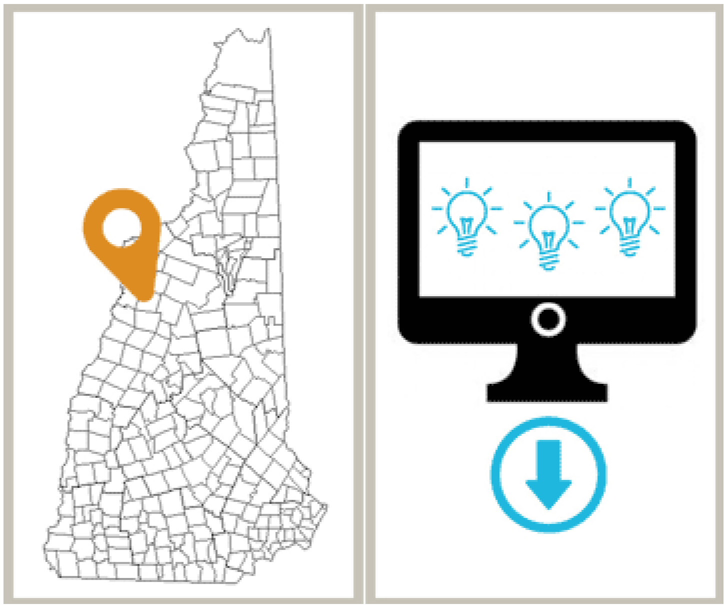
Almost two hundred years have now passed since Jefferson wrote these letters, but his diagnosis of the problem has become increasingly relevant. The apathy and frustration among the people, which he predicted would result from this failure to incorporate the towns into the overall structure and business of government, manifest themselves on a daily basis across the nation, and have become for many in the United States regular features of life. But Jefferson's proposed solutions to this problem have never been taken seriously, and one of the reasons for this is that he never wrote about them in his formal works, but only in his private letters. Even when he did write about them in his private letters, he remained vague as to what these salutary and revitalizing political tasks for the people in the towns would be.

The following is an attempt to sketch out what these tasks would look like.

An Overview of the Project

1. We select a town in New Hampshire whose citizens have been particularly well-organized and energetic during the recently-concluded New Hampshire Rebellion.

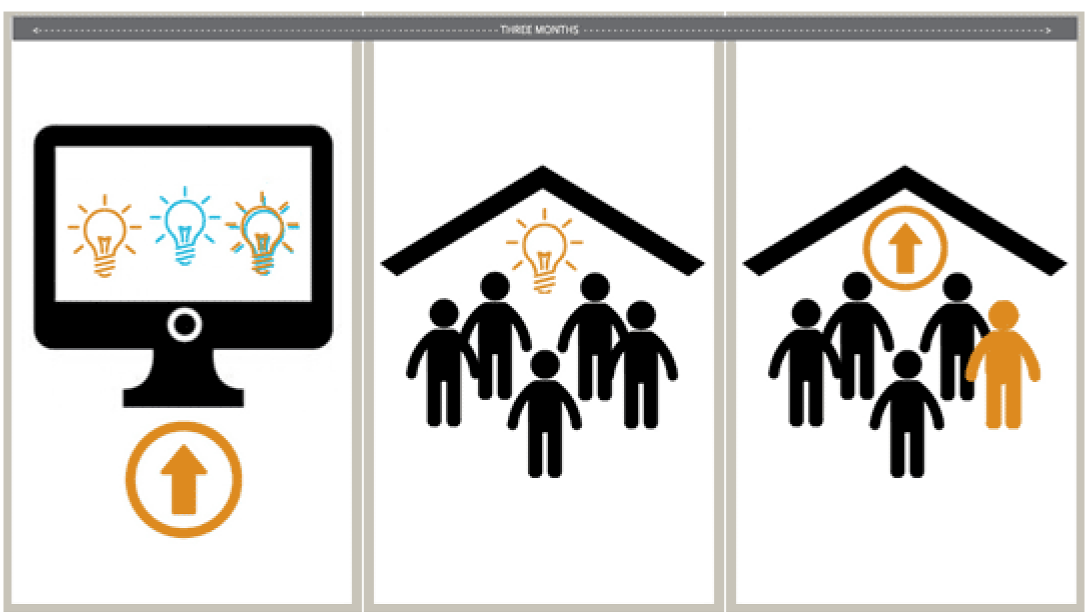
2. We post online the different leading proposals for how best to implement campaign-finance reform at the federal level, which the citizens download and study.



3. We charge the citizens to come up with their own proposal, either arguing in favor of one of the existing proposals, or creating a hybrid proposal that incorporates elements from either several or all of the existing proposals.

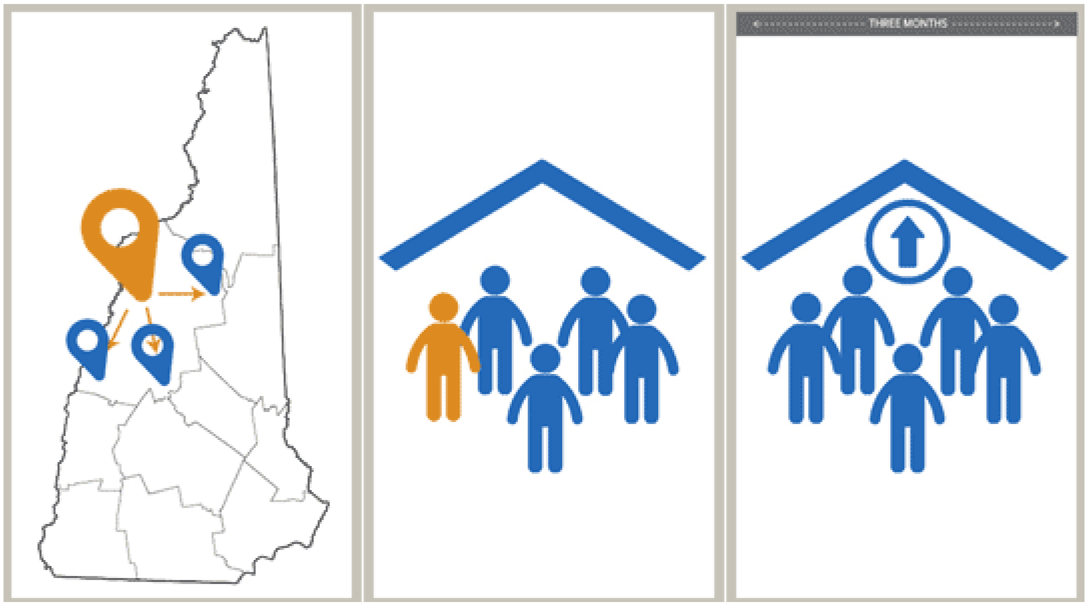
4. We give the citizens three months to do this, during which time they debate and deliberate on, in a series of public meetings, the merits of the different proposals, at either a town hall or some other central location like a town library, in addition to meeting with each other informally.

5. At the end of the three months, we ask them to post online the proposal that they have come up with, and also to nominate from among their number several representatives who in their opinion showed themselves to be unusually good at this process of debating and drafting proposals.



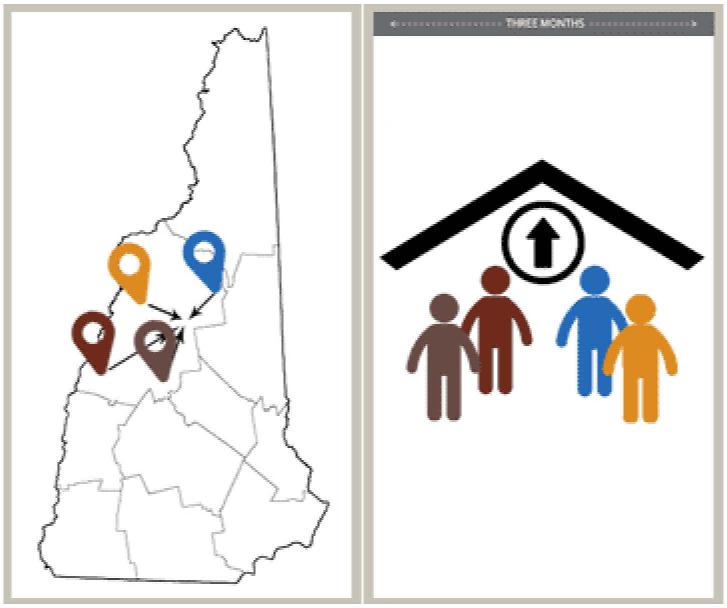
6. Once the proposal has been drafted, and the representatives have been nominated, we introduce the same project to several of the neighboring towns in the county.

7. Citizens from the first town travel to the neighboring towns to talk about their experiences during the deliberation process, and to give advice.

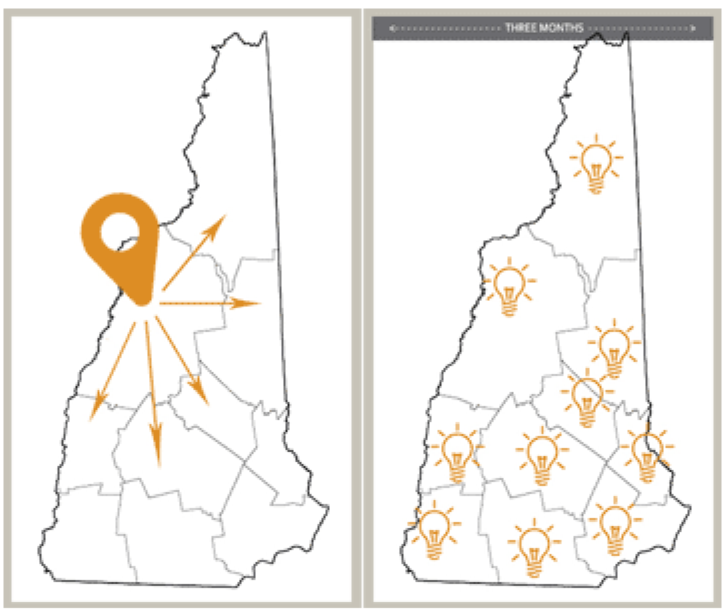


8. Again, the citizens of each of the participating neighboring towns are given three months to draft a proposal for how best to implement campaign-finance reform, which they post online, and to nominate several representatives.

9. Armed with the proposals generated by their towns, the representatives meet with each other at a centralized location in the county. Over a period of three months, they debate in a series of meetings the merits of the proposals that their towns have generated, refining them in light of this process of deliberation. At the end of three months, they post the refined proposal online, and also nominate from among their number several citizens to represent the county at the level of the state.



10. While the representatives are meeting at the county level, we introduce the project to each of the towns in the surrounding counties. Citizens from the first county travel to towns in the new county to talk about their experience during the deliberation process, and to give advice.



11. Over a period of three months, the process repeats itself in the towns in the new counties. Citizens from the different towns draft proposals, and nominate from among their number representatives, who meet with each other in turn at a centralized location in each of their respective counties, to draft a refined proposal, and to nominate several citizens to represent the county at the state level in Concord.

12. Once each of the counties has both generated a refined proposal and nominated representatives, the representatives, armed with the refined proposals, meet in Concord over a period of three months to draft a state proposal, which they post online, and to nominate

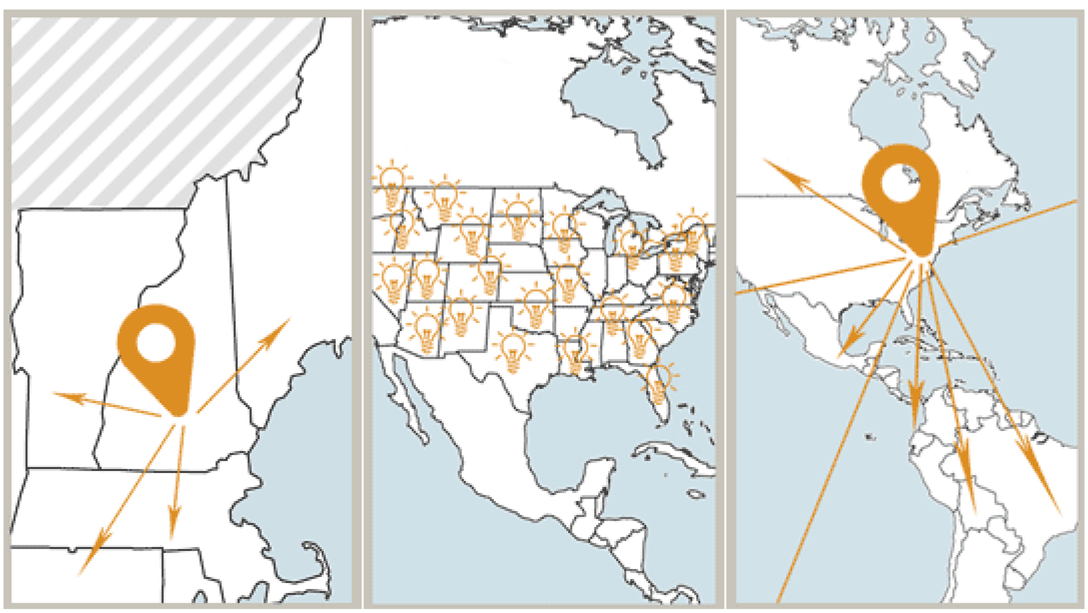
from among their number two citizens to represent New Hampshire at the national level Washington, D.C.

13. While the representatives from the county are meeting on the state level in Concord, we introduce the same project to the towns in the counties of the surrounding states. Citizens from New Hampshire travel to towns in the surrounding states to talk about their experiences during the deliberation process, and to give advice.

14. The citizens in the towns in the counties of the surrounding states repeat the process initiated by the citizens of New Hampshire. Over a three month period, they draft a proposal and nominate representatives, who meet in turn at a centralized location in the county to draft a refined proposal and nominate representatives, who then meet in turn in the state capital to draft a state proposal and nominate two representatives, who will represent the state on the national level in Washington, D.C.

15. Once each of the states has both generated a state proposal and nominated representatives, the representatives meet in Washington, D.C. to draft a finished proposal, which they present to Congress as the proposal of the American people for how best to solve this problem of corruption.

16. The entire process having run its complete course, and each of the towns, counties, and states across the nation having had a chance to contribute, several new issues are introduced on the town level. Different citizens work on different issues, depending on which of the issues concern them, but for each of the issues the process remains the same: moving from the towns to the counties to the states to Washington, D.C., with citizens being nominated as representatives at each level.



17. Once the process has run its full course on several issues, we introduce the same project to other nations. Beginning in the equivalent of towns in the other nations, citizens generate proposals for how best to solve the issues facing their countries. Representatives are nominated to represent the towns at the level of the county-equivalents, where they draft refined proposals and nominate representatives, who meet in turn at the state-equivalents to

draft state proposals and to nominate representatives, who meet in the capital of their country to draft finished proposals, which they then present to their government.

18. Once the process has run its full course on several issues in several nations, the representatives on the national level in Washington, D.C. nominate from among their number several citizens to represent the United States on the global level on the issue in question. The national-level representatives from the other countries do the same. These representatives meet at an international city of renown to draft a multinational proposal for how best to go about addressing a problem of global significance. This is jointly presented to the governments of several of the leading nations of the world, and posted online for citizens around the world to access.

The Website

1. Clicking on the Jefferson Project link leads you to a page with a single box in the middle, instructing you to register your town by entering its postal code.

2. If somebody else has already registered your town, you are directed to your town's homepage, where drafts of proposals can be uploaded, links to relevant articles can be posted, videos can be shared, announcements can be made, etc. If your town has yet to be registered, then you are directed to a different page, which asks you to verify your residence in the town by supplying your name and address. Once your residence in the town has been verified, your town is registered.

3. Everybody in the country, regardless of the town they live in, can access the homepage of any town. It may be that certain homepages contain more valuable information than others, and this should be shared.

4. Once the deliberations on the local level have been completed, similar homepages will be created for the counties and the states, where similar information can be shared.
5. Each of the town homepages contain a link to the homepage of the Jefferson Project itself, where the proposal sheets for each of the issues as well as the nomination sheets can be found.

6. The proposal sheets are very simple. They contain at the top of the page a question, to which the towns can supply as long or as short an answer as they choose, and information on how and when to submit it.

7. The nomination sheets are even simpler. They ask for the name of the town and the names of the people chosen to represent it.

8. The homepage of the Jefferson Project itself will also contain a list of the issues to be addressed:

Campaign Finance Reform
Taxation
The Debt
Healthcare
Education
Climate Change
Immigration

and the questions:

"How should federal campaigns in this country be financed?"
"What should the country's tax code be?"
"What should the country do to reduce its debt?"
"How can the country's government-sponsored healthcare programs be improved?"
"How can the country's government-sponsored education programs be improved?"
"What would a solution to the problem of climate change look like?"
"What should the country's policy on immigration be?"

The Rules

1. The number of representatives that each town selects should be in direct proportion to the size of the town. Towns with populations of 1 to 25,000 should nominate two people; towns with populations of 25,000 to 50,000 should nominate four people; towns with populations of 50,000 to 75,000 should nominate eight people; and so forth. This applies to the counties as well, with the smallest counties nominating two people, the counties with the next smallest population nominating four people, and so forth. On the other hand, each state, regardless of size, will nominate two representatives.

2. Towns, counties, or states that fail to submit either a finished proposal or nomination sheet by the due date will be disqualified for that particular issue.

3. It will be left to the towns, counties, and states to organize themselves and their homepages, and to frame the rules for how they proceed in drafting the proposals and nominating the representatives.

4. Towns will have three months, from the official beginning of the project, to complete their proposals and to nominate their representatives. Counties will have three months, after the towns have submitted, to complete their proposals and to nominate their representatives. States will have three months, after the counties have submitted, to complete their proposals and to nominate their representatives. The representatives in Washington, D.C., who will be housed and fed by the Jefferson Project, will have three months to complete their proposals.

5. The Jefferson Project is not responsible for feeding or housing representatives on the town, county, or state levels, but only in Washington, D.C. Similarly, the Jefferson Project is not responsible for transportation, or for finding and securing places to meet, on any level except that of the nation.

6. Citizens of any age can participate in the Jefferson Project at any level.

Jefferson's Letter to Samuel Kercheval, Monticello, July 12, 1816

“Divide the counties into wards of such size as that every citizen can attend, when called on, and act in person. Ascribe to them the government of their wards in all things relating to themselves exclusively. A justice, chosen by themselves, in each, a constable, a military company, a patrol, a school, the care of their own poor, their own portion of the public roads, the choice of one or more jurors to serve in some court, and the delivery, within their own wards, of their own votes for all elective officers of higher sphere, will relieve the county administration of nearly all its business, will have it better done, and by making every citizen an acting member of the government, and in the offices nearest and most interesting to him, will attach him by his strongest feelings to the independence of his country, and its republican constitution. The justices thus chosen by every ward, would constitute the county court, would do its judiciary business, direct roads and bridges, levy county and poor rates, and administer all the matters of common interest to the whole country. These wards, called townships in New England, are the vital principle of their governments, and have proved themselves the wisest invention ever devised by the wit of man for the perfect exercise of self-government, and for its preservation."

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Does U.S. Foreign Policy Serve the People? Institutional Corruption Promoted U.S. Military Engagement in Libya

Simona Ross

According to Search for Common Ground, 1.6 million people die annually due to violent conflict. In Syria, over 130,000 innocent civilians have already lost their lives in an ongoing civil war. By comparison, the recent Libyan civil war caused between 10,000 and 30,000 deaths.

The difference in death tolls may be due to the swift intervention by the United Nations; specifically, strong military support from the United States. In early 2011, the U.S. government began taking an active role in resolving the conflict in Libya. Then, in March 2011, U.S. President Barack Obama ordered the deployment of U.S. military operations to enforce a U.N.-sanctioned no-fly zone. Given the horrific violence unfolding in the region, why hasn't the U.S. responded similarly to human loss during the conflict in Syria? While the resolution to intervene in Libya may have been based on security intelligence, there is reason to believe that institutional corruption played a central role in the final decision.

Lawrence Jacobs and Benjamin Page conducted a study on actors influencing U.S. foreign policy. The study revealed that the public has little influence on U.S. foreign policy, whereas corporations hold the greatest power to shape decisions on foreign affairs. In fact, Jacobs and Page emphasized that when there is a shift in opinion in the business community, members of Congress change their stand on that particular issue in the same direction. As recent evidence, U.S. military operations in Libya demonstrate how corporate interest and U.S. foreign policy are intertwined.

In contrast to Syria, the Democratic Republic of Congo, and other conflict-ridden countries, Libya benefits from significant foreign direct investment in their oil production. Oil Companies that had large financial investments in Libya include ExxonMobil, Marathon Oil, BP, ConocoPhillips, Hess Corporation, Chevron, and Occidental Petroleum. In 2011, the oil industry spent $150 million on lobbying efforts, with ExxonMobil, Marathon Oil, BP, ConocoPhillips, Chevron, and Occidental Petroleum as the top spenders. All of the above-mentioned oil companies have also been the top clients lobbying on Libyan issues.

There is little doubt that backing from the U.N. Security Council and NATO aided the decision to undertake military intervention in Libya or that President Obama unilaterally decided to deploy U.S military forces. Nevertheless, President Obama enjoyed strong support from many members of Congress—support inevitably needed to authorize military action after 60 days, as enforced by the 1973 War Powers Act. Several members of Congress publicly advocated for an advisory resolution, which outlined operations for a no-fly zone in Libya. The resolution eventually passed the Senate. Members of Congress who drafted and promoted the resolution included: then-Sen. John Kerry, Sen. John McCain, Sen. Carl Levin, Sen. Dianne Feinstein, Sen. Lindsey Graham, Sen. John Hoeven and Sen. Joseph Lieberman. To further advocate for military engagement in Libya, Kerry also published an article in the Wall Street Journal titled "Libya and the Just Use of American Force." But while their support may have been merely strategic, these members of Congress share a great personal interest in Libya's political stability.

For example, Secretary of State John Kerry has invested heavily in oil companies like ConocoPhillips, ExxonMobil, and BP—all of which were operating or had immediate plans to operate in Libya. In 2007, BP signed a $900 million deal for future oil extractions in Libya—a deal that marked the largest exploration commitment ever by BP at the time. However, as the civil war spread, foreign investments like this became increasingly vulnerable to disruption. Indeed, rising conflict hampered exploration in many regions, and the unexpected downturn cost ConocoPhillips an estimated loss of over $100 million.

Sen. John McCain is the top recipient of campaign contributions from the oil and gas industry, which is one of the largest spenders on campaign contributions and lobbying efforts. In 2012, John McCain received some of the highest campaign contributions from Chevron, Hess Corporation, Marathon Oil, ConocoPhillips, and Occidental Petroleum. Harvard Law Professor Lawrence Lessig argues that lobbyists tend to target politicians that already share a belief system with their clients but merely attempt to influence their priorities.[1]

Other recipients of hefty campaign contributions are Sen. Lindsey Graham and Sen. John Hoeven, who both received generous donations from Hess Corporation and Marathon Oil. Sen. Dianne Feinstein and other members of Congress that voted for intervention in Libya received substantial campaign contributions from Marathon Oil's Political Action Committee.

Marathon Oil is worth highlighting not only because of its large campaign contributions to all of the above-mentioned Congress members, but also because it is the most active corporation lobbying on Libyan issues.

Marathon Oil had a great stake in the political situation in Libya. Between 2009 and 2010 sales of crude oil to the Libyan National Oil Company accounted for 13 percent of Marathon Oil's annual revenue. In 2010, Marathon Oil's investment in Libya was approximately $760 million, and the company had ambitions to increase drilling by 2011. By December 2010, Marathon Oil had already issued a 10-K Form stating that continued conflict in Libya could cause their revenues and margins to decline and limit their future growth prospects. By 2011, halted productions began to impact Marathon Oil's revenues, even while the company continued to cover maintenance costs for their facilities.

Besides oil companies and human rights groups, defense contractors were the main clients mentioning Libya in their lobbying efforts, with Halliburton and Boeing among the top clients. In 2010 alone, the defense industry spent over $138.8 million on federal-level lobbying. Their lobbying efforts proved successful. Members of Congress voted against budget cuts for the defense sector, expressing concern over reduced defense spending during active military engagement in Libya.

Meanwhile, Sen. John McCain, Sen. Carl Levin, Sen. Dianne Feinstein, and Sen. Lindsey Graham received campaign contributions from the leading defense contractors Lockheed Martin, Northrop Grumman, General Dynamics, Boeing, and BAE Systems.

Further, President Obama, who confirmed U.S. support for military involvement in Libya, received substantial campaign contributions from the oil and defense industries. Anthony Gregory, who studies the influence of Wall Street and Banks on U.S. foreign policy, argues that Obama's reliance on military contractors and Arab oil explains his engagement in Libya. Gregory found that the U.S. Federal Reserve provided the central bank of Libya with $26 billion of almost interest free emergency loans between 2007 and 2010. At the same time, the central bank was the only business exempt from U.S. sanctions against Libya.

Obama's advocacy for U.S. military engagement paid off. During the 2012 presidential election cycle, Obama was the top recipient of contributions from individuals affiliated with the defense sector, noting his military engagement in Libya as one of the reasons for their support.

Pro-Israel lobbying groups and think tanks were also actors that shared a stake in the Libya intervention. At the time, Libya posed no imminent security threat to the U.S. Yet it is no secret that the relationship between Israel and the Gaddafi regime were strained. In 2012, NorPAC, a political action committee working to strengthen U.S.-Israel relations, spent over $16 billion dollars on lobbying and on campaign contributions. Sen. Carl Levin was among the primary beneficiaries of NorPAC's support.

With regard to think tanks, Scholar Darius Nazemroaya claims that the National Endowment for Democracy (NED) was also actively engaged in shaping U.S. foreign policy towards Libya. NED was among the first institutions publicly stating the need for a humanitarian intervention in Libya. According to Nazemroaya, NED provided financial resources to organizations promoting regime change in Libya. Moreover, NED directors allegedly included Libyan activists listed as terrorists by the U.S. Department of State.

Lastly, Sen. Joseph Lieberman benefited from his support for military engagement in Libya through his lobbying firm Kasowitz Benson Torres & Friedman. The firm recently signed a lobbying contract with Basit Igtet, a Libyan politician running for office. During the 2011 revolution, Igtet was a key opponent of the Gaddafi regime.

The decision to support military operations in Libya may have been based on a set of strategic factors; but the disturbing truth is that U.S. foreign policy is not guided by idealistic values promoting democracy, peace, and human rights.

This is not to suggest that the U.S. should not have played a central role in the Libya intervention—quite the opposite. The moment has come where "Never Again," as was pledged after Cambodia and Rwanda, must transcend rhetoric and materialize into action for Syria. The key question is whether institutional corruption provides a concept that can help explain the motives for military intervention or non-intervention, and whether foreign policy decisions dictated by humanitarian needs would have a positive impact on the outcome of such interventions.

As Kofi Annan put it, “while humanitarian intervention is a moral and strategic imperative when the alternative is genocide or gross violations of human rights, military action pursued for narrow purposes without global legitimacy or foresight about the consequences (…) can be as destructive as the evils it purports to confront.”[2]

The events surrounding the military operations in Libya demonstrate a range of failures in the U.S. political system. However, it remains difficult to determine the greatest tragedy highlighted by these events. Is it that American citizens express no interest in U.S. foreign policy, that interest groups take advantage of the political system, or that the political system makes politicians dependent on financial contributions?

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1. Lawrence Lessig, Republic, Lost: How Money Corrupts Congress—And a Plan to Stop It (Twelve, 2011).
2. Kofi Annan, Interventions (Penguin, 2012), xii.

February 3, 2014

Fixing the Revolving Door

Chandu Krishnan

On February 1, 2014, the New York Times published a depressing article claiming that the law to regulate the "revolving door" on Capitol Hill is not working. It alleges that several congressional aides have started lobbying their former congressional bosses and colleagues on behalf of new corporate employers within the proscribed one year period by exploiting a loophole in the law.

The law does not apply if an aide's salary is below a certain cap. In 2013, the cap was $130,000. So aides are alleged to have ensured that their salaries were below this limit in order to circumvent the ban.[1]

Such behavior is an example of the sort of institutional corruption in the nation's capital that undermines public trust and confidence in government. In Transparency International's 2013 Global Corruption Barometer, 64% of US respondents felt that the U.S. government was run by a few big interests looking out for themselves (this figure was higher in only 5 of 28 OECD countries).[2]

The congressional aides playing this game are not breaking the law. But their behavior is damaging because positions of trust are being abused and the industries/companies that employ these persons have an unfair advantage in influencing government policy in their favor. Furthermore, the promise of employment with a company after leaving Capitol Hill may induce aides to behave in ways that undermine Congress's ability to make laws that reflect the will of the American people rather than that of industry lobbies.

Of course, the U.S. is not alone in confronting the revolving door problem. In the U.K., for example, it was revealed in May 2011 that a former Defense Secretary, Geoff Hoon, included helicopter manufacturer Agusta Westland among his consultancy clients. Interestingly, in 2005, when he held the defense portfolio, he approved a £1 billion contract with this company, which was controversially declared a preferred bidder, despite claims that other companies could have provided better value-for-money.[3] In fact, compared to the U.S., the U.K. has a bigger problem because it does not actually have an enforceable law on the revolving door. Instead, it has an astonishingly lax regime where an Advisory Committee on Business Appointments (known as ACoBA) provides advice to ministers and senior civil servants seeking private sector jobs after demitting public office. Since ACoBA is a purely advisory body, it has no monitoring or enforcement powers. There is nothing to stop individuals from ignoring the advice they are given. Even worse, the remit of ACoBA does not extend to members of parliament and their aides!

So how can we fix the problem? Shutting down the revolving door completely is neither feasible nor desirable. In the U.S. and in other countries, the interchange of skills and experience between the public and private sectors can be mutually beneficial and provide significant benefits to society as a whole. Companies are enriched by persons with government experience, and government benefits when it draws on the expertise of those who know how the private sector works. The trick is to manage or regulate the revolving door more effectively so as to maximize benefits to society while minimising corruption risks, which are greater when government officials and legislators can be unduly influenced in their policy or procurement decisions by the interests of past or prospective corporate employers.

There is no magic bullet to solve the problem and we need more research to identify good (and bad!) practice from around the world. That said, the following general principles may be helpful (even if some are rather controversial):

First, scrap income-based criteria and increase the length of the "cooling off" period before a person takes up post-public employment. One year is probably too short. Two, or, ideally, three years, is better because the kind of insider knowledge and contacts that tend to be exploited in corrupt ways have a limited shelf life and tend to lose their value over time.

Second, sensitive posts (in the executive branch or legislature) should be audited to assess the level of corruption risk. In some cases (e.g. involving public procurement or regulation in key sectors such as defense, energy and health), the "cooling off" could be increased. In exceptional circumstances, a person involved in procurement decisions that have benefited a company, should be barred from taking up employment in that company.

Third, rules and regulations should be statutory, and the body or agency that enforces them should have adequate resources to monitor and enforce them.

Finally, we should impose strong sanctions (fines and imprisonment) on individuals and employers who violate the law, in order to deter bad behaviour.

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1. Eric Lipton and Ben Protess, "Law Doesn't End Revolving Door on Capitol Hill," New York Times, February 1, 2014.

2. Transparency International, "Global Corruption Barometer," 2013, 15. OECD is the Organization for Economic Co-operation and Development.

3. Transparency International UK, "Fixing the Revolving Door between Government and Business," August 2012, 4.

February 10, 2014

Yes, Contributions Really Matter. But How? And What are their Broader Impacts?

Clayton D. Peoples

Despite the fact that the public continues to believe that campaign contributions have an outsize influence on policymaking, a growing number of scholars have begun to argue that contributions don't have much impact on policy, if any.[1] Jumping on the bandwagon, some commentators have also chimed in, contending that contributions don't really matter.[2] But is this true? Does research really suggest that contributions don't have much impact? (And, by extension, does it imply that contributions don't matter?) Put simply: No.

For those who argue that contributions don't matter, the basic argument they present is as follows: The research literature on contribution influence is mixed; some studies show influence, but some do not. As such, the evidence is "thin," at best.[3] This means that (logical leap) contributions don't really matter, and those who argue otherwise risk being derided as "dishonest scholars" (as lamented by Lawrence Lessig).[4]

Yet as I discovered in a critical review I recently wrote for *Sociology Compass*,[5] the research literature in fact shows quite conclusively that contributions *do* influence policy. Probably the strongest evidence is found in two recent meta-analyses—one by Roscoe and Jenkins, and one by Stratmann.[6] (Meta-analysis involves conducting analysis on data or results from already-published studies in a field to determine if there is a consensus.) Both meta-analyses looked at dozens of studies—nearly the entirety of the existing research literature—and reached the same conclusion: contributions significantly influence policy. To quote from the studies, Roscoe and Jenkins say that "a reasonable conclusion" from their analysis "is that one in three roll call votes exhibits the impact of campaign contributions."[7] Stratmann states his conclusion more strongly: "This meta-analysis reverses the finding reported in existing studies that campaign contributions have no effect on legislative voting behavior. The meta-analysis performed here suggests that money does indeed influence votes."[8]

So, there you have it. The literature that purportedly shows that contributions don't matter *actually* shows that contributions significantly influence legislative voting (which, by the way, is the last step in the policymaking process, and, thus, is likely a conservative measure of the actual impact of contributions).

Where do we go from here?

I think first and foremost we should finally put to rest the notion that contributions don't matter. It was a logical leap to begin with, and the literature simply doesn't support it. As the above-referenced meta-analyses make clear, when the literature is put to analytical scrutiny, it reveals that contributions do, indeed, influence policy (and, thus, matter).

Once we put to rest the notion that contributions don't matter, I think we should begin moving on to other important questions, such as *how contributions influence policy* and *what are their broader impacts*.

How do contributions influence policy? Some possible answers to this question have begun to emerge. First, contributions provide access to contributors,[9] which, in turn, opens the door to lobbying, etc. The importance of lobbying as an extension of contributing probably can't be overstated, as research suggests that social ties,[10] as well as the "mobilization of bias,"[11] are critical, both of which are likely linked (no pun intended) to contributions *and* lobbying. Once access is obtained and lobbying begins, lawmakers may ultimately feel compelled to "return the favor" of a contribution because of a social-psychological pull we're all subject to—reciprocity.[12] This could occur at virtually any stage of the legislative process, from agenda setting and the drafting of legislation to committee votes and, ultimately, final roll call votes.

What is the broader impact of contributions? Here, too, we have the beginnings of some answers. For business PACs, contributions provide tax benefits.[13] They also aid in the passage of regulatory changes beneficial to these businesses.[14] Additionally, business lobbyists frequently ask for "help in obtaining government contracts . . . and government subsidies for the lobbyist's corporation."[15] In the grander scheme of things, contributions may well be related to the rise in income inequality we've seen in the U.S. over the past few decades. If so, as Lessig puts it, "This isn't the rich getting richer because they're . . . working harder; . . . it's because their lobbyists are working harder."[16]

In conclusion, the literature shows very clearly that contributions influence policy; contributions really do matter. We should consider this settled. What we should do now is focus our attention on other questions, such as how contributions influence policy as well as their *broader impacts*. Early answers suggest that contributions affect policy via social ties and lobbying, and result in tax benefits, regulatory favors, and possibly even government contracts and subsidies for contributors. This, in turn, may be hurting the majority of the populace, as it is likely increasing inequality. Future work should continue to examine these themes—with an eye toward reform.

Note: This post is related to an article by Clayton D. Peoples, "Campaign Finance and Policymaking: PACs, Campaign Contributions, and Interest Group Influence in Congress," *Sociology Compass* 7.11 (2013): 900-913.

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1. E.g. Paul Burstein, "Is Congress Really for Sale?" *Contexts: Understanding People in their Social Worlds* 2.3 (2003): 19-25; Frank J. Sorauf, *Inside Campaign Finance: Myths and Realities* (Yale University Press, 1992).

2. E.g. David Brooks, "Don't Follow the Money," *New York Times*, October 18, 2010,http://www.nytimes.com/2010/10/19/opinion/19brooks.html?_r=0; George Will, "Why is There So Little Money in U.S. Politics?" *Jewish World Review*, December 30, 2002,http://www.jewishworldreview.com/cols/will123002.asp.

3. Stephen Ansolabehere, John M. de Figueiredo, and James M. Snyder, Jr., "Why is There So Little Money in U.S. Politics?" *Journal of Economic Perspectives* 17.1 (2003): 105-130, 116.

4. Lawrence Lessig, *Republic, Lost: How Money Corrupts Congress—and a Plan to Stop It* (Twelve, 2011), 125.

5. Clayton D. Peoples, "Campaign Finance and Policymaking: PACs, Campaign Contributions, and Interest Group Influence in Congress," *Sociology Compass* 7 (2013): 900-13.

6. Douglas D. Roscoe and Shannon Jenkins, "A Meta-Analysis of Campaign Contributions' Impact on Roll Call Voting," *Social Science Quarterly* 86.1 (2005): 52-68 and Thomas Stratmann, "Some Talk: Money in Politics. A (Partial) Review of the Literature," *Public Choice* 124.1/2 (2005): 135-156.

7. Roscoe and Jenkins, "A Meta- Analysis of Campaign Contributions' Impact on Roll Call Voting," 64.

8. Stratmann, "Some Talk: Money in Politics," 146.

9. Martin Schram, *Speaking Freely: Former Members of Congress Talk about Money in Politics* (Center for Responsive Politics, 1995).

10. Clayton D. Peoples, "Contributor Influence in Congress: Social Ties and PAC Effects on U.S. House Policymaking," *Sociological Quarterly* 51.4 (2010): 649-77.

11. Richard L. Hall and Frank W. Wayman, "Buying Time: Moneyed Interests and the Mobilization of Bias in Congressional Committees," *American Political Science Review* 84.3 (1990): 797-820.

12. Robert B. Cialdini, *Influence: Science and Practice*, 4th ed. (Allyn & Bacon, 2001).

13. Dan Clawson, Alan Neustadtl, and Mark Weller, *Dollars and Votes: How Business Campaign Contributions Subvert Democracy* (Temple University Press, 1998).

14. Matthew C. Fellowes, and Patrick J. Wolf, "Funding Mechanisms and Policy Instruments: How Business Campaign Contributions Influence Congressional Votes," *Political Research Quarterly* 57.2 (2004): 315-24.

15. R. Kenneth Godwin and Barry J. Seldon, "What Corporations Really Want from Government: The Public Provision of Private Goods," in Allan J. Cigler and Burdett A. Loomis, eds., *Interest Group Politics*, 6th ed. (Congressional Quarterly Press, 2002), 205-224, 205.

16. Lessig, *Republic, Lost*, 157.

February 13, 2014

A Fixed Game? Institutional Corruption Charges Taint Global Markets—Again.

Gregg Fields

Is the fix in? If it's 4 p.m. in London, and you're talking about foreign exchange trading, the answer is a definite "maybe."

Actually, the hour of 4 p.m. London time has long been a fixture in international finance. It's a pivotal moment when exchange rates between currencies are set. Based on the trading around that time, the price of a dollar versus the euro, for instance, can climb or fall, depending on demand. It was historically known as the 4 p.m. fix. The most commonly used exchange rates are distributed by a joint venture called WM/Reuters.

In theory, the price is a simple function of supply and demand among the handful of global financial institutions that dominate this gigantic market. More than $5 trillion in currency trading occurs daily, according to a survey conducted last April by the Bank for International Settlements. That's a 35 percent increase since 2010, the BIS said. And with such huge volumes, even the slightest move in a currency's value can mean giant profits for some traders, and their institutions.

Therein lies the problem—and a large, growing scandal with significant implications related to the study of institutional corruption. Regulatory bodies around the world are now examining some suspiciously convenient price swings that have occurred around the 4 p.m. fix. In a scandal reminiscent of last year's rate-rigging improprieties surrounding the London Interbank Offered Rate, or Libor, regulators now are questioning the institutional integrity on which the 4 p.m. fix is purportedly based.

Some reports contend a whistleblower alerted regulators in the U.S., U.K. and Switzerland as early as 2011, to little avail. Last June, Britain's Financial Conduct Authority, somewhat vaguely, said it was "aware of allegations" of currency rigging, according to Bloomberg. The story broke open in October when FINMA, the Swiss markets regulator, disclosed it was "conducting investigations into several Swiss financial institutions in connection with possible manipulation of foreign exchange markets."

Swiss officials made it clear that the alleged transgressions went far beyond the Alps, however. "FINMA is coordinating closely with authorities in other countries as multiple banks around the world are potentially implicated," it said.

Soon after, the U.K.'s FCA disclosed: "We can confirm that we are conducting investigations alongside several other agencies into a number of firms relating to trading on the foreign exchange (forex) market."

Late last year, in a rare interview on an open case, U.S. Attorney General Eric Holder Jr. hinted to the New York Times that proof of rate manipulation had already been found.

"The manipulation we've seen so far may just be the tip of the iceberg," Holder said. "We've recognized that this is potentially an extremely consequential investigation."

The Audacity of Opacity

The forex case bears some striking similarities to other recent financial scandals, including those that figured centrally in the economic collapse of 2008. And it brings renewed scrutiny to practices that, upon close examination, share unsettling likenesses with the systems and influences that produce the institutional corruption that is the focus of the Edmond J. Safra Center for Ethics.

Among the parallels:

There is compelling evidence of lax to no regulation. As a lively headline in the Daily Mail put it last June: "Wild West currency market hit by latest fixing scandal."

There is also a clear corporate culture driven by short-termism—huge profits in this case can be earned in a matter of seconds. As Malcolm Salter, business professor emeritus at Harvard and senior faculty advisor at the Edmond J. Safra Center for Ethics, has argued, "short-termism also invites institutional corruption." Institutional corruption, in Salter's view, "refers to institutionally supported behavior that, while not necessarily unlawful, erodes public trust and undermines a company's legitimate processes, core values, and capacity to achieve espoused goals."

Finally, there is an almost complete lack of transparency in forex. When it comes to how exchange rates are set, mum's the word. A client doesn't have any independent way of knowing, for instance, if the price is good or bad relative to what others are paying.

"If traders were then given the carrot of a massive bonus and a way of fudging the figures to get there, where is the stick that keeps them in line?" Andre Spicer, a professor of organizational behavior at City University London, wrote last October. "Often, there isn't one."

Troubling Numbers

A quick tutorial on how this opaque system works is in order. The reality is that currencies are traded around the world 24 hours a day. However, the United Kingdom is the dominant player, with a 41 percent market share, followed by the U.S. with 19 percent, according to the BIS. In Asia, the dominant centers are Singapore, Japan and Hong Kong. The U.S. dollar is on one side of currency exchanges 87 percent of the time, according to the BIS.

Prices change throughout the day. But shopping for the best deal is daunting. So over time the London 4 p.m. fix became a de facto benchmark. The 4 p.m. fix is based on trading that occurs in a 60-second window around that time.

The recent allegations are that traders skewed the 4 p.m. figures to serve their own interests, potentially at the expense of clients, which can include entities like pensions and mutual funds.

When trading runs to the trillions of dollars a day, a slight change can make a big difference. Bloomberg, for instance, took a sample trade of $1 billion Canadian into U.S. currency on June 28 of last year. The trader would have received $5.4 million less if the transaction used the WM/Reuters rate, rather than the spot rate available 20 minutes before the 4 p.m. window.

How can such a huge market be manipulated by such a small number of traders? One example is a process, not exclusive to foreign exchange, known as "banging the close." In banging the close, traders place a blizzard of orders around the time benchmarks are set, skewing prices.

Regulators have apparently noted that price spikes around 4 p.m. have often evaporated soon after a new benchmark price was set.

Other reports, including coverage in the Financial Times, say investigators are looking at old-fashioned collusion. Traders are in theory competitors. But reportedly some shared strategies via text message groups and chatrooms, with nicknames like "the cartel," and "the bandits club."

No question, foreign exchange trading is a club—a quite exclusive one. Deutsche Bank and Citigroup are the world's largest currency traders, with roughly 15 percent of the market each, according to a 2013 survey by Euromoney Institutional Investor. Barclays and Switzerland's UBS had roughly 10 percent each.

Libor 2.0?

If the allegations have a familiar ring, it's because we have seen this pattern before. In testimony to Parliament earlier this month, Martin Wheatley, who heads the FCA, acknowledged the allegations "are every bit as bad" as with Libor.

Libor is, in theory, the rate at which banks borrow from one another. The problem was that banks self-reported the Libor, manipulating it to serve their own interests. There, social injury includes the fact that trillions of dollars in consumer borrowing, including home equity loans in the U.S., are priced against the Libor benchmark.

Libor and similar benchmarks "have been readily and pervasively rigged," Gary Gensler, then-chairman of the Commodity Futures Trading Commission, noted last year. In December, the European Union fined a group of banks that included Citigroup and JPMorgan Chase $2.3 billion for manipulative behavior that went back several years.

(A number of Libor traders have been charged, and press reports in England contend that further indictments are in the pipeline. The Libor scandal and its links to institutional corruption was examined in an Edmond J. Safra Center for Ethics working paper last June, authored by Justin O'Brien, director of the Centre for Law, Markets & Regulation at the University of New South Wales.)

Separately, foreign exchange trading bears some clear parallels to the market in derivatives, which played a central role in the economic meltdown in 2008. As with derivatives, foreign exchange isn't conducted in a central market like with stocks. It's driven by private transactions, away from the glare of transparency.

"The foreign exchange market is unregulated, opaque and controlled by a small tight-knit group of traders who have little commitment to their employers," noted Spicer, the organizational behavior professor at City University London. "If the allegations are true, these are the networks that provided the social infrastructure for rate fixing."

Social infrastructure, in this context, can be viewed as a subculture of sorts. In this case, the social infrastructure could include not just the traders and their institutions but also the regulators who turned a blind eye. Cumulatively, strategic and systemic influences such as these often manifest as institutional corruption, Lawrence Lessig, director of the Edmond J. Safra Center for Ethics, wrote in a recent article for the Journal of Law, Medicine and Ethics.

Burning Issues

Unfortunately, one of the primary casualties of institutional corruption is a decline in public trust, as well as the trustworthiness of vital societal institutions, Lessig added. It's particularly relevant in this case, in the midst of efforts to restore public confidence through reforms mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Looking ahead, the investigations into foreign exchange markets are continuing. Although resignations and early retirements on foreign exchange desks seem unusually high lately, it should be noted that no charges have been brought.

Nevertheless, the sad reality is that, when it comes to global finance, in recent years the smoke of scandal has inevitably signaled the subsequent discovery of the fires of institutional corruption.

February 14, 2014

When It Comes to Liability and Patient Safety, What's Good for Hospitals Can Be Good for Patients

Michelle Mello re-blogged from The Blog of the Huffington Post

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Joanne Doroshaw's blog post on hospital-based communication-and-resolution programs (CRPs) is a stunner—not for its insights about patient safety, but for the suggestion that CRPs are a step in the wrong direction.

CRPs are an approach taken by hospital systems and their liability insurers to responding to unexpected outcomes of medical care ("adverse events") that is based on simple principles: Report events to hospital risk-management and quality-improvement personnel quickly. Tell the patient and family what happened. If the harm was caused by a medical error, admit it and apologize. If you're not sure at the outset, let the family know a review is being conducted and that you'll be contacting them when it's finished—then make sure you do. Conduct that review expeditiously. If an error caused the harm, offer compensation that is adequate to redress the patient's losses, without waiting for him or her to sue. If the standard of care was met, on the other hand, explain why and answer the family's questions. Let them know the hospital will stand behind the care providers but will make appropriate efforts to meet the patient's medical and psychosocial needs. Finally, scrutinize each case for opportunities to prevent a recurrence of the event.

Doroshaw is an advocate, and advocates should ask hard questions. But her characterization of CRPs is misleading in several respects. Moreover, she doesn't ask the questions patients should be asking about these programs.

I've spent the past five years asking questions about CRPs in a series of academic research projects funded by the federal Agency for Healthcare Research and Quality and the Robert Wood Johnson Foundation. I led the studies about which Doroshaw wrote in her post. Some of this work has involved studying CRPs from the outside, while other projects have involved trying to implement them in new settings.

What have we learned? My conclusion is that the CRP model is the most promising, achievable avenue for improving the medical liability environment for both patients and care providers. But doing CRPs well is hard. Routine disclosure and proactive settlement are nothing short of a cultural transformation for many hospitals, insurance companies, and physicians. They don't get it right all the time—but patients should support their efforts to evolve. Here's why.

Although nobody disputes that disclosing medical errors to patients is the right thing to do, historically, hospitals haven't done a great job of supporting physicians in doing it. Patients might be surprised at how many hospitals still don't provide disclosure training, coaching, and support to their clinical staff. We also know from safety culture surveys that many hospitals still have a long way to go in creating an environment in which care providers believe they can be open about errors without triggering an unduly punitive response. Finally, physicians confront a high-risk malpractice liability environment in which disclosure can have serious personal and professional consequences—especially since they get reported to the National Practitioner Data Bank (NPDB) and state boards of discipline whenever a malpractice claim against them is paid.

Doroshaw's post raises the question: Isn't that reporting a good thing? The NPDB was set up to improve patient safety by preventing incompetent physicians from being able to hop state lines and get credentialed at another hospital, endangering a new group of patients. Of course we need to prevent that from happening.

The problem is that malpractice payments are a poor proxy for incompetence. Research by my group at Harvard found that about a quarter of paid claims don't actually involve an injury caused by a medical error. And when errors do occur, they're often not the sort that Doroshaw appears to have in mind. Lapses and slips, interacting with systems that fail to stop them from causing harm, are more frequently the culprits than outright incompetence. Unfortunately, requirements for reporting to the NPDB and state licensing boards don't distinguish incompetence from lapses, or individual from organizational failings. So one question that patient advocates should be asking is: What are we getting from all this reporting of malpractice payments? Is it making health care safer? Although the system surely has caught the occasional "bad apple," at the population level, there's no evidence that it has improved safety outcomes.

What does seem clear is that these reporting requirements chill physicians' willingness to report and disclose adverse events, and to agree to provide compensation to injured patients, especially where they feel systems problems were a major contributor to the injury. Without their full participation, we lose information and opportunities for rapid intervention. Because of this problem, I have begun to wonder whether the NPDB is serving its goal or whether there are better ways to identify incompetent providers.

Asking this question isn't, as Doroshaw suggests, forcing a choice between honoring patients as the true victims of medical errors and slapping the victim label on physicians. No one is suggesting that providers be relieved of accountability for errors. Nor are CRPs shying away from reporting individual practitioners when they are individually negligent. What is being suggested, instead, is that there are better ways of holding individual and institutional healthcare providers accountable than our traditional processes of reporting malpractice payments and suing physicians. A key question for patients to ask is: When hospitals decide an NPDB report isn't appropriate, what do they do to make sure the systems problems they found won't recur?

CRPs, when operated in a manner faithful to their principles, hold out the prospect of addressing problems in care far more consistently, efficiently, and effectively than traditional systems. Our studies found that they resulted in many more adverse events being tracked and investigated by hospitals than would otherwise be the case. They can also improve economic incentives for safety by increasing the likelihood that an error will result in a compensation payment to a patient—something that is exceedingly low in the present system, in which only 2-3 percent of patients injured by negligence file malpractice claims.

Our research also found, though, that CRPs aren't always operated with high fidelity to their principles. When it comes to offering compensation, some insurers aren't as proactive as they might be, preferring to wait for the patient to raise the topic of compensation and sometimes requiring the patient to jump through procedural hoops. That isn't consistent with the goals of CRPs, and it's not characteristic of all programs, but where it occurs it needs to be addressed. Thus, an important question for patients to be asking about CRPS is, what do you mean when you say you're "proactive" in offering compensation?

But Doroshaw is off the mark in suggesting that CRPs are out to "short-change" patients with quick, "partial" settlements, that they conceal key facts, and that they do not allow patients the chance to consult with others about whether they are giving up important rights. There is, quite simply, not a shred of evidence to support the proposition that what patients are offered is less than reasonable compensation for their injuries. Further, hospitals and insurers tend to be quite particular about making sure that patients are represented by an attorney before they accept a settlement and waive their right to sue. They don't want to run the risk that a judge might later overturn the settlement, for one thing. This is especially true in the scenario Doroshaw presents, the severely brain-injured newborn. To suggest that such a case would be settled without the involvement of an experienced plaintiff's attorney is ludicrous.

What we do have evidence for, in spades, is that the traditional litigation system is exceedingly difficult for patients to access; isn't a reliable mechanism for sorting meritorious from nonmeritorious claims; and results in wildly varying damages awards for similar injuries. Plaintiffs lose four out of five malpractice trials. They don't get paid in a quarter of claims that involve an injury due to negligence. Temporary or moderate-severity injuries are rare among claims because they aren't attractive to plaintiff's attorneys, who work on a contingent-fee basis. The median time between filing a claim and getting a resolution is three years. Does Doroshaw really think patients ought to be forced to use this system to obtain compensation? Instead, patients should take advantage of the opportunity to work with CRPs, where available, and ask, what resources can be developed to connect patients with high-quality legal representation at affordable cost?

About one thing, Doroshaw is right: Hospitals still have a long way to go in improving patient safety. They've made some significant strides, as a recent report highlights, but preventable harms still occur with dismaying frequency. Doroshaw criticizes the hospitals in our study for admitting they have room for improvement in using lessons learned from adverse events to improve safety. But if I ever encountered a hospital that claimed otherwise, as a patient, I would run.

Medical error prevention is a work in progress. We should be impatient with the pace of progress, as Doroshaw is, because it means that patients are daily suffering avoidable harm. But we should also seek to understand the reasons why the pace isn't faster. Hospitals can't fix what they don't know about, so a basic prerequisite is fostering a culture in which adverse events get promptly reported. CRPs do that. Acting on clear opportunities for improvement is also critical. CRPs do that.

There are a couple of big barriers that remain, though. One is that now that hospitals have addressed a lot of the low-hanging fruit in patient safety—highly prevalent injuries with an obvious cause that can clearly and easily be fixed—what they're left with is a highly heterogeneous group of injuries with much more complex causation. The fixes are tougher, and it's not always obvious which hole in the dike one ought to focus on plugging, when there are so many.

Another problem is resources. I have often been surprised to learn how low the budget and manpower are for risk-management and patient-safety functions within hospitals. The people who staff these offices are caring, hardworking individuals who are often overwhelmed by their responsibilities. They are so consumed with "putting out fires" that it can be hard to maintain focus on prevention activities like tracking patterns of adverse events and implementing process improvements. So patients should be asking of their hospitals, are you giving your safety improvement offices the resources they need to succeed in their mission?

The resource problem emerged in our research as a reason why some CRPs haven't achieved as much as others in terms of safety improvement. But CRPs can help hospitals make better use of the resources they have—coordinating work among offices of risk management, safety, and quality, for example, or helping them organize workflow so that cases move along without delay or missed steps. Under-resourcing has to be addressed, but is hardly a reason to jettison CRPs as useless.

In 1980, presidential candidate Ronald Reagan famously asked voters, "Are you better off now than you were four years ago?" Similarly, patient advocates ought to ask, "Are patients better off with CRPs or without them?" To me, the answer is clear.

Anyone who has watched a loved one get wheeled into an OR knows the intense vulnerability that patients and families experience in receiving healthcare. When their worst fears are realized, they deserve to have their needs met. We know from research by Tom Gallagher and others that this means getting information about what happened, hearing providers accept responsibility for preventable harm, and knowing that steps will be taken to prevent another family from having the same experience. CRPs can create an environment of care in which we can realistically expect this to occur consistently. However loudly Doroshaw might demand it, without that environmental change, it won't.

February 19, 2014

Fighting Tragedies in Dutch Child Welfare with ICT

Bart Penders and Inge Lecluijze

In 2004, the Netherlands were shocked by the death of "Savanna." Just a toddler, she was beaten to death by her parents. An investigation afterwards revealed that there appeared to be several signs and reports of child abuse in this case; however, it seemed that nobody had acted on them.

Another similar catastrophe took place in 2006, when the "Maas girl" was found in pieces in the river Meuse (Maas in Dutch). A few years earlier, in 2000, the UK was confronted with the death of a little girl as well. The death of "Victoria Climbié" also paints a picture of child welfare as an institution that failed to respond to available signs and lacks multidisciplinary collaboration.[1] Early in 2013, the two Dutch brothers "Ruben" and "Julian" were killed by their father—prompting national mourning, but also questions about whether or not such tragedies may be prevented in the future.

The institution of child welfare as a whole was held responsible for not being able to respond accurately, and these and other tragedies prompted politicians to call for action. This resulted in the development and introduction of early warning ICT infrastructures in child welfare, the so-called *child indexes*, which aim at early detection of children at risk and an improved quality of care by stimulating collaboration between child welfare professionals.

While the initial response suggests sincere worry for the fate of children in the Netherlands, the ensuing implementation of the child indexes shows a radically different picture starring skewed stimuli, delayed, postponed and even dodged responsibilities, as well as controversial labeling practices of "children at risk." The ICT infrastructure was thought to be the solution to the tragedies plaguing the child welfare system.

We have been critically following the introduction of the child index for over 5 years now, monitoring its implementation in child welfare. While a detailed account of the research is well beyond the scope of this blog post, we can and will point out a few of the most salient effects of the ill-conceived implementation of the child index.

"Children at risk"

Is every child potentially a child at risk? Since the aim of the child index is to act as an infrastructure, housing each and every concern or risk signal any type of child welfare professional encounters, it would seem so. With legal structures in place enforcing the use of the Index by child welfare professionals, there seems no escape. However, forcing professionals to identify and diagnose risk, requires some consensus about the meaning of risk. Obviously, child abuse falls within these criteria, but what about being overweight or getting dismissed from school? Because of these difficulties, some organisations in Dutch child welfare have decided to enter every child they encounter into the child index. For the same reason, other professionals have decided not to use it at all.

Collaboration

The rules of the system prescribe that once a second risk signal is entered into the system, action is compulsory. Professionals should contact one another and start providing the required care collaboratively and decide who will coordinate the care process. That means that the first professional, who already determined that something is wrong, has to wait for another professional to share his or her concerns through the index. Without professionals entering signals into the system, it cannot create the "match" professionals are looking for. While the rhetoric of the system is directed at improving collaboration, in practice collaborative networks appear to be prerequisites for the system to be able to work in the first place, since professionals must coordinate their use of the Index.

Implementation

The child index implementation process is supported by all the right terminology: consultations, pilot projects, fine-tuning according to several steps and in various phases—all meticulously planned out in advance. However, the implementation jargon hides the fact that it is implemented top-down with little room for actual improvement as it disseminates into the care field. Embedded in the system is a distrust of professional expertise and autonomy and a redistribution of power from caregiver to child welfare manager, who monitors the number of risk signals professionals have entered from his office.

Justification

While the death of these children has offered a powerful momentum for Dutch politicians to implement this system, we cannot help but ask whether it was sufficiently justified to infringe on children's, parents' and child welfare professionals' lives this way. From the beginning the system was associated with unrealistic expectations, including total prevention of any future infanticides and "no child falling between two stools." It was forced upon child welfare in which smooth implementation plans were a rhetorical lubricant, considering that, for instance, parents and children were never consulted. Moreover, the opportunities to actually help children and families continuously decrease because of budget cuts and permanent reorganizations of child welfare.

Child welfare is an institution under pressure. Public trust in child welfare is heavily influenced by child deaths and the growing pressure upon the institution to provide risk-free lives for all of our children. The real tragedy is that in the pursuit of total risk-prevention, and in the pursuit of better and safer lives for Dutch children, child welfare professionals were stripped of their autonomy, every child is now a potential "child at risk," and collaboration between caregivers is obstructed by bureaucracy, all without a decent public justification.

Dutch child welfare is being corrupted not because of financial dependencies or external interests. In fact, (almost) everybody works hard and means well. It is a continuous and misplaced trust in ICT, technology and accountancy that gave birth to this tragedy.

About Inge Lecluijze

Inge holds a M.Sc. (2010) in Health Sciences Research from Maastricht University (the Netherlands). During this M.Sc. program she completed a research proposal to study the implementation of a novel ICT infrastructure in Dutch child welfare. She is currently conducting this research as a Ph.D. candidate at Maastricht University. Drawing on insights from Science and Technology Studies, Inge investigates how the implementation process of a novel ICT system in child welfare relates to the construction of "children at risk" and how such an innovation trajectory affects the relationships and trust between State, professionals, parents and children and the quality of care for youth. Inge is mainly doing research at the interface of technology, politics, science and professional practices. She is especially interested in the way ICT infrastructures are constructed, processes of implementation, and how new technologies affect professional practices, especially in the field of child welfare and public health.

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1. House of Commons Health Committee, "The Victoria Climbié Inquiry," Sixth Report of Session 2002-03, HC 570, June 25, 2003, and Nigel Parton, "'Every Child Matters': The Shift to Prevention whilst Strengthening Protection in Children's Services in England," Children and Youth Services Review 28.2 (2006): 976-992. The political response in the U.K. resembled that in the Netherlands, with the creation of a child index named "ContactPoint." The U.K. pulled the plug on the system since it caused more problems than it offered solutions.

February 24, 2014

Internal Compliance: Is it Really about Compliance?

Reuben Guttman

With the growth of multinationals whose business transcends geographic boundaries and whose revenue streams exceed the gross national product of some nations, legislators and regulators—at least in the United States—have looked to leverage the resources of whistleblowers to bolster compliance enforcement. Under the right circumstances whistleblowers can be an invaluable resource.

First, whistleblowers can surface information not readily available, or otherwise concealed from regulators. Second, in places like India and China they add eyes and ears with cultural and language sensitivity and skills that the enforcement agency itself may not have available, at least in these particular locales. Third, they can have technical or scientific skills in areas that will assist the enforcement agency. Fourth, they often come equipped with counsel who can spend the time translating lay complaints into cogent legal arguments.

The potential for whistleblowers to leverage global enforcement of securities, food and drug, and environmental laws, is significant. Bridging or lessening "the compliance gap," which has occurred because it is simply not feasible to hire enough regulators to exercise adult supervision over global enterprise, is a reality. If it is an exciting prospect for some, it is apparently not one for the United States Chamber of Commerce, which has other ideas. In recent months the Chamber and its members, or counsel representing its members, have campaigned for legislation giving deference to internal corporate compliance programs as their solution to bridging the compliance enforcement gap. This is the "trust us to watch ourselves strategy" which has worked so well in the past. Really? Remember Enron, Tyco, and WorldCom? They all had internal compliance programs, none of which prevented massive harm to shareholders or consumers. The same can be said of Glaxco-Smith-Kline, Abbot Labs, and three subsidiaries of Pfizer. Their internal compliance programs did not halt conduct which ultimately resulted in guilty pleas to criminal violations of the Food Drug and Cosmetics Act stemming from marketing derelictions that placed countless patients at risk for injury or illness. In each of these situations the wrongful conduct was pervasive, and where the conduct is pervasive internal compliance will simply not correct a wrong. How do you tell a corporate official, whose pay is tied to revenue, that a large portion of the corporate revenue stream may come from illegal marketing schemes or the distribution into commerce of defective products? Do the words "claw back" go over well?

Other than then the "trust us to watch ourselves" argument, large corporations love internal compliance programs for another reason. Indeed, they love them so much that they spend oodles of money on consultants and law firms to draft manuals and develop training programs. The idea is simple; if you cannot convince Congress to favor internal compliance over whistleblowers, then why not manipulate the psyche of the workforce to believe that there is no reason to suspect wrongdoing and thus blow the whistle? Ask an employee of a pharmaceutical giant whether their company markets drugs outside the FDA approved indication, and the employee will no doubt point to a company rule that precludes such conduct or a training program where employees were counseled about the evils of "off label marketing." Yet ask the same employee whether their company encourages sales representatives to compete their drugs against others that have different—or more expanded—FDA indications and the employee may say "of course."

With extensive training programs given by purportedly respected professionals or counsel, compliance manuals, and company rules, the goal is—perhaps oddly enough—not to actually prevent wrongdoing, but to convince potential witnesses to wrongdoing that what they see, hear or read, cannot be possibly be wrong. Employees who are paid well and have solid benefits and prospects for retirement have no incentive to rigorously question employer conduct, and internal compliance programs give them moral comfort that there is no need to do so. These programs suppress whistleblower complaints and witness cooperation with regulators. Think of the mine inspector who asks the miner about safety conditions in the mine. "Well," says the miner, "we have a safety program and an internal compliance officer that we can report problems to and the company posts signs that say safety first." Does the inspector drill down deeper and inquire about the age of the safety equipment or the specifics of the safety protocol, or does he pack up and go home?

There is nothing really new about this strategy. Over the years there have been variations of the "trust us to watch ourselves" strategy. Back in 1935, when Congress began to regulate the relationship between employers and employees seeking to engage in concerted protected activity, or unionization, it recognized that employers would respond to organizing efforts by creating their own company unions. These company unions created the illusion of employee power while suppressing true oversight. Within the context of Federal Labor Law, "the trust us to watch over ourselves" argument was not only rejected by Congress but it was made illegal under the National Labor Relations Act as company dominated unions were outlawed by the NLRA's Section 8(a)(2). In 1964, in a case known as NLRB v. Exchange Parts Co., the United States Supreme Court upheld a National Labor Relations Board ruling finding a violation of Federal Labor Law where the employer conferred benefits on employees shortly before a union election. Back then the Supreme Court understood that that the "trust us" strategy interfered with employee free choice.

Today, employers maintain that with hefty penalties under an array of statutes ranging from the Foreign Corrupt Practices Act to the False Claims Act and the Food Drug and Cosmetics Act, their call for self-oversight is sincere. Yet, while the optics of the penalties are high, when juxtaposed against the revenue secured through unlawful conduct, the penalties are in some cases no more than a fee for the license to break the law. In 2009, Pfizer paid $2.3 billion to resolve marketing derelictions that placed patients at risk. Yet the penalty was modest in comparison to the billions of dollars that the pharma giant made from unlawful sales.

Do companies "game the system" by calculating the cost of noncompliance and the likelihood that they will be caught? Undoubtedly they do. And for these culprits, internal compliance programs are a tool to further game the system by suppressing internal questioning of conduct that may indeed be questionable.

About the Author

Reuben Guttman heads the whistleblower practice and the Washington, D.C. office of the law firm of Grant & Eisenhofer. He has represented whistleblowers in cases against Abbott Labs, Pfizer, Amgen, and Glaxco-Smith-Kline, where his clients have participated in recoveries exceeding $ 5 billion. He is a Senior Fellow and Adjunct Professor at the Emory University Law School Center for Advocacy and Dispute Resolution, and the International Business Times has referred to him as one of the most prominent whistleblower lawyers in the world.

February 24, 2014

On Differing Understandings of "Corruption"

Matthew Stephenson, re-blogged from the Global Anti-Corruption Blog

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I'm sometimes asked how my work on anticorruption (and this blog) relates to the work of my Harvard Law School colleague Larry Lessig, who is the Director of Harvard University's Edmond J. Safra Center for Ethics (and who also has a widely-read blog). Under Larry's leadership, the Safra Center has been focused primarily on "institutional corruption," and Larry's 2011 book *Republic, Lost* likewise focuses on how money corrupts the U.S. Congress. So, what's the relationship between our two projects?

The short answer is that, although I respect and admire Larry's work, our corruption projects are about very different things. By itself that's not terribly interesting, and I wouldn't bother posting about it except that I think the differences in our projects highlight a longstanding difficulty about the term "corruption" and its use in social science and political advocacy. I don't want to belabor the issue—when academics run out of ideas, they argue about definitions—but maybe a few quick observations on this point are in order.

First of all, "corruption" implies deviation from some ideal state, and so defining corruption usually involves an implicit or explicit selection of a baseline standard of "correct" behavior. The three most common possibilities—none entirely satisfactory—are:

1. ***Law*** ("corruption" entails violation of specific legal prohibitions on, say, bribery, nepotism, embezzlement, etc.)

2. ***Public opinion*** ("corruption" involves acts, or patterns of behavior, that would be viewed by most citizens as wrongful abuses of power, whether or not they are illegal)

3. ***Public interest*** ("corruption" involves acts, or patterns of behavior, that contravene the public interest—whether or not the actions in question are illegal and/or the subject of widespread disapproval).

In a future post, I might go into greater detail on the strengths and weaknesses of these different approaches to defining corruption. (They all have problems.) For now, it's sufficient to note that they are potentially quite different from one another (though they may often overlap—certain types of bribery or theft of public resources are typically illegal, widely condemned, and contrary to the public interest). Larry's working definition of "institutional corruption" is very much a "public interest" definition:

"Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness."

Indeed, Larry has developed the category of "institutional corruption" precisely to differentiate it from "other more familiar forms of corruption" which are specifically excluded from his definition. (It's worth noting that he is not alone in advancing this sort of understanding of corruption; in recent work the anthropologist [Janine Wedel] has [advocated a similar "public interest" definition], though her definition is capacious enough also to include more traditional forms of illegal corruption.)

By contrast, this blog focuses on what we might think of as more traditional forms of corruption—bribery, embezzlement, extortion, nepotism, misappropriation of resources, etc.—which are usually either illegal or widely condemned, or both. I have no interest in insisting on a particular definition as the correct one, or in policing the boundaries of what we consider topical. It's more a matter of clarification.

Now, one might reasonably ask whether any of this is all that important. Corruption is a term, like many others, that has a range of different meanings. As long as those who use the term are sufficiently clear about what meaning they have in mind, why does it matter what gets labeled "corrupt"? That's more or less my view, but I do think there are two reasons it's important to take seriously these conflicts over the definition of corruption:

* *First*, people are not, in fact, always clear about what they mean by "corruption"—this is true, for example, of a number of widely-used corruption indices, which rely on asking experts or average citizens about their perception of the extent of "corruption," usually without defining the term (or using a vague, capacious definition).

* *Second*, in ordinary speech the word "corruption" is not just a descriptive term, but connotes moral condemnation. So there's a political aspect to what gets labeled "corruption," even if, for social scientific research, the word (if appropriately and clearly defined) can be treated as a neutral term of art. I think that's precisely the reason Larry invokes the concept of "institutional corruption" to describe a set of problems and issues (like the role of money in politics) that were already quite familiar. By relabeling certain acts or behavior patterns as "corrupt," he and his colleagues at the Safra Center are trying to influence public opinion (and the law). Likewise, scholars like Wedel have pointed out that by labeling certain forms of nefarious influence (those more prevalent in poor countries, like bribery) as "corruption," while treating other forms (those more prevalent in rich Western countries, like lobbying and campaign donations and shady influence networks) as outside the scope of "corruption," we may create a distorted perception of patterns of undesirable influence on government decisions.

Nonetheless, while we need to be mindful of those concerns, it seems to me that there's value in studying the causes and consequences of traditional forms of "corruption." Doing so is not meant to convey an inherent normative judgment. Whether "corruption" (according to the legal and/or public opinion definitions) is good or bad–and whether corruption, so defined, is better or worse than other questionable forms of influence over decision-makers (like lawful lobbying or campaign contributions or social ties)–are matters for research, not matters of definition.

February 24, 2014

Mr. Connaughton Goes to Washington: An Inside View of D.C.'s Institutional Corruption

Gregg Fields

Whether it's the gilded executive suites of Wall Street or Washington's lobbyist-lined K Street, it's all about the numbers—and that's the problem, according to Jeff Connaughton, an eyewitness, from several vantage points, of the interplay between capital and the Capitol

"It all adds up to dependency corruption, and that's bad," Connaughton said last Wednesday, February 19th, in a lecture sponsored by the Edmond J. Safra Center for Ethics.

The Edmond J. Safra Center for Ethics' mission is the study of institutional corruption, and dependency corruption is one of the leading species of the genus. Wall Street's dependence on market-friendly financial regulation, and Congress's counter-dependence on deep-pocketed donors from the banking sector, is a prime example.

Connaughton isn't the first to spot the cash-slick axis that connects Washington and Wall Street. But he has the benefit of having viewed it from a variety of insider perspectives. In 1987, he joined Joe Biden's presidential campaign in a fundraising capacity and later became a special assistant when Biden chaired the Senate Judiciary Committee. He would go on to work in the Clinton White House as well.

He was able to parlay government service into Washington's equivalent of a winning lottery ticket when he helped found Quinn Gillespie & Associates (now QGA) in 2000. Named for Jack Quinn, a Democratic political operative, and Ed Gillespie, a Republican strategist, it was among the earliest of the bipartisan super-lobbying firms that elevated the price of influence in Washington's corridors of power.

During those years, "the money rain went from a downpour to a deluge," Connaughton said. "I succumbed to the temptation to turn my umbrella upside down."

The sale of Quinn Gillespie left him rich, and he returned to politics, working for Biden. In 2009, Connaughton went to work for Ted Kaufman, who filled the Senate seat Biden vacated to become vice president. Kaufman declared he wouldn't seek the post, meaning he would only serve as a senator until 2010. He held to his promise, and Connaughton left D.C. behind, disillusioned and highly cynical about democracy's dysfunctions. That led to *The Payoff: Why Wall Street Always Wins*. The book, Connaughton noted ironically, actually cost him money once he factors in the costs of self-marketing it.

His conclusion: "Frankly banks own the place," Connaughton said, noting that he was channeling Sen. Dick Durbin, the Illinois Democrat. "All that's left is to try to change a corrupted system."

The Blob Mentality

Of course, manipulating government for private gains may very well be Washington's oldest profession. But Wall Street's money and power make it particularly potent at the process, Connaughton said. And it was especially relevant when he was working for Sen. Kaufman, as the nation reeled from a grave economic crisis.

Since Kaufman wasn't going to run for re-election, he didn't need to placate Wall Street in the name of campaign contributions. Among his endeavors was an effort, with Sen. Sherrod Brown of Ohio, to break up the so-called "too big to fail" banks.

But the dependency corruption alliances proved a formidable foe. "You take on the blob," Connaughton said. "The blob moves together. They dine and drink and take vacations together. You're up against a deeply ingrained culture."

The blob mob includes the regulators that, at least in theory, are there to serve the public, Connaughton said. That became critically clear during the crafting of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The Treasury and the Federal Reserve didn't "want the Senate to write any hard lines into the statute," he said.

Instead, Dodd-Frank came in at a hefty 2,100 pages that, somewhat surreally, was shockingly short on specifics. Instead, it called for more than 400 rules to be drafted by five regulatory bodies—a process that has fallen woefully behind schedule. The Brown-Kaufman amendment on "too big to fail" banks went down in flames.

Dodd-Frank "was a reshuffling of the regulatory deck," Connaughton said. "By throwing rule-writing back to agencies, Congress had played right into Wall Street's hands."

Too Big to Jail

Besides dependency corruption, Connaughton said the cozy relationships between government and finance are embodied in a second phenomenon common in institutional corruption: the revolving door syndrome. Regulatory agencies are staffed "by people in their early 30s," he said. "There's just this pervasive feeling that if you play ball you'll do well. The revolving door has become as big a problem as fundraising."

That helps explain the dearth of prosecutions related to the crisis, he said. "Whenever independent fact-finders look at the financial crisis, they find fraud," he said. The multiple multi-billion dollar civil settlements can't mask the fact that virtually no individuals have been held accountable. "This is checkbook justice," he said. "This is like making banks go through a tollbooth."

Goodbye to All That

Not surprisingly, not everyone in the District—Connaughton now lives in Savannah—feels fondly about his memoir. It was written, as he acknowledges, after he inverted his umbrella amid a money monsoon. Politico, the political website, called it an "angry tell-all," and said the book is “a reprise of the familiar cautionary tale” about an idealistic youth “who came to Washington to make a difference but went native.” (A lengthy New Yorker article was far more flattering, as was a Rolling Stone story.)

If the criticism has left him a bit bloodied, Connaughton nevertheless came across as unbowed in his determination to criticize institutional corruption, Washington-style. “We don’t have a two-party system,” he said. “We have an ongoing Wall Street contribution system.”

February 27, 2014

The Economics of Access to Information

Mariano Mosquera

There has been an important development in the study of the right of access to public information and the so-called economics of information: by combining these two premises, it is possible to outline an economics theory of access to public information.

Moral Hazard

The legal development of the right of access to public information has been remarkable. Many international conventions, laws and national regulations have been passed on this matter. In this regard, access to information has consolidated within the framework of international human rights law.

The Inter-American Court of Human Rights was the first international court to acknowledge that access to information is a human right that is part of the right to freedom of speech. The Court recognized this right in two parts, as the individual right of any person to search for information and as a positive obligation of the state to ensure the individual's right to receive the requested information.

This right and obligation can also be seen as the demand and supply of information. The so-called economics of information has focused on the issue of information asymmetry between the principal and the agent. The principal (society) and the agent (state) enter into a contract.[1] This contract is based on the idea that the agent's specialization and professionalism (or the politician's, according to Weber[2]) enables him to attend to the principal's affairs, such as public affairs in this case. This representation contract does not provide for a complete delegation,[3] but rather it involves the principal's commitment to monitoring the agent.

When we study corruption, it is important to note that monitoring aims to ensure that the agent adjusts its behavior to comply with the contract, in order to pursue public goals, and not to serve private interests. Stiglitz[4] describes moral hazard as a situation arising from information asymmetry between the principal and the agent. The principal takes a risk when acting without comprehensive information about the agent's actions. The moral hazard means that the handling of closed, privileged information by the agent could bring about negative consequences for the principal.

In this case, it is a risk related to corrupt practices, since a public official could use the state's power and information to achieve private benefits, and not to resolve public issues in accordance with the principal-agent contract. This creates negative social consequences.

In this model, there are a number of safeguards against moral hazard, such as monitoring institutions (with members of the opposition) and rewards for efficient and effective administration,[5] among others. Access to public information could also serve as an effective means of monitoring the agent, so that the agent adjusts its behavior to comply with the contract.

The Economic Principle of Public Information

According to this principal-agent model, public information should be defined as: information whose social interpretation enables the state to act in the best interests of society. This definition is based on the idea of information for monitoring purposes and uses a systematic approach to feedback. This definition also implies that the state is not entirely effective at adjusting its behavior by itself.

Technically, as an economic principle of public information, public information is: information whose interpretation by the principal is useful for the agent, so that the latter adjusts its behavior to comply with the principal-agent contract. It should be noted that this is very different from the legal definition of public information, such as "any information produced or held by the state." This type of legal definition is focused only on supply, but not on demand.

In this principal-agent model, public information stems from two different rationales: the principal's interpretation and the usefulness for the agent. The measure of the principal's interpretation is the likelihood of being useful for the agent. The measure of usefulness for the agent is the likelihood of adjusting the principal-agent contract.

Another totally different situation is the development of institutions that ensure the application of this principle. For example, the channels of supplied, and demanded, information, and the channels of feedback, could be strengthened so that the social interpretation that is useful for the state actually reaches the public authorities that are able to adjust policies.

Supply and Demand[6]

The state produces information for its own operation and for public purposes. However, for this information to form a supply of public information with an acceptable level of demand, the agent should not be the only entity to have such information.

The agent should also promote the principal's interpretation. Otherwise, the information available is for internal monitoring purposes or general internal use, but it is not public information with significant levels of social demand. Promoting the principal's interpretation is possible if the agent reduces the cost of access for the principal, lowering the cost of interpretation as well as the bureaucratic cost of information. This is a creative exercise, in which the agent should put himself in the principal's shoes when supplying information.

On the supply side, the main assumption is that the agent is aware of the usefulness of public information. Through feedback, public information (after being interpreted by the principal) enables the state to adjust its means and purposes more effectively. It is also assumed that information supply in the state is perfectly elastic. In other words, at a certain "price" of information, the state is able to supply infinite amounts, at least over the medium term. This is a monopoly situation in which the producer sets the price.

On the demand side, it is assumed that societies are able to interpret information within their own cultural frameworks. In this case, it must be considered that not all interpretations are valid, but only those that the agent can use to adjust its behavior to achieve social objectives. In other words, information demand cannot be used for private or market purposes.[7] Information demand needs to be tailored to the agent's usefulness, so that the latter adjusts its behavior to comply with the principal-agent contract. This is a creative exercise, in which the principal should put himself in the agent's shoes when demanding information.

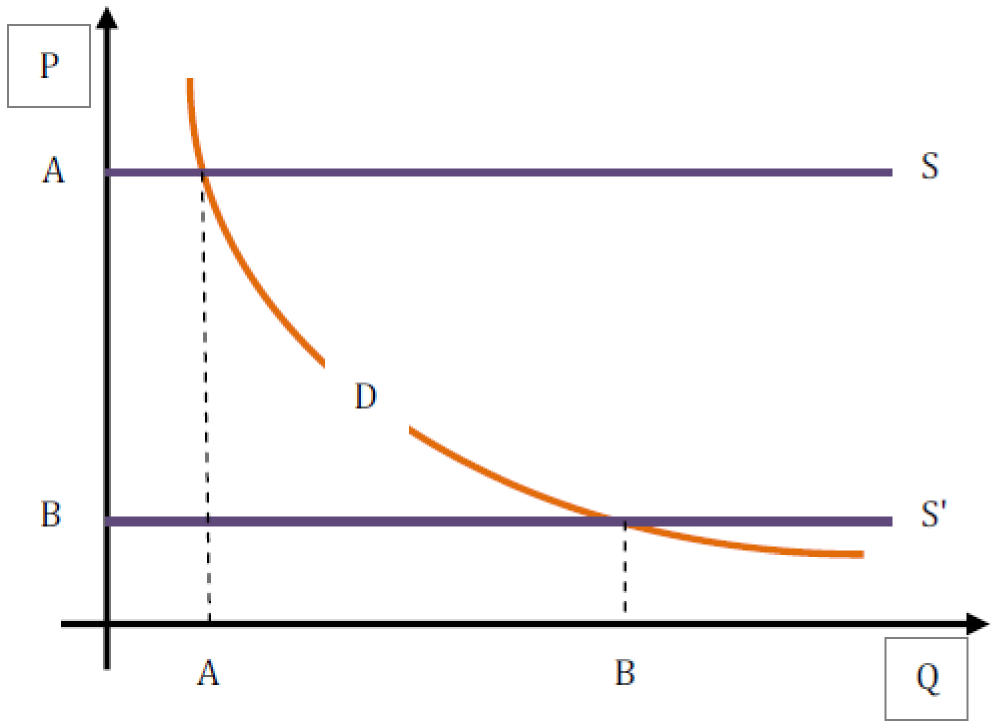
As a general rule, the lower the cost of access to information, the greater will be the demand. There is more demand at lower prices. It has been found that there is a need to appeal to an imaginative strategy that can be related to Harsanyi's equiprobability concept.[8] In this case, this concept indicates that it is equally likely to hold the positions of principal and agent.

This situation, clearly, is possible in democratic contexts. The possibility of exchanging roles between citizen and public official is real in a democracy. Therefore, this strategy enables us to consider the demand's interpretation on the supply side and the supplier's usefulness on the demand side. This strategy aims to solve the huge problems of an agent with closed handling of information and of a principal without interest in the operation of the state. It is understood that there is a principle of responsibility that arises from democratic order and equiprobability. The principal is responsible for knowing the minimum criteria for state operation, in order to monitor the state through the demand of public information. The agent is responsible for promoting civil monitoring through the supply of low-cost public information to the principal.

Price and Equilibrium

With a perfectly elastic information supply, the information price should be lowered (from PA to PB) to shift the supply curve (from S to S') and increase the demand "D" (from QA to QB). Price is important, since it is equal to the cost of access to public information for the principal.

The downward shift of a perfectly elastic information supply curve (in order to reduce the price) depends on two variables: the cost of interpretation (whether the information is "friendly" or not for the principal's interpretation) and the bureaucratic cost imposed to the principal. Friendly information is open information, without interpretation filters created by the agent, and with some sort of translation to promote its interpretation within the society's reference frameworks. The lower the interpretation and bureaucratic cost, the lower the cost of access to information for the principal will be. This increases the demand for information.



Say's Law

The variables that shift the supply (interpretation and bureaucratic cost) determine a lower price of information, which enables a higher level of demand. In other words, in a classical economics model, there is a direct relationship between the price and the production value determined by the supplier. However, it is also necessary to devise mechanisms to avoid Say's law in public information.

Say's law states that every supply creates its own demand. This has been the prevailing view on both active and passive access to public information. With regard to active information, the state decides what information is relevant and how it is published. However, with regard to passive information, the state uses various protections in order not to change its supply. Examples of this are provisions that do not explicitly make it mandatory for the state to produce the information that it does not have and which has been demanded from society.

The state also uses restrictive definitions of public information; for instance, when public information is defined as information that is related to administrative acts.
In this case, the state can refuse to provide information, claiming that information that is not related to a preexisting administrative act is not public information.

The situation today is that the supply determines the price, and weak demand does not force the state agent to lower the information price. In contrast, information supply and demand should be adjusted to the definition of an economic principle of information. Supply should be friendly with the demand.

On the other hand, if information demand is not correlated with a preexisting supply, the agent should examine the production of such information, provided that it is useful for the agent itself. In other words, demand can also create supply if the information is useful for the state to comply with its social objectives.

Certain institutional arrangements could lead the state itself to consider the production of information that it does not have.[9] There could also be legal processes available, so that those requesting information can appeal any refusals to produce public information that the state claims are not useful. In addition, the lack of public information demand should be a mandatory indicator that the supplier must lower its price, reducing the interpretation and bureaucratic cost of information. In other words, a system such as the present one, with supply but without demand due to high prices, should be avoided.

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1. Strictly from the point of view of contractual theories, it is a "pact" between the ruled and the rulers, as in the work of John Locke, and not a social contract. The term "contract" is used in order to respect the principal-agent model.

2. Max Weber, Politik als Beruf (Reclam, 1919).

3. Delegative democracy is the term O'Donnell uses to criticize the absence of social monitoring of the state. Guillermo O'Donnell, Contrapuntos: Ensayos Escogidos sobre Autoritarismo y Democratización (Paidós, 1997).

4. Richard J. Arnott and Joseph E. Stiglitz, "Moral Hazard and Optimal Commodity Taxation," Journal of Public Economics 29.1 (1986): 1-24.

5. Incentive may be based on rewards for public officials when government targets are achieved.

6. It is not possible to make a direct analogy of information supply and demand with active and passive public information. The supply also includes conditions for passive public information.

7. Laws usually limit the information demand in this same line.

8. John Harsanyi and Reinhard Selten, A General Theory of Equilibrium Selection in Games (MIT, 1988).

9. The regulations pertaining to the law of access to public information in the City of Córdoba (Argentina) introduced the idea of that a state could consider producing the information that it does not have.

February 27, 2014

Why American Think Tanks Are Becoming More Transparent

Brooke Williams, reblogged from Transparify

Think tanks in the United States have been under increasing scrutiny in the past few years, with reports of them shilling for corporate and foreign government donors and using cozy relationships with lobbyists and lawmakers to shape public policy—all without disclosing exactly who paid them how much to do it. But things are changing. Slowly.

Indeed, there is hope for transparency advocates or those who simply want to follow the money. Some of the most powerful think tanks in the country are reevaluating their policies and making decisions that could give people more access to details about who funds their work and why.

Executives at the Brookings Institution, one of the most influential think tanks in the world, have been meeting internally to try and be more transparent about donations from 19 foreign governments. This is in response to a letter the Lab @ Edmond J. Safra Center for Ethics at Harvard University sent to top U.S. think tanks asking for details about donations from corporations and foreign governments. Brookings currently lists the names of donors (unless they ask to remain anonymous) in its annual report, grouped by funding ranges.

Also in response to the letters, which I sent as a part of my project on think tanks for the Lab, the National Bureau of Economic Research decided to publish its corporate donors. James Poterba, the think tank's president, said they had to get approval from the companies first—which they eventually did for most. In July 2013, they published the list online, which shows more than a dozen companies have given between $10,000 and $25,000, including global giants such as ExxonMobil, Pfizer and General Motors.

Most think tanks were not eager to increase transparency. Most wouldn't consider it. Common reasons provided were donors' rights to privacy—one think tank attorney pointed to five Supreme Court rulings he said confirmed these rights—as well as the concern that other groups seeking charitable money would harass named contributors.

But in the end, it is almost certain the information will come out one way or another. Corporations often give through their nonprofit foundations, which must disclose contributions to think tanks in tax forms. As a part of my project for the Lab @ Edmond J. Safra Center for Ethics, I have built a database of these donations, which soon will be available to the public online.

Not long after journalist and former Lab fellow Ken Silverstein wrote about corporate donors to the Center for American Progress, and as its president John Podesta moved back to a position in the White House, the think tank decided to start disclosing the names on its own.

It's likely more think tanks will release donor names voluntarily, whether it's due to a revolving door with the government, questions from journalists or, perhaps, simple recognition of people's right to know how private interests are paying to shape public opinion and policies.

March 3, 2014

Tarnished Brass

Katherine Silz Carson

Is the recent rash of ethics scandals in the Department of Defense the latest example of institutional corruption?

Lately, the news has been full of headlines describing stories of ethical lapses among members of the United States military. Recent headlines include:

Records Cite Lavish Gifts in Navy Bribery Case

Nuclear Corps, Sidelined in Terror Fight, Produces a Culture of Cheating

Fraud in Army Recruiting Bonus Program May Cost Nearly $100 Million

Navy Opens Inquiry Into Cheating in Reactor Training

Although some in the Pentagon describe incidents such as these as a few people doing bad things, the pervasiveness of some of the scandals has led others to question whether there is a larger, systemic problem within the military, and prompted Secretary of Defense Chuck Hagel to appoint a senior officer for ethics who will report directly to the Secretary on these issues.

If the problem is systemic, then one ought to consider institutional corruption as a possible cause. Professor Lawrence Lessig, Director of the Edmond J. Safra Center for Ethics, defines institutional corruption as "influence, within an economy of influence, that weakens the effectiveness of the institution or weakens the public trust in the institution."

According to this definition, in order for institutional corruption to be present there must be an economy of influence. There are two obvious sources of economies of influence that are relevant to the Department of Defense. One is external, the other internal.

The sheer volume of funds that the Pentagon controls creates the opportunity for external economies of influence to develop. One need look no further than the list of people and organizations who cried foul at Secretary Hagel's recent proposal to cut the Army to pre-World War II levels to identify the potential players in a defense-related external economy of influence. Such economies are most likely to arise out of the Department of Defense's contracting and acquisition functions. Contracting involves the establishment of an agreement between the DoD and a private entity for the provision of services, such as those provided by Glenn Defense Marine Asia to the Navy's Pacific Fleet. Acquisition involves the purchase of weapons systems, such as the F-35 joint strike fighter. Economies of influence can arise from the repeated interactions between members of the private sector and Defense Department officials who are a part of negotiating complex contracts and purchases. This relationship between potential contractors and the Defense Department is not unlike the one that exists between the financial sector and its regulators in the Treasury, Fed, and other organizations. The revolving door between senior Pentagon officials and the defense industry is similar to the financial sector as well. The presence of former defense officials in senior positions in defense companies creates another avenue for economies of influence to develop.

Internally, the rigidness of the military personnel system may create an environment in which short-termism, as described by Harvard Business School Professor Emeritus Malcolm Salter (2013), contributes to institutional corruption. Military personnel change assignments every three or four years (sometimes even more frequently). This, combined with the "up-or-out" nature of the military promotion system, creates incentives for individuals to make a splash in a hurry so as to generate good performance reviews before they move on to their next assignment. In addition, the military may suffer from "noble cause corruption," exemplified after the 2008 financial crisis by Goldman Sachs CEO Lloyd Blankfein's claim that Goldman was "doing God's work." Such an attitude can lead members of organizations to conclude that they are special, and subject to a different set of rules. Some argue that fighting in a decade-plus war from which the majority of society has been isolated has created just such an attitude among military members. Ironically, the military has a term for organizations that become blind to their own faults in this way. They are called "self-licking ice cream cones."

The existence, or potential existence, of an economy of influence does not necessarily mean that institutional corruption is present. According to Lessig, that influence must either weaken the effectiveness of the institution and/or weaken the public's trust in the institution to qualify as institutional corruption. To what extent have these repeated ethical lapses undermined the effectiveness of the DoD, or weakened the public's trust in the organization?

Arguably, delays and cost overruns, as have occurred with the production of the F-35 joint strike fighter and procurement of the Air Force's new air refueling tanker, have reduced the effectiveness of the military. Although defense officials assured the public that the U.S. nuclear arsenal was safe in the wake of cheating scandals affecting both the Air Force's and Navy's nuclear forces, the potential consequences of reduced effectiveness of this component of our national defense are frightening. Reduced retention, particularly of our best young officers, may be another symptom of our military's reduced effectiveness.

What of the public's trust? The results of a 2013 Gallup survey indicate not only that the military is the institution that Americans trust the most, but also that it is the only one of the 16 institutions listed for which Americans' trust has increased consistently over the past two decades. Undoubtedly, the sacrifices made by many military members in the wake of the 9/11 attacks and subsequent wars in Afghanistan and Iraq have contributed to Americans' trust and respect not only for individual military members, but also for the institution as a whole. This idea has been reinforced by the Pentagon's PR machine, which in addition to flyovers and band performances includes financial sponsorship of numerous sporting events, such as Monster Energy AMA Supercross and NASCAR. Although of dubious value for recruiting, the omnipresence of the military at sporting events may contribute to the public's good will toward the institution. With the wars winding down and public events and sponsorships reduced in the name of fiscal austerity, will the recent rash of scandals diminish the public's trust in the institution?

If institutional corruption is the problem, what are the potential solutions? Former Under Secretary of Defense for Acquisition, Technology, and Logistics Jacques S. Gansler recently suggested ways to increase competition in defense acquisition programs. This approach, combined with blinding (Robertson 2013) in acquisition and contracting, could serve to constrain the effects of the external economy of influence. Another solution is constraints on the revolving door between the Pentagon and the defense industry—a solution that has been suggested for other realms of policy-making as well. The reality remains, though, that the economy of influence in defense spending extends far beyond the Department of Defense. It may not be possible to mitigate the effects of this influence in a meaningful way without addressing the role of Congress and campaign finance.

Internally, what can be done to curb short-termism and prevent a culture of "a military apart" from evolving? Economist and author Tim Kane, in his book *Bleeding Talent: How the U.S. Military Mismanages Great Leaders and Why It's Time for a Revolution*, proposes a radical set of reforms to the military personnel system. The reforms would move the military personnel system from what is essentially a command-and-control-based system to a more market-based system. The system Kane proposes would contain, among other things, more competition for jobs, and a more flexible promotion system. Those who demonstrate leadership potential would be rewarded with early opportunities for promotion and leadership that do not exist under the existing time-in-grade model. These changes could help to alter the mentality that some claim contributed to the cheating scandal among nuclear launch officers at Malmstrom Air Force Base in Montana. Kane also proposes allowing officers to move laterally in and out of the military, as military needs and market conditions permit. Although such a change could result in less of a divide between the military and the rest of society, it could exacerbate problems associated with the revolving door.

What if the problem is not institutional corruption, but rather the unethical acts of a problematic few? What can the military do to promote more ethical behavior among its organizations? A recent seminar at the Edmond J. Safra Center for Ethics by fellows Maryam Kouchaki, Elizabeth Doty, and Yuval Feldman, and Harvard Business School Professor Francesca Gino provides some evidence and advice on improving the ethical environment within organizations. Another avenue for exploration is the issue of toleration. In the recent cheating scandals in the Air Force and the Navy, numerous individuals in those organizations knew about the cheating, but did nothing about it. Research by Carrell, Malmstrom, and West (2008), among others, has shown that unethical behavior is less likely to occur in environments in which peers hold each other accountable. Creating ethical organizations in which peers hold each other to a high standard can not only curb incidences of individual unethical behavior, but also help to inoculate an organization from the effects of institutional corruption.

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Acknowledgements

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March 5, 2014

Transparency is Fine—Just Not for Us

Jim Morris

Last November, the U.S. Occupational Safety and Health Administration unveiled a proposal to improve tracking of work-related injuries and illnesses by having larger employers electronically submit incident data more often than is currently required. It also announced plans to post the data online at some point.

The latter, in particular, drew a predictably sour reaction from the business community, which has spent the past 40-plus years vilifying OSHA as a regulatory bully (never mind that the agency is perpetually short-staffed and under-funded). OSHA has received nearly 1,000 public comments on the proposal during the past four months; the comment period closes March 10.

A sampling of what's come in so far:

• *"Making this data readily available may be easily misinterpreted. This may allow for trolling of [the OSHA] site by lawyers; privacy of our employees is a concern as well."*

• *"It appears that in an attempt to motivate employers to improve health and safety, and under the guise of transparency, that OSHA is attempting to shame employers as a means to improve workplace safety . . . [S]ome employers may not report or may underreport injuries if they know that there may be an increased risk of an inspection."*

• *"Sometimes some things just do not need to be changed. This is one of those times."*

This isn't to say that everyone opposes the idea of quarterly, rather than annual, submission of injury and illness numbers by companies with 250 or more workers.

"OSHA's proposal would improve workplace safety and health through the collection of useful, accessible, establishment-specific injury and illness data," Public Citizen said in a January press release. "At present, OSHA does not electronically receive an establishment's injury and illness data log. This void forces the agency to rely on data that is more than a year old when attempting to respond to hazardous workplace conditions."

Still, OSHA faces an uphill battle, as it does with virtually every rule it proffers. That became abundantly clear at a hearing last month before the House Subcommittee on Workforce Protections. Chairman Tim Walberg, a Michigan Republican, opened the hearing with several examples of what he called "executive overreach" by the agency. Next up: A parade of longtime OSHA-bashers, notably representatives of the U.S. Chamber of Commerce and the National Association of Manufacturers, who voiced all manner of grievances.

The agency's lone advocate at the hearing was lawyer Randy Rabinowitz, who observed that the "rulemaking process is now saddled by so many procedural requirements that OSHA is incapable of issuing standards to protect workers in a timely manner." Hence the need for creative approaches—using the catchall "general duty clause" of the Occupational Safety and

Health Act rather than hopelessly outdated chemical exposure limits to protect workers from toxic substances, for example.

In a statement for the record sent to the subcommittee after the hearing, OSHA chief David Michaels wrote that the agency "has a robust rulemaking process that allows for and encourages extensive stakeholder involvement through public comment periods and public hearings."

Desperate times, however, require desperate measures. That's why OSHA chose last year to supplement the web page listing permissible exposure limits (PELs) with more protective numbers recommended by the National Institute for Occupational Safety and Health or mandated by the state of California.

"There is broad consensus within the Nation's health and safety community that many of OSHA's PELs are based on half-century-old science, and provide inadequate protection for today's workers," Michaels wrote. His implicit message to Congress and industry: The regulatory system is so jammed up that workarounds are necessary.

March 20, 2014

New IRS Rules Could Gut Think Tanks

Brooke Williams

Two blocks from the White House, a think tank, a Super PAC and a 501(c)(4) outside spending group share the fifth floor suite of an office building. A powerful trio, indeed. But new rules the Obama administration proposed could be a real buzz kill to their operation.

The rules specifically seek to rein in 501(c)(4) nonprofit groups, which are organized under a section of the law meant for "social welfare" but have become increasingly popular vehicles for influencing elections without disclosure. Perhaps most well known for this "dark money" spending is the Koch-backed Americans for Prosperity, which has spent tens of millions of dollars in federal elections without disclosing donors.

But the rules stand to change how myriad nonprofits operate, including think tanks.

Upon publication of the proposed rules in November, the Treasury asked for comments and guidance on the extent to which they also could be applied to 501(c)(3) "charitable" groups—the tax status of most think tanks. Widespread criticism ensued from an array of groups across political and ideological spectrums. Many said the rules would stifle civic engagement, create even more corruption or simply prompt donors who want anonymity to find other vehicles.

Reminiscent of the letter blitz surrounding the Volcker Rule, a key part of Wall Street reform efforts, the Treasury has received an unprecedented 146,037 public comments on the proposal. That's an average of about 1,600 a day.

At least five think tanks and their 501(c)(4) affiliates commented on the rule, including the Bipartisan Policy Center, American Action Forum, Center for Security Policy, Competitive Enterprise Institute and Heritage Action for America.

The Rockefeller Brothers Fund, an international philanthropic organization that gives to a variety of nonprofits, including think tanks, said that while it supports the intent, the rule "does little to address the corrupting influence of money in politics."

It is concerned about the scope of what would constitute political activity and "the impact the proposed rule could have on groups such as our grantees, and more generally, on democratic practice in the United States."

Like other commenters who supported the intent but took issue with specifics, the Rockefeller Fund urged the Treasury to develop "a single, clear definition of political activity that can apply to all tax exempt categories (and all tax categories where possible) so that donors and others do not game the system."

So how could the rules change the way think tanks behave?

Significantly, it could prohibit them from mentioning candidates on their websites or other public forums during election seasons. It's not hard to imagine how this would make it difficult to publish papers seeking to influence public policy and discourse.

The rules also would prohibit them from inviting officeholders to parties, meetings and other events during election season. This could cut a key part of many think tank's donor privilege programs, which give corporations, foreign governments and others access to lawmakers in exchange for certain sums of money

Another change could involve a think tank's ability to recommend people for federal office.

The Competitive Enterprise Institute, a free-market public policy organization, wrote in opposition to the rule, saying among other things that groups including "think-tanks, commonly propose qualified people with specialized expertise, sometimes even their own staff, for positions that require such expertise, in fields such as international trade regulation."

Another letter, which the presidents of the Bipartisan Policy Center and American Action Forum co-signed, said the rules would create a sea change with "disastrous consequences" and turn "the historically tax-favored activity of think tanks into a minefield."

They also pointed to how the rule would prohibit mentioning candidates within 30 days before a general election and 60 before a primary election, among other things.

"Rather than treating any and every policy discussion as a potential attempt to influence elections or legislation, the law has quite consciously been shaped to ensure that the restrictions on lobbying and political campaign intervention do not unduly infringe on this traditional area of charitable and educational activity," they stated.

They also said the rules would be a burden to think tanks who have 501(c)(3)s and 501(c)(4)s operating in tandem, often sharing office space, staff and other resources. But they didn't disclose the fact that their own groups fall into this category.

Rather they said, the think tanks submitting this letter "may receive contributions from 501(c)(4) organizations to help sponsor conferences or fund policy work on issues of common concern."

Nor did they mention that the American Action Forum has a 501(c)(4) arm that has spent more than $31 million on federal campaigns since the 2010 election cycle without disclosing donors, according to data available from the Center for Responsive Politics.

The 501(c)(4) arm, the American Action Network, also contributes to the think tank, accounting for $1.5 million out of $4.8 million it received in fiscal 2012.

The American Action Network also shares an office and a president with the Congressional Leadership Fund, a Super PAC that spent $9.4 million in the 2012 election cycle opposing Democratic candidates. (As the Sunlight Foundation noted the return on investment in 2012 was around 60 percent for both groups.)

As a Super PAC, the Congressional Leadership Fund is required to disclose donors. However, one of them is its office-mate, the American Action Network, meaning the original source of that money remains anonymous. (American Crossroads/Crossroads GPS, a 501(c)(4) and Super PAC duo linked to Karl Rove, also has been known to share an office with the group.)

So what is next?

The Treasury must continue wading through hundreds of thousands of comments—many of them form letters or statements totally unrelated to the issue at hand (or any issue, for that matter).

There also have been lawsuits and congressional hearings. An internal audit last year found the IRS had improperly targeted tea party and conservative groups using key words to scrutinize them specifically.

On February 5th, IRS Commissioner John Koskinen was called to testify about the proposed rules before the House Means and Ways subcommittee on Oversight.

Republican Congressman Dave Camp of Michigan, who chairs the committee, introduced a bill in January to block rules. In the two hour hearing, Republican members pressed him to explain why the IRS proposed the rules and demanded correspondence leading up to that decision. They were concerned the rules would affect this year's midterm elections and were intended to do so.

Koskinen said the rules wouldn't be finalized in the near future.

April 1, 2014

Margin, Mission, Morals and Moniker in Big Pharma: An Industry Perspective

Jennifer E. Miller

Jennifer E. Miller, of the Edmond J. Safra Center for Ethics of Harvard, chats with Kevin Brewer of Astellas Pharma about the mission, ethics and reputational challenges of pharmaceutical companies. They conclude by discussing reform strategies.

Jennifer: What are the key bioethical challenges that arise at Astellas Pharma and which ones do you feel are most pressing to address?

Kevin: I think of the bioethical challenges that arise at Astellas as Corporate Social Responsibility (CSR) issues, which can be thought of in terms of the economy, employees, environment, compliance and society. Broken down, it looks like this:

Economy: does Astellas have ethical business practices ranging from the execution of clinical trials all the way to the promotional/marketing practices of an approved product?

Employees: are employees treated in an ethical manner and provided a work platform in which they can perform and have opportunity for personal growth?

Environment: this may be less of a bioethical challenge, but an important challenge nonetheless; do company initiatives reduce or increase environmental burden?

Compliance: do we uphold business/personal integrity and adhere to all laws and ethical practices during all business activity?

Society: for me, this is the most important issue with Economy and Compliance—does Astellas contribute to society and the health of the global community?

As far as these core components of CSR are concerned, Astellas excels in the first 4 arenas. We have room for growth in the Society sector. And I think every company does. It's important to consider two factors: medicine as a commodity and corporate mission statements. It is my firm belief that medicine is beyond a simple commodity—it is a product essential to saving lives. Thus, it must not be thought of in simple free-market terms, that is, a priced good based on supply/demand. This, coupled with the fact that EVERY pharmaceutical firm states within their mission statement to some extent that it is their goal to provide for the health of humanity, makes it a moral obligation for the pharma firms to provide, within reason, access to medicine for those that cannot afford it. Clearly, a company does not have the resources or capability to give free medicine to all those who need it, but when a company provides access to segments of impoverished people they are staying more consistent with their mission statements and some would argue are making it possible for these people to one day be able to pay for medicine.

Jennifer: Are these the same issues that other drug companies face, and industry as a whole?

Kevin: The issues Astellas faces are the same the whole industry faces. Although the pharmaceutical industry, on balance, delivers huge benefit to humanity relative to the negative aspects (ranging from unethical marketing practices to irrational pricing structures), the general public doesn't know or believe this. The pharmaceutical industry is thought of in the same terms as Big Oil, Big Tobacco, and Wall Street. The onus is on the industry to not only clean up its act, but to not allow the media to dictate negative terms in order to gain eyeballs for their stories. The industry needs to be proactive and let the public know about all the good done. Many do not know that the pharmaceutical industry gives out more free medicine than all the global NGOs and governments combined.

Jennifer: Are these industry challenges the same ethics issues the public thinks you are dealing with and should reform? If public perception differs from industry realities, do you have an idea as to what the public thinks you deal with and why their perception may be wrong?

Kevin: Public perception, regulation, pricing and marketing are 4 issues the industry needs to address. Pricing and marketing are big public concerns as well. And they are all very interrelated. Because of pricing and marketing practices, negative public perception has been the impetus for increased oversight and regulation. The industry needs to take a close look at pricing and marketing. Because overall mission statements dictate that it is the goal of pharma firms to provide "health for humanity," there is a moral obligation to provide access to more than just paying customers.

I'm fine with a company having a 400% markup on medicine if in their statement they say their goal is to provide shareholder return and working capital for the future. But to be consistent and genuine to mission statements that declare their duty is to stakeholders, not simply shareholders, a firm must provide reasonable *tiered pricing* programs for impoverished areas or make an effort to donate products to areas in dire need. It's not rational or possible for the pharmaceutical industry to provide access to medicine for all those that need it. But it is possible to do a much better job in developing drugs for neglected tropical diseases (NTDs) or working with NGOs and governments to help provide access to more medicine for those in need.

From a marketing standpoint, there needs to be zero tolerance for unethical marketing practices. And I think this has evolved. It is only the short-sighted executive who would green light promotion of a drug in non-indicated areas. It just does not make business sense. The large pecuniary fines and negative impact on brand equity make it an irrational move. So regulation has worked.

Yet, I believe, as an industry, we have allowed media to highlight all the negative issues around the industry. This is ludicrous, for I have met hundreds of pharmaceutical executives and employees that care about humanity and want to make a difference. And I'd wager that from a positive global impact standpoint, we do as much or more for public health than any other industry. It's about ensuring ethical business practices moving forward at all costs. The pharma industry is about health—we should not be thought of in the same terms as the tobacco industry.

Jennifer: Does this negative reputation and distrust affect the industry and individual companies' ability to do business? If so, how?

Kevin: The pharma industry, really because of its own doing, has developed a bad reputation amongst the public. If you are executing unethical clinical trials on poor people, marketing products in non-indicated areas, or charging exorbitant prices for me-too drugs, an industry will pay a large reputation price. This drives increased scrutiny and regulation and accelerates the cost of doing business. If one has no moral fiber within, and is simply a numbers driven business executive bent on margins, you still need to do the math. It makes zero business sense to have these short-term strategies. The public is my concern here, but look at what the industry has done to itself. The long-term costs far outweigh any billion dollar streak a firm may have had by adhering to unethical business practices.

Jennifer: Is there is a way to reform the industry's reputation and any genuine ethics problems?

Kevin: There is a way for the pharma industry to heal its reputation. First and foremost all unethical business practices and executives who drive this type of archaic thinking must be excised. Then the industry needs to address more rational pricing and access issues. Also, work together, as Astellas is with other companies to develop drugs for NTDs [Neglected Tropical Diseases] or other diseases that may not drive profit but are part of the "healing humanity" equation. These are difficult steps but I am seeing it happen.

The industry also needs to utilize an agreed upon ethical platform, such as Bioethics International's [rating system] or the Access to Medicine Index, in order to monitor and gauge their bioethical footprint relative to their competition. And then get this information to the public in order for people to comprehend that the industry is about all stakeholders, not just their shareholders.

April 2, 2014

Regulating Campaign Finance

Chandu Krishnan[1]

The United States Supreme Court's April 2nd decision in *McCutcheon v. Federal Election Commission* to remove aggregate caps on federal campaign contributions will hurt rather than strengthen American democracy.[2]

The Court decision "will open a floodgate"[3] that threatens to drown the U.S. political system with big money at a time when U.S. politics needs more ideals and less money. It will accelerate the country's transformation into a plutocracy where a wealthy minority has undue influence over who governs the U.S. and how the country is governed.

As a New York Times editorial pointed out last year, "the very wealthiest Americans already have disproportionate influence: in the 2012 election, 1,219 donors reached or nearly reached the overall limit, and together they were responsible for giving $155 million to federal races . . . without the overall limit in place, those donors would have contributed nearly triple that amount—or 50 percent more than President Obama and Mitt Romney received from all small donors combined."[4] Such statistics are particularly disturbing because, as Clayton Peoples points out, "the research literature in fact shows quite conclusively that contributions do influence policy."[5]

Chief Justice John G. Roberts, Jr. was correct in writing in the Supreme Court's controlling opinion that "there is no right in our democracy more basic than the right to participate in electing our political leaders."[6] But that "right" should be exercised across a level playing field, which is why Congress capped aggregate contributions many years ago. Exacerbating the damage already caused by the Court's *Citizens United* decision in 2010, which allowed companies the right to make unlimited campaign expenditures independently, five U.S. Chief Justices have now ensured that the playing field will be even more skewed in favor of those who have more money. In seeking to protect the freedom of speech afforded to U.S. citizens by the First Amendment, these Chief Justices are, perversely, undermining it by allowing a minority of citizens to have even more influence over the electoral process, thus increasing its vulnerability to corrupt practices.

The U.S. is not alone in grappling with the problems of corruption in campaign financing. Nor is it unique in turning into a plutocracy. In Transparency International's 2013 Global Corruption Barometer, it is was one of 51 countries (out of the 107 that were surveyed) where respondents saw political parties as being the most affected by corruption relative to 11 other institutions.[7] Although the Barometer did not shed any light on why respondents held such views, it is arguable that a major reason for the poor reputation of political parties (and politicians, by inference) was the prevalence or risk of corruption in funding these organisations and election campaigns.

When it comes to key campaign finance regulations, the U.S. is one of the relatively better performers among this group of 51 countries. It caps donations to both parties and candidates (at levels that are lower than in several other countries). It bans direct corporate donations to parties and candidates. It outlaws donations by government contractors to parties and candidates, and requires statutory public disclosure of party finances. Unfortunately, the *Citizens United* ruling has had the effect of undermining the caps on donations to parties and candidates by allowing unlimited expenditure by third parties (as long as this is not coordinated with parties and candidates). And the latest Court decision drives a coach and horses through this already weakened barrier against the corrupting influence of big money.

Interesting debates are taking place in other countries (such as the U.K.) on how to curb the influence of big money in politics, and it would be tragic if this most recent Supreme Court decision is cited as justification for weakening, or not introducing (the U.K. has no caps on donations), measures to limit political financing from private sources.

Of course, regulatory measures, such as caps on donations, are not a panacea for eliminating corruption in campaign finance. Imperfections can be found even in countries that tick all the right boxes in terms of regulatory practice. However, effective and properly enforced regulations are better than no regulations, and the U.S. and other democracies may be in a better position to lower corruption risks in political party funding by having:

* effective regulations (with no loopholes) that encompass: caps on donations and expenditure (by parties, candidates and third parties); prohibitions or limits on corporate and anonymous donations; full public disclosure of the finances of parties and candidates, including listing of all donors; and a degree of public funding acceptable to citizens after public campaigns have increased awareness of the corruption risks associated with large amounts of private financing of political activity;

* robust systems for monitoring and enforcing regulations with strong sanctions for offences; and

* a regulatory system that is underpinned by a strong and stable political culture.

The U.S. (and others) cannot afford to disregard or be complacent about corruption in politics. It is much harder to reform systems in which corrupt practices have become deeply embedded and rebuild public trust and confidence in democratic institutions. The Supreme Court's decision will help corruption to grow in the U.S. political system. A Gallup poll conducted in June 2013 found that 8 in ten Americans, if given the opportunity, would vote to limit the amount of money candidates for the Senate and the House of Representatives could raise and spend on their election campaigns.[8] The country may pay a high price for the Supreme Court's disregard of public opinion.

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1. This blog draws upon a forthcoming working paper by the author on "Tackling Corruption in Political Party Financing: Lessons from Global Regulatory Practices."

2. The Court's decision removes the current cap of US$123,200 on the aggregate contributions an individual may make directly to federal candidates, party committee and political action committees in each two-year election cycle. However, it leaves intact the current cap of $2,600 on individual donations to candidates.

3. Justice Stephen G. Breyer, quoted by Adam Liptak in "Supreme Court Strikes Down Aggregate Limits on Federal Campaign Contributions," New York Times, April 2, 2014.

4. Editorial Board, "Politicians for Sale," New York Times, October 7, 2013.

5. Clayton D. Peoples, "Yes, Contributions Really Matter," Edmond J. Safra Research Lab blog post, February 10, 2014.

6. Quoted in Liptak, "Supreme Court Strikes Down Aggregate Limits on Federal Campaign Contributions."

7. Transparency International, "Corruption Barometer Index 2013," July 19, 2013. The Barometer used public opinion polls to survey perceptions and experiences of corruption among 114,000 people. The other 11 institutions were: police, public officials/civil servants, parliament/legislature, judiciary, business/private sector, medical/health services, education, media, military, NGOs and religious bodies.

8. Megan Thee-Brennan, "Polls Show Broad Support for Campaign Spending Caps," New York Times, April 2, 2014.

April 14, 2014

The Breakthrough Institute's Inconvenient History with Al Gore

Paul D. Thacker

While sometimes functioning as shadow universities, think tanks have been exposed as quasi lobbying organizations, with little funding transparency. Recent research has also pointed out that think tanks suffer from a lack of intellectual rigor. A case in point is the Breatkthrough Institute run by Ted Nordhaus and Michael Shellenberger, which describes itself as a "progressive think tank."

If you've been following recent news on climate change, then you must have witnessed the recent meltdown happening over at the Breakthrough Institute. In a March 19 post at Nate Silver's new FiveThirtyEight journalism site, Breakthrough Institute Senior Fellow Roger Pielke wrote a piece titled "Disasters Cost More than Ever—But Not Because of Climate Change." The article was highly criticized for cherry picking information on climate change impacts, with Slate labeling it an "Unnatural Disaster" and an embarrassment to Silver's new venture.

Responding to the outcry, Silver commissioned a counter piece written by Kerry Emanuel "MIT Climate Scientist Responds on Disaster Costs And Climate Change," an article that essentially debunked Pielke's original storyline on hurricanes and climate change. Since that catastrophe, the Breakthrough Institute has ramped up their PR, doing everything they can to protect their Senior Fellow through twitter and claims that he is highly cited in the scientific literature.

The Breakthrough Institute has a clear history as a contrarian outlet for information on climate change and regularly criticizes environmental groups. One writer describes them as a "program for hippie-punching your way to fame and fortune." So it was not shocking to see their column last Wednesday in the *New York Times* criticizing a new documentary on climate change that was put together by award-winning journalists. In their article, Ted Nordhaus and Michael Shellenberger state that the documentary will raise public skepticism about climate change because it uses scare tactics.

To buttress their claims, the duo cite Al Gore, and his 2006 documentary on climate change "An Inconvenient Truth." According to Nordhaus and Shellenberger, Gore's documentary "contributed to public backlash and division" on climate change. When this op-ed was refuted by one of the documentary's expert advisors, the duo doubled down on the claim, citing multiple lines of research, including studies by professors Aaron McCright of Michigan State University and Robert Brulle of Drexel.

"Shellenberger and Nordhaus are definitely missing what I argue in my paper," Brulle wrote in an email. "As far as I can see, there is ZERO empirical evidence that supports [their] hypothesis." Apparently, he says, the *New York Times* does not fact check op-eds.

Professor McCright was also dismissive of Nordhaus and Shellenberger. No reputable researcher would make the claim that Al Gore contributed to partisanship on climate change, he says. "We simply have insufficient data," he adds. Instead, he points to disinformation put out by organized climate denialists as a more likely explanation.

For Nordhaus and Shellenberger, Gore and his documentary are a favorite talking point and topic for bashing. In fact, it's hard to find anything they haven't written that doesn't contain some reference to this documentary and the former Vice President. This personal obsession has sent the two running in circles, and tying themselves in contradictory knots—at times claiming Gore has increased partisan divisions on climate change, at other times claiming that his documentary was irrelevant.

For instance, the two again charged Gore with inciting partisan divisiveness back in February 2011, on the Breakthrough's website:

Gore famously claimed, "the truth about the climate crisis is an inconvenient one that means we are going to have to change the way we live our lives." Those apparent calls for sacrifice by Gore and other green leaders **drove rising partisan polarization.** [emphasis added]

However, Nordhaus and Shellenberger had a decidedly different take on Gore's effect on Americans in 2009. Writing for Yale's Environment 360, the two then wrote that Gore's "Inconvenient Truth" had been a pointless exercise and had no effect at changing public opinion:

Three years after it seemed that "An Inconvenient Truth" had changed everything, **it turns out that it didn't.** The current Pew survey is the latest in a series of studies suggesting that Al Gore probably had a good deal more effect upon elite opinion than public opinion.

Public opinion about global warming, it turns out, has been remarkably stable for the better part of two decades, despite the recent decline in expressed public confidence in climate science. [emphasis added]

Yet a few months prior, while writing for the *New Republic*, the Breakthrough team was singing a different tune about Gore:

Recall that the inconvenient truth for which Gore named his movie was "that we have to change the way we live our lives"—and nobody could have the impression, after watching the movie, that it would be for the better. No new technology could save us—we would have to live differently. **The public got the message.** Of the 67 percent of voters who told the Pew Research Center for the People and the Press in 2006 that it is possible to reduce the effects of global warming, nearly twice as many said it would require major sacrifices than said it could be done with technology. [emphasis added]

But while writing for the *Los Angeles Times* in 2008, the two were stuck recounting that the movie had no impact:

Democrats and greens ended up in this predicament because they believed their own press clippings—or, perhaps more accurately, Al Gore's. **After the release of the documentary film and book "An Inconvenient Truth," greens convinced themselves that U.S. public opinion on climate change had shifted dramatically, despite having no empirical evidence that was the case.** In fact, public concern about global warming was about the same before the movie—65% told a Gallup poll in 2007 that global warming was a somewhat or very important concern in comparison to 63% in 1989. Global warming remains a low-priority issue, hovering near the bottom of the Pew Center for People and the Press' top 20 priorities**.** [emphasis added]

It's hard to understand exactly what Nordhaus and Shellenberger are trying to say about Al Gore and the documentary "An Inconvenient Truth." Apparently, it increased "public backlash and division" and "drove rising partisan polarization" during a time that the public opinion on climate change "has been remarkably stable for the better part of two decades" except that "the public got the message" but "greens convinced themselves that U.S. public opinion on climate change had shifted dramatically, despite having no empirical evidence that was the case."

Got that?

A recent working paper by two Harvard Law students finds that Al Gore and his documentary remain a favorite target of climate skeptics, and that the matter is one of many themes that comprise the "contrarian corpus" of climate skepticism. But why a think tank that seeks to advance solutions to climate change engages in such shoddy scholarship and a campaign of disinformation remains unclear.

April 16, 2014

General Motors and the Road Ahead

Jonathan H. Marks

Moral outrage. Muted apology. Multiple investigations. This is what we heard when Mary Barra, the CEO of General Motors, testified before House and Senate committees earlier this month about the company's failure to address faulty ignition switches in millions of Cobalts and other vehicles for close to a decade.

It is a predictable pattern in response to institutional failures—or moral meltdowns, as some call them. It is certainly familiar to me, as a faculty member at Penn State, a university still recovering from its own meltdown, the Sandusky crisis.

Although there is much we don't know, it is clear that GM employees had long been aware there was problem. But a number of ill-advised decisions followed.

First, GM decided not to replace the defective part with a switch that met the company's specifications. It did so because the cost, less than a dollar per unit, would not have been offset by the projected savings.[1] This decision had obvious safety implications, not to mention ethical dimensions. But it was treated as a simple business decision, one made with short-term profitability in mind.

In the longer-term, of course, this decision—and the ensuing decade's delay in the recall of now more than 2.6 million vehicles—has proven extremely costly.

The company also worked hard to conceal its tracks. When the defective ignition switch was replaced, an employee tried to mask the substitution by retaining the same part number. When GM was sued following a number of fatal accidents, the company's lawyers made confidential settlements with the plaintiffs, thereby keeping vital information about a potential health hazard out of the public domain.

It is not hard to anticipate what happens next. Various investigations will identify a small handful of individuals as the culprits. These employees will lose their jobs. Prosecutions and more civil law suits are likely to follow.

GM's lawyers will argue that the company is not liable for accidents occurring prior to its bankruptcy in 2009. This contention will be disputed. But the company will settle the claims it considers most damaging, commercially and politically. The services of Ken Feinberg will come in handy here. But, most of all, GM will rely on Mr. Feinberg's reputation as impartial administrator of the 9/11 compensation fund.

There will be talk about a new institutional culture at GM. A public relations campaign will begin, and the company will rebrand itself in an effort to restore confidence in GM and its products—and to stave off increased regulation.

Congress is likely to feel some pressure to respond. But car manufacturers will lobby hard to take the teeth out of prospective reforms. GM spent more than $8.8 million last year on lobbying alone. And many members of Congress—including those currently investigating GM—have received money from GM's PAC.[2]

In time, we will move on, and forget about the scandal, just as most of us have forgotten about the Ford Pinto. This debacle from the 1970s survives only as a business ethics case study taught by professors like me. There too, the company failed to address a life-threatening defect—a fuel tank that ruptured during low-speed rear-end collisions. Executives figured it was cheaper to pay damages when people were killed or injured than to spend $11 per car to fix the problem.

There was moral outrage then too. A jury awarded more than $125 million dollars in punitive damages, but this was reduced substantially on appeal.

If we want to try to prevent these kinds of moral meltdowns, we must be careful not to embrace "patches" or symbolic measures that appear to address yesterday's crisis. Companies need to take serious steps to address structural incentives and institutional cultures that promote the kind of decision-making that occurred in GM—and that is almost certainly occurring, as I write this, in many other companies.

Too often we are told that regulation stifles innovation. We should be more skeptical of such claims. Who is making them, and why? Effective regulation can and should play an essential role in protecting the public from defective products.

And there is work that state lawmakers and their staffers should begin immediately. Some states have laws or rules of procedure that prevent courts from approving confidential settlements where hazards to public health and safety are involved. But many states do not. Litigation may not be the most effective means of addressing public health hazards. But it can be a powerful way of highlighting that the systems employed by both industry and regulators are far from adequate.

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1. GM, Internal email communications, September 2005, http://blogs.wsj.com/corporate-intelligence/2014/04/01/emails-show-cost-to-gm-of-a-better-ignition-switch-90-cents/.

2. Robbie Feinberg, "Many Lawmakers Investigating GM Have Long Been Helped by Auto Maker," OpenSecretsBlog, March 31, 2014, http://www.opensecrets.org/news/2014/03/many-lawmakers-investigating-gm-have-long-been-helped-by-auto-maker.html#.Uzw0KgIxWDo.email.

April 21, 2014

Flashing Insights: Michael Lewis, Elizabeth Warren Illuminate Institutional Corruption

Gregg Fields

In an unusual harmonic convergence, two of the nation's most talked-about books probe deeply into the topic of institutional corruption in the financial sector and its regulatory overseers.

Flash Boys: A Wall Street Revolt, Michael Lewis's riveting ride through the high-stakes world of high-frequency stock trading, is singlehandedly refuting the notion that print is dead. Solid atop the New York Times best seller list, it is also reportedly the fastest-selling book ever by its publisher, W.W. Norton.

Lewis, a longtime clear-eyed chronicler of Wall Street's moral blind spots, follows the adventures of a gang of traders and techies who take it upon themselves to neutralize the competitive advantage programmed high-frequency trading gives to the gurus who master the algorithmic universe.

It's a mysterious world where an information advantage that lasts a few milliseconds can, cumulatively, produce billions of dollars in profits, often at the expense of everyday investors, Lewis writes.

"What people saw when they looked at the U.S. stock market—the numbers on the screens of the professional traders, the ticker tape running across the bottom of the CNBC screen—was an illusion," Lewis writes, on page 36 of the book.

The book's hero, a Canadian named Brad Katsuyama, transplanted from Toronto to New York by Royal Bank of Canada (RBC), reaches a dispiriting conclusion: "That's when I realized the markets are rigged."

Also Rigged

Ironically, "Rigged" was the original working title of the new book by Sen. Elizabeth Warren, the Harvard Law professor. I met Warren when she was in the midst of creating the Consumer Financial Protection Bureau, an agency she was destined never to actually lead, as the Obama administration bowed to relentless pressure from bankers and Congress members offended by her populist protocols.

She then successfully challenged Republican incumbent Scott Brown for a Massachusetts Senate seat. She's now arguably the loudest voice on the Senate Banking Committee, and her dressing down of regulators and bankers are some of the liveliest government hearing videos you'll ever see on YouTube. (This one has been viewed 239,000 times.)

Ultimately, Warren's book was retitled *A Fighting Chance*. Officially out this week, it has already been widely excerpted. Much of the book is about her parents' financial struggles, and her lifetime empathy for those whose resume doesn't have any Ivy League entries or White House appointments.

From the standpoint of institutional corruption, Warren, as she has before, rails against how, in her opinion, Washington is ultimately an insiders' game, where power and money align against the little guy.

In an excerpt in the *Boston Globe*, Warren recounts a 2009 dinner with Larry Summers, the former Harvard president and one of Obama's top economic advisors. Warren had been tapped to lead a Congressional oversight panel set up during the Wall Street bailouts in 2008. She was soon at loggerheads with much of official Washington, particularly Treasury Secretary Timothy Geithner.

"He teed it up this way: I had a choice," Warren writes about Summers. "I could be an insider, or I could be an outsider." Outsiders can say what they want. But insiders don't listen to them. Insiders can push their ideas into public policy. "But insiders also understand one unbreakable rule: They don't criticize other insiders," Warren says Summers told her. "I had been warned."

Mutually supportive insiders sounds a great deal like the phenomenon known as dependence corruption that Lawrence Lessig, Director of the Edmond J. Safra Center for Ethics, details in his book, *Republic, Lost: How Money Corrupts Congress—and a Plan to Stop It.* His book is largely about the dependence of Congress on campaign contributors, often at the expense of constituents.

But the concept is applicable to other institutions, he adds. "Where there is such a dependency, those responsible for the effectiveness of the institution must ask whether that dependency too severely weakens the independence of the institution," Lessig writes, on page 17. "If they don't ask this question, then they betray the institution they serve."

Flash the Cash

Flash Boys is wonderful reading (although frankly the story ends a bit before the book does), but at times seems like it was written with a movie treatment in mind. At the end of Chapter Three, for instance, the book's hero turns to his wife and says: "If I don't do something right now—me, Brad Katsuyama—there's no one to call." Don't people who talk like that usually wear a cape?

One of Lewis's more compelling characters is a former wrestling champion named John Schwall, and should probably be played by Mark Wahlberg should a film be made. One of the book's more affecting scenes—and one rich with institutional corruption implications—is when Schwall spends hours in the Staten Island library trying to research "front-running," or the Wall Street practice of capitalizing on information before it becomes public. He finds that the practice isn't new, but computers and algorithms mean high-frequency traders can appear and disappear in milliseconds, far faster than eyes can blink, manipulating prices in the process.

"The entire history of Wall Street was the story of scandals it now seemed to him, linked together tail to trunk like circus elephants," Lewis writes on page 81. "Every systemic market injustice arose from some loophole in a regulation created to correct some prior injustice."

Lessig wasn't referring to front-running, but perhaps could have been, when he offered this definition of institutional corruption: "Institutional corruption is manifest when there is a systemic and strategic influence which is legal, or even currently ethical, that undermines the institution's effectiveness by diverting it from its purpose or weakening its ability to achieve its purpose, including, to the extent relevant to its purpose, weakening either the public's trust in that institution or the institution's inherent trustworthiness."

Regulation, Captured?

In the financial sector, regulatory capture is often a symptom of institutional corruption. A real-life case in point might be when the lead players in *Flash Boys* took their concerns about market manipulation to the Securities and Exchange Commission. A number of staffers told them they were being unfair to the mysterious market traders.

That was perhaps due to another phenomenon common in institutional corruption—the revolving door syndrome. "After the meeting, RBC conducted a study, never released publicly, in which they found that more than two hundred SEC staffers since 2007 had left their government jobs to work for high-frequency trading firms or the firms that lobbied Washington on their behalf," Lewis writes, on page 85. "Some of these people had played central roles in deciding how, or even whether, to regulate high-frequency trading."

The Flash Boys ultimately form their own trading exchange, called IEX, with technology to combat high-frequency trading abuses. (The original title of Investors Exchange was scrapped because the Internet address of investorsexchange.com could get confusing.)

A host of regulators and government agencies now say they are investigating high-frequency trading, which has been the subject of widespread suspicions for some time. In May 2010, for instance, the famed "flash crash" saw the market drop 10 percent in minutes, then mysteriously bounce back. Lewis also suggests high-frequency trading may have played a role in the botched initial public offering of Facebook in 2012.

As for the public trust that is often the casualty of institutional corruption, Lewis notes on page 157 that before the flash crash 67 percent of American households owned stocks. But 2013, it was down to 52 percent. "It wasn't hard to see why their confidence in financial markets had collapsed," Lewis writes. "As the U.S. stock market had grown less comprehensible, it had also become more sensationally erratic."

The Fight Continues

Meanwhile, Warren's book, her 10th, arrives as scuttlebutt about her running for president in 2016 is reaching a Hillary-like crescendo. Warren has steadfastly denied she plans to enter the race. It's a stance that, with other politicos, has been known to evolve.

In an interview with the CBS Sunday Morning program this week, she reiterated her non-desire to occupy the White House. But she remains dedicated to the notion that, when it comes to Washington and Wall Street, everyday Americans deserve a fighting chance.

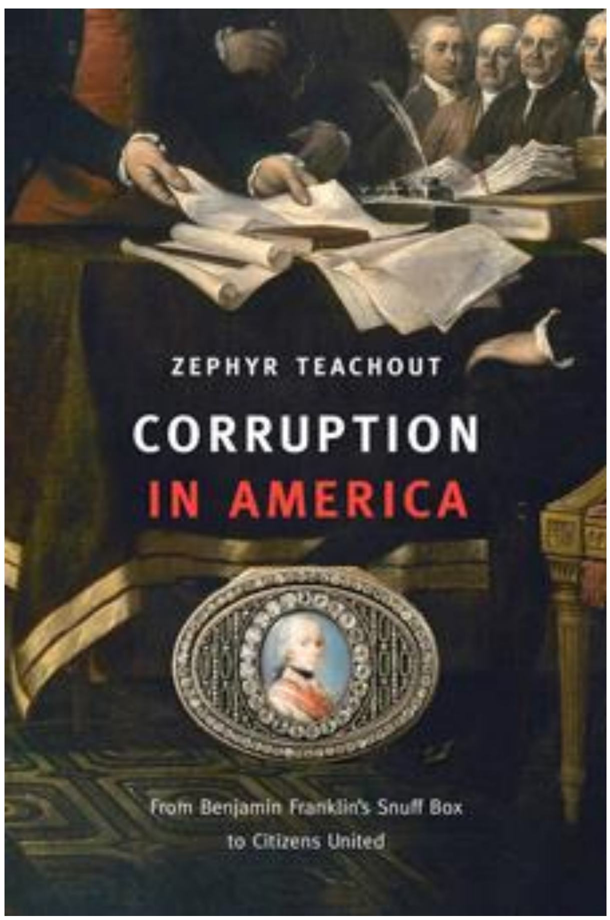
"How can it be that if you're just big enough and you commit big enough crimes that there's no one out there who wants to hold you accountable?" she said. "This is the consequence, again, of too much concentration of money and power."

Apr. 24, 2014:

McCutcheon and Corruption in America

[Reblogged from Harvard University Press Blog](#)

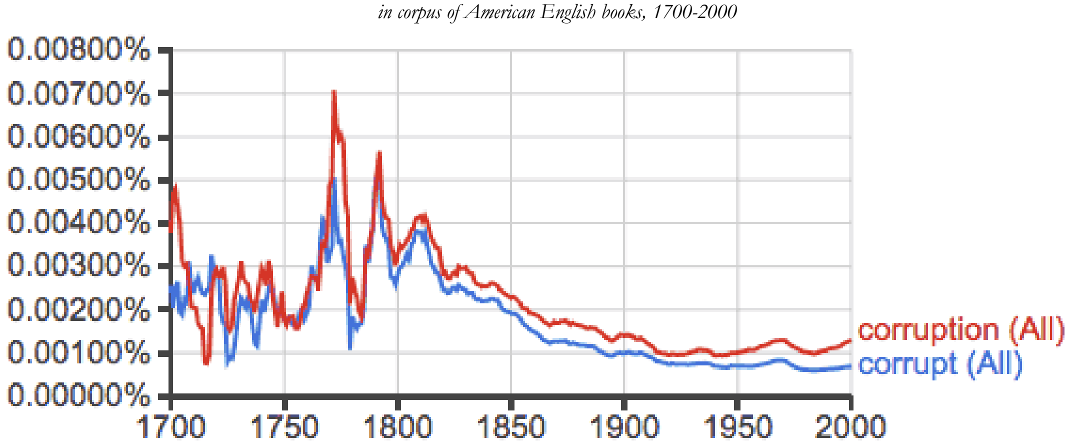
In 1785, having spent several years representing American interests, Benjamin Franklin left Paris in possession of a parting gift from Louis XVI: a golden case adorned with the King's portrait and 408 diamonds. Though the gift was in line with common courtesy throughout Europe, in the new United States such a luxurious present was perceived as having the power to corrupt its recipient. As legal scholar Zephyr Teachout writes in her forthcoming history of the American concept of corruption, Franklin's snuff box was "a symbol of seduction, addiction, dependency, luxury, and the confusion about the relationship between politics, power, intimacy, and friendship." In 18th century America such gifts were regulated transactions requiring Congressional approval.



In *Corruption in America: From Benjamin Franklin's Snuff Box to Citizens United*, Teachout reminds us that the particularly demanding notion of corruption represented by that early gifts rule is central to American law and democracy. This notion of corruption, she explains, is not limited to the blatant bribes and explicit quid pro quo to which Chief Justice Roberts referred in this week's *McCutcheon v. FEC* ruling, and Justice Kennedy in *Citizens United* before that. The foundational American understanding of corruption encompassed emotional, internal, psychological relationships in an effort to protect the morality of interactions between official representatives of government and private parties, foreign parties, or other politicians.

As the story of Franklin's gift shows, and as Teachout details, corruption is not just a criminal law term. It plays a larger role in American history, that of a broadly conceived taboo policing the line between acceptable and unacceptable political behavior. Departing from European norms in an effort to constitute a society with civic virtues, the American founders created not only a new country but a powerful new political grammar built on a concern for temptation and influence, not mere material transaction. Inspired by Teachout's work here, Lawrence Lessig and others mapped how the constitution's framers used the word "corruption" and found, as Lessig noted in the *Daily Beast*, that it was "absolutely clear from that research…that by 'corruption,' the Framers certainly did not mean quid pro quo corruption alone. That exclusive usage is completely modern." Complete modernism, of course, is a funny stance for the originalists on the court's right to adopt.

Taken from Google Ngram showing frequency of words "corrupt" and "corruption" in corpus of American English books, 1700-2000



Teachout describes the laws meant to prevent corruption in American history as prophylactic, in that they were designed to clearly prohibit certain behaviors that *may* result in undue influence, rather than allowing them and attempting later to identify corruption clearly enough to warrant conviction. The laws, in other words, accounted for ambiguity, instead of imagining some readily sniffed smoking gun accompanying quid pro quo exchange. The latter, of course, is the approach apparently favored by Chief Justice Roberts, and so his court continues its reshaping of American law in that image, ignoring 200 years of judicial respect for public morality. In the absence of strict campaign spending limits the Supreme Court would have us rely on explicit bribery laws that would punish only lazy politicians if defined narrowly, while posing too much potential for abuse if too sweeping. "After two centuries of attempts," writes Teachout, "no one has been able to craft a bribery law that covers something in between the two, because influence simply doesn't work through contract-like arrangements." And yet five members of the current Supreme Court openly prefer bribery laws to prophylactic campaign spending limits.

Teachout writes for a deeper understanding of the complex ways in which private and public morality intersect, and greater respect for the political dangers that flow from untethered self-interest. Her hope is that such an understanding will lead to judicial support for clear rules that pre-commit us, instead of judicial preference for after-the-fact punishments. She argues, too, for legislative campaign finance reform, making the case in yesterday's *Washington Post* for a system that would take away the corrupting threats posed by unlimited independent expenditures while freeing politicians from begging "at the feet of oligarchs." For while gifts from the King of France may no longer threaten, we have today our own lords of industry upon whom political candidates depend for contributions. What we newly lack, Teachout shows, is the deep American impulse to protect our society from their corrupting influence. *Corruption in America* will be published this September, a moment when unlimited midterm election spending will likely make American corruption all too apparent.

April 25, 2014

Dodd/Frank on Dodd-Frank: Former Reformers on Their Namesake Law

Gregg Fields

The clock was ticking, the world was watching, and Washington was elevating in-fighting from standard practice to something of an art form. And yet, in the summer of 2010 the mammoth Dodd-Frank Wall Street Reform and Consumer Protection Act was passed, a reaction to the crippling financial crisis of 2008 and the ensuing Great Recession. President Obama quickly signed it into law. Could such an ambitious law get passed today? Emphatically no, according to the men for whom Dodd-Frank is named.

"That's one window that emerged from the crisis," said Chris Dodd, who as the Democratic chairman of the Senate Banking Committee, shepherded Dodd-Frank through that chamber. "The window that existed was the one window we went through." Dodd today heads the Motion Picture Association of America.

Dodd's sentiments were echoed by Barney Frank, the Massachusetts Democrat who, at the time, headed the House Financial Services Committee. He remembers a conversation with Elizabeth Warren, who fought to have Dodd-Frank include a Consumer Financial Protection Bureau (CFPB), a controversial notion that nearly derailed the law.

When the CFPB made it through Frank's committee markup, "Elizabeth Warren said, 'They told me not to even try it because the banks always win. Well, they didn't win today,'" Frank recalled.

Act of Congress

The process of passing Dodd-Frank has been chronicled before, most notably in *Act of Congress*, the book by Robert Kaiser, who was a guest lecturer at the Edmond J. Safra Center for Ethics last fall. But Thursday's forum, hosted by the Institute of Politics at the Kennedy School, was a rare opportunity to get unfiltered views from Dodd and Frank of how the landmark legislation came to pass. (Coincidentally, Elizabeth Warren, who is now on the Senate Banking Committee, was speaking just up the street at a Harvard bookstore event.)

What was the rare window that opened to allow Dodd-Frank to be passed? An essential element, from Dodd's standpoint, was the ability to muster 60 Senate votes in support of a sweeping banking reform law. That was the minimum needed to keep the bill from being filibustered to death. "With 59, this all goes away," Dodd said.

But in terms of a legislative negotiation process, that meant that each of those 60 senators had the leverage, potentially, to derail Dodd-Frank. One result: there were ultimately 401 amendments to the law offered up. "Every so often you get to be the 60th senator," quipped Frank. "It's like being queen for a day."

An Olympian Effort

In that context, both Dodd and Frank acknowledged compromise was the order of the day. An example: the highly controversial Volcker Rule. Named for former Fed Chairman Paul Volcker, who lobbied loudly, it would restrict the ability of big banks to engage in so-called proprietary trading. That's where they risk their own capital by trading in, for instance, financial derivatives. Gigantic losses in derivatives preceded the Wall Street bailouts of 2008.

Lois Romano, the moderator and current senior political reporter for Politico, asked the men: "Where did Paul Volcker come from?"

"Mt. Olympus," deadpanned Frank. Volcker had chaired Obama's Economic Recovery Advisory Board, a group that in truth had few clear responsibilities. "Paul Volcker had been appointed to be head of some advisory board and had felt somewhat ignored."

Volcker deployed his considerable political clout in the nation's capital. Eventually, a compromise was reached where banks could own up to 3 percent of individual hedge funds or private equity funds. Why wasn't it more? Or, for that matter, less?

"I could get 60 votes with 3 [percent]," Dodd said. "I wish I could tell you it was more complicated than that." (An Edmond J. Safra Center for Ethics podcast on the Volcker Rule is available here.)

Frank added that the Volcker Rule was, in effect, a way to address the political firecracker issue of "too big to fail" banks. "The Volcker Rule is a way to make big banks smaller by reducing their functions," he said.

Neither man was defensive about the notion that Dodd-Frank is imperfect. For one thing, it leaves derivatives regulated by two relatively small, and perennially underfunded, agencies: the Securities and Exchange Commission and the Commodity Futures Trading Commission.

"It would be perfectly reasonable to merge the two," Frank said. "But you'd have Shays Rebellion." (A quick explanation: Daniel Shays led an uprising of Massachusetts farmers in 1786, protesting, fittingly, a foreclosure crisis.)

Dodd concurred that, though the merger of the SEC and CFTC is perfectly logical, that isn't always enough to carry the day on Capitol Hill. For one thing, the agencies are overseen by different Congressional committees. "They don't like giving up jurisdiction of much," Dodd said.

The Known Unknowns

In response to a question from Romano, Dodd said he does in fact think Dodd-Frank is working. But he and Frank acknowledged that certain parts of it remain untested and, for that matter, unimplemented as of yet. Banks have until July 2015, for instance, to reach full compliance with the Volcker Rule.

"You hope you never have to deal with a too big to fail" bank collapse, Dodd said. The Dodd-Frank law requires large institutions to develop orderly resolution plans, which have been nicknamed living wills. How effective they'll be at containing contagion remains subject to speculation. "Some of those provisions, we'll only know they work when they're used," Dodd said.

In response to an audience question, Frank addressed the issue of why, in the wake of such a massive collapse, virtually no major executives have been prosecuted. "I share your frustration," he told the questioner. "I have been critical of the administration" over the dearth of prosecutions.

But Dodd noted that the focus of Dodd-Frank isn't criminal code. "This was an opportunity to reform the architecture of financial services and harmonize global regulations," he said. "We were not in the business of being punitive. There's a responsibility (for that) but not in this bill. People have forgotten how our job was not to become a cop."

In response to another question, Dodd and Frank spoke about the effect lobbying had in shaping the law. The financial industry routinely ranks at or near the top in both lobbying expenditures and campaign contributions.

Dodd said the influence isn't always negative. "My experience in 36 years was that good lobbyists played a very valuable role in the process," he said. His and his staff's job was separating out good information from bad, he added.

Meanwhile, outraged voters, at least in this case, ultimately held the trump card, Frank said. "I believe public opinion beat campaign contributions," he said.

May 7, 2014

New Report Rates Think Tank Transparency

Brooke Williams

Transparify, a small group based in Tbilisi, Georgia, released a report today that rates think tanks around the world based on how much, if anything, they publicly disclose about who funds their work. Only 12 percent of think tanks surveyed—a total of two in the United States—received the highest, five-star rating. But even those two don't publicly name all of their donors.

Hans Gutbrod, executive director of Transparify, said in the report that a lack of transparency about funding "can raise questions about hidden agendas" and "undermine the effectiveness of the think tank sector as a whole."

The ratings, he said, seek to provide those think tanks that are highly transparent about their funding "a tool for signaling to policy makers, the media and the public that they deserve their trust and respect."

Jennifer Lappin, spokeswoman for Transparify, said they are offering only those think tanks rated with five stars a logo to display on their websites.

Transparify rated 169 think tanks in 47 countries, from Ukraine to Brazil to Ghana. This is a tiny fraction of the 6,800-some think tanks worldwide.

It selected "leading think tanks" from third party lists, noting that institutions in Central and Eastern Europe are overrepresented because the area is of particular interest to its donor, the Think Tank Fund, a program of billionaire George Soros' Open Society Foundations. (Transparify gave Open Society zero stars while noting it doesn't actually consider itself a think tank and is "funded exclusively by George Soros.")

One other organization in the U.S. received zero stars—the Belfer Center for Science and International Affairs at the Harvard Kennedy School. Belfer doesn't publish a donor list online, but it also doesn't appear to solicit or accept donations on its website. A spokesman for Belfer hadn't seen the report and declined to comment Tuesday afternoon.

Also at the Kennedy School, the Center for International Development (CID) received a two-star rating because it lists donors online but doesn't include amounts.

Chuck McKenney, communications manager for the CID, said they must consider broader school policies on donors and gifts and are looking into the possibility of publishing dollar amounts online.

"Harvard is a leader, so it will be really great to see if Harvard takes a lead," Transparify's Lappin said.

Two think tanks in the U.S. received five-star ratings—the Center for Global Development (CGD) and the World Resources Institute (WRI). Both recently changed the way they publicly disclose who funds their work.

In a Labcast published May 6, executives of the Center for Global Development in Washington, D.C. talk about how and why they recently created a beta webpage devoted to "How We're Funded." It lists amounts and purposes of all grants and donations more than $100,000, but three of the donors are labeled "anonymous."

Katie Douglas Martel, deputy director of Institutional Advancement at CGD, said they solicited feedback from all of their donors before launching the webpage. She said the three anonymous donors are individuals who had longstanding requests not to be named.

"I think moving forward, we will continue to honor those requests, especially from individuals," she said. "If a corporation or a larger entity wanted to be anonymous, I think we'd really have to think about that and respond to that as it happened."

Douglas Martel said no foreign government or corporate donors have requested anonymity.

At the World Resources Institute, Steve Barker, chief financial officer, said publishing more details about its funding was fairly simple. WRI did not broadly alert or seek feedback from all donors, he said, though they might have reached out to a few.

Barker said there are a few small, individual donors who wish to remain anonymous, and WRI will continue to honor those requests. He said no corporate or foreign government donors are anonymous.

"I think there are other organizations who might want to obfuscate that somewhat, but we're just not like that at all," he said.

Gutbrod, executive director of Transparify, said in an email that while their methodology says five star organizations have "all donors listed," they ended up allowing for a small percentage of anonymous donors. He said it became clear that "you cannot easily identify donors that previously were promised anonymity."

In all, at least 15 think tanks changed their disclosure practices between January and April 15, according to the Transparify report, and another 23 said they would be making more details about their funding publicly available in the "foreseeable future."

May 26, 2014

California Officials Sue Opioid Makers for False Advertising, Raising Institutional Corruption Themes

Christopher Robertson

This week, officials from two California counties sued several of the makers of opioids, raising allegations that the companies violated California's false advertising, unfair competition, and public nuisance laws.

The novelty of the case is not in its substantive allegations; those have been well-publicized for several years. Nonetheless, the complaint does a very nice job of explaining how the pharmaceutical industry created a new market for their product, by corrupting key opinion leaders, patient advocacy organizations, and the scientific literature, all playing down the risk of addiction to suggest that opioids could be safely and effectively used for long-term nonmalignant pain relief. For the institutional corruption themes in particular, see pages 35-51 of the complaint.

The novelty of this case is that state officials—rather than private plaintiffs or qui tam whistleblowers—have stepped forward to litigate the case. While uncommon in pharmaceuticals, this move echoes the strategy of states' attorneys general in the tobacco wars. Mississippi State A.G. Michael Moore was one of the leaders of that battle, which transformed the litigation strategy from one of individual plaintiffs struggling to show causation in relatively small-dollar suits to a bet-the-company case involving billions of dollars and attracting top legal talent. This opioid case, likewise, appears to be a partnership between public officials and private litigators (a well-known class-action firm). And, like tobacco, this case avoids the difficult task of proving on an individual level that the pharmaceutical companies' alleged misrepresentation caused any one particular prescription to be written or any one particular patient to become addicted and suffer the consequences. This case illustrates how state officials have a special power to reframe an issue as one of public health rather than personal damages.

Nonetheless, unlike tobacco, this case will be litigated in the shadow of the Food and Drug Administration, which directly and heavily regulates these very same products. I predict that a primary theme of the manufacturers' defense will be that if there is a problem here, it is a problem for the FDA, not one for local county officials. This is not exactly a legal argument, since federal law does not preempt the sort of state laws that are implicated here. But it may be a compelling way to paint the case, in hopes that the state court judge will decide preliminary and procedural questions in ways that are favorable to the industry. If the industry succeeds in creating a general sense that this case is in the wrong place, the state officials will have to go for silver bullets that are clear violations of state law. They need singular instances of false and misleading statements, which are beyond the pale. Some of the current allegations, such as the claim that "addiction is rare," leave a lot of room for interpretation.

As soon as this case looks like genuine dispute within the medical community, the industry wins. That is why the institutional corruption themes are so important. If the medical community has itself become corrupted by industry, and if the plaintiffs can demonstrate that fact, then the case may have legs.

June 3, 2014

Are We Missing Something Important? The Role of Human Resource Management in Building the Integrity of Corporations and Organisations

Dieter Zinnbauer

In this blog post, Dieter Zinnbauer of Transparency International* details an insightful thought experiment on executive commitment to corporate integrity.

Take a short test and start wondering:

1: What sends a stronger signal about executive commitment to corporate integrity and is the more likely pathway to a corporate culture of ethical responsibility?

a) Once your company has been indicted and convicted for pervasive ethical lapses and corruption, put all staff through a compulsory ethics education session from 4 to 5 p.m. on a busy Tuesday, while emails keep on flooding in and work piles up on their desks;

or

b) Hire people who show a sensibility and mature, practical level of reflection on ethical dilemmas or corruption risks that they might encounter in their prospective roles.

2: When are employees most eager and committed to reflecting on ethical dilemmas and corruption risks that they might face in their jobs?

a) At the recruitment stage when they badly want the job and are eager to shine on all aspects that their future employer might care about;

or

b) From 4 to 5 p.m. on a busy Tuesday in a compulsory ethics education session, while emails keep on flooding in and work piles up on their desks.

3: What is the most common approach in practice?

a) Put everyone from 4 to 5 p.m. on a busy Tuesday . . . you get the gist;

or

b) Make ethical awareness and reflection an explicit criteria in your staff recruitment process.

4: Interviews with HR experts and practitioners indicate that most believe in the potential and importance of using the recruitment stage for promoting corporate integrity, yet they report that little is happening in practice. Why is this the case?**

a) Do not know;

or

b) Do not know.

5: Even if a recruit has successfully "faked" sensibility of ethical issues he or she (tick all that apply)

a) will have at least thought about and reflected on the ethical dilemmas, conflicts of interest, and bribery risks that he or she will face in the job;

and/or

b) might have changed his mind somewhat as a consequence of what social psychologists call counter-attitudinal advocacy (having people take and publicly argue for a position they disagree with makes them more likely to begin sympathising with it, in order to reduce cognitive dissonance).

So what are the most promising techniques to use in the recruitment stage to gauge ethical sensibilities and have potential employees reflect on ethical dilemmas? What is already practiced, and what has been found to work? Any ideas?

Please discuss:

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* Transparency International has adopted promoting business integrity as one of its strategic priorities. We undertake a number of diagnostic, collective action and advocacy initiatives in this area (see here for more).

** We actively seek to incubate fresh ideas and approaches for enhancing business integrity, and have recently worked with a group of students at the Norwegian School of Economics who interviewed human resource professionals about the current and future role of HR in supporting corporate integrity.

June 4, 2014

Unappealing? A Higher Court Sides with the SEC against Judge Rakoff

Gregg Fields

When he refused to rubber stamp a $285 million consent agreement between Citigroup and the Securities and Exchange Commission, U.S. District Judge Jed Rakoff was widely viewed as one of the good guys in the fight against institutional corruption.

As the New York Times described it Wednesday: "And to critics of Wall Street, the judge developed something of a celebrity status, becoming a symbol of the effort to crackdown on Wall Street misdeeds."

But the Times reference was in a story about the U.S. Court of Appeals for the Second Circuit overturning Rakoff on Wednesday. It would be understandable, in that context, for Rakoff's supporters to conclude that the good guy has lost.

Rakoff, a federal judge in the Southern District of New York, threw out the prepackaged settlement between the SEC and Citigroup in 2011. His reasoning: he had no way of knowing whether the amount, or the terms, were fair. The reason: the SEC did almost no discovery regarding the facts of the case. The allegations were that a Citigroup subsidiary had essentially bet against its own investors in a securities offering related to debt backed by subprime mortgages.

The lack of investigation, Rakoff wrote, meant he had no real facts with which to assess the fairness of the settlement. "An application of judicial power that does not rest on facts is worse than mindless, it is inherently dangerous," Rakoff wrote. "If its deployment does not rest on facts—cold, hard, solid facts, established either by admissions or by trials—it serves no lawful or moral purpose and is simply an engine of oppression."

In that context, the settlement was an abdication of regulatory responsibility by the SEC, he said. "In much of the world, propaganda reigns and truth is confined to secretive, fearful whispers," Rakoff wrote. "Even in our nation, apologists for suppressing or obscuring the truth may always be found. But the SEC, of all agencies, has a duty, inherent in its statutory mission, to see that the truth emerges."

But Rakoff's ruling was quickly appealed—ironically, by both plaintiffs and defendants. A group of 19 legal scholars filed a friend of the court brief in support of Rakoff. "The requirement of judicial review serves as an independent check on settlements that may meet the needs of the settling parties, but do not serve the public interest because they neither inform the public of the truth of the allegations nor deter future violations," they wrote.

"Citigroup and its affiliates have been enjoined from violating securities laws four times since 2000, yet have not been the subject of a contempt proceeding," the scholars added.

Yet the appeals court had previously indicated it believed Rakoff had overstepped his authority. And in Wednesday's ruling, it concluded that the practical convenience of consent agreements trumps whatever might be unearthed at a trial.

"It is an abuse of discretion to require, as the district court did here, that the SEC establish the 'truth' of the allegations against a settling party as a condition for approving the consent decrees," the appeals court wrote. "Trials are primarily about the truth. Consent decrees are primarily about pragmatism."

Certainly, it is understandable why the SEC and its regulatory brethren, such as the Commodity Futures Trading Commission, would seek pragmatism. Litigation is wildly expensive, and the SEC and CFTC are often woefully outmatched in terms of resources.

And not surprisingly, the SEC voiced support for the appeals court. "We are pleased with today's ruling by the Second Circuit Court of Appeals reaffirming the significant deference accorded to the SEC in determining whether to settle with parties and on what terms," Andrew Ceresney, director of enforcement, said in a statement. "While the SEC has and will continue to seek admissions in appropriate cases, settlements without admissions also enable regulatory agencies to serve the public interest by returning money to harmed investors more quickly, without the uncertainty and delay from litigation and without the need to expend additional agency resources."

Furthermore, both are funded by Congress, which is dependent upon the financial sector for campaign contributions. Year in and year out, the financial sector is at or atop the list of campaign donors as well as lobbying expenditures.

Complaints of regulatory capture—a common indicator of institutional corruption—are rife. In his recent bestseller Flash Boys, Michael Lewis's protagonists are rebuffed by the SEC when they voice their suspicions about abuses by high-frequency traders. Later, they conduct private research and find that over 200 former SEC employees had decamped to work for high frequency trading firms.

One of the leading criticisms of the regulators following the financial crisis was that virtually no executives were prosecuted. Institutions whose behaviors led to the collapse weren't held accountable but, in fact, were bailed out by taxpayers.

That, in turn, produced palpable public outrage and a decline in trust in vital public institutions. The appeals court, however, held that whether the settlement serves the public wasn't Rakoff's call to make. "It is not within the district court's purview to demand 'cold, hard, solid facts, established either by admissions or by trials.'"

It added: "The job of determining whether the proposed SEC consent decree best serves the public interest, however, rests squarely with the SEC, and its decision merits significant deference."

Rather than determining if the public interest is served, Rakoff should "consider whether the public would be disserved by entry of the consent decree."

The appeals court then remanded the case back to to Rakoff "in accordance with this opinion."

June 5, 2014

India's Whistleblower Protection Act—An Important Step, But Not Enough

Christine Liu*, reblogged from the Global Anticorruption Blog

This post on India's Whistleblower Protection Act is reposted, with permission, from a guest post on Harvard Professor Matthew Stephenson's Global Anticorruption Blog.

As Raj noted in his last post, the recent election of Narendra Modi as prime minister of India demonstrates that the Indian population wants change and supports actions against corruption (as do recent polls, such as the Lowy Institute study, which found that 96 percent of Indians believe corruption is holding the country back, and 92 percent believe that reducing corruption should be one of the government's top priorities). One of the most important obstacles to fighting corruption in India has been the lack of adequate whistleblower protections. Individuals reporting incidents of bribery or corruption faced numerous hurdles, including verbal threats, physical violence, and ostracism. Others encountered workplace retaliation. Confronted with these risks, many potential whistleblowers chose to remain silent.

But there are encouraging signs that this may change. On May 14, 2014, Indian President Pranab Mukherjee cleared the way for the Whistleblowers Protection Act. This action represents a much-needed change from the history of delay surrounding the original bill, which was first introduced in August 2010 and then took years to pass the two Houses of Parliament—it passed in Lok Sabha on December 11, 2011 and in Rajya Sabha on February 21, 2014. The new whistleblower law is a significant achievement. Nonetheless, the law has some important limitations, and there are outstanding concerns about whether the law will be enforced effectively and foster public confidence.

The new Whistleblower Protection Law gives the Central Vigilance Commission (CVC) the task of receiving complaints, assessing public disclosure requests, and safeguarding complainants. The law further strengthens protection for whistleblowers through stronger anti-retaliation provisions: The CVC has the power to order that whistleblowers who suffered employment retaliation be restored to their prior positions. Moreover, the new law puts the burden of proof on the public official to show that any adverse action taken against a whistleblower was not retaliatory. Another key feature of the new legislation is that it ensures confidentiality and penalizes any public official that reveals a complainant's identity, without proper approval, with up to three years imprisonment and a fine of up to 50,000 rupees. Additional penalties apply to organizations and individuals that fail to comply with CVC requests for information, or that knowingly provide incomplete, incorrect, or misleading information.

On the other hand, the law also places various limitations on complainants. Most notably, there is penalty of up to two years imprisonment and a fine of up to 20,000 rupees for individuals that bring false or frivolous complaints. There is also a 7-year time limit to bring complaints, dating from the time the alleged corrupt practices occurred. In essence, the whistleblower law seeks to balance two conflicting interests—the need to protect the individuals raising complaints against the need to prevent unnecessary harassment of public officials and minimize frivolous claims.

While the new law is certainly an important step, a number of limitations and concerns remain. First, the law lacks specific criminal penalties for physical attacks on whistleblowers—and given the number of violent attacks on complainants in the past, this is not a minor concern. Second, the law does not provide civil penalties for workplace retaliation. Thus, protection for whistleblowers under the bill is still inadequate. Moreover, whereas other countries like the United States, the United Kingdom and Canada define "disclosure" and "victimization" broadly for purposes of their respective whistleblower protection laws, India's law does not define "victimization" and has a relatively narrow definition for "disclosure." This again limits the effectiveness of any complainant safeguards.

Beyond these specific deficiencies, there is a broader set of concerns about whether the law will actually be enforced effectively. Enforcement—and rebuilding public trust in the government—will be critical to the new law's success. Given the history of scandals, the government needs to regain the people's confidence and help them believe that the whistleblower law will really provide the type of protection it promises. Otherwise, individuals will continue to stay silent regarding abuses of power. Also, without proper enforcement, the protections described will be ineffective and may even exacerbate the problem of corruption altogether.

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Jun. 17, 2014

Corruption at Universities is a Common Disease for Russia and Ukraine

Elena Denisova-Schmidt, Elvira Leontyeva and Yaroslav Prytula

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Russia and Ukraine might not have common views on foreign policy or their own geographical borders today, but what they do have in common is a problem with endemic corruption in their countries. The higher education system is one of the areas suffering from this problem.

Both countries' higher education systems were formed under the Soviet Union, where some institutions were responsible for teaching (instituty and universitety) and others for research (akademii nauk). The number of students was determined by the appropriate ministries and every graduate had a guaranteed job placement thanks the system of raspredelenie. Higher education was free, and full-time students who performed well even received a scholarship from the state, giving them the opportunity for a degree of financial independence. The academic profession was highly respected in society and generously remunerated by the state. All of this changed significantly after the collapse of the Soviet Union: the institutions responsible for teaching were expected to conduct high-level research; the system of mandatory job placements for graduates was canceled; some universities had to introduce tuition and fees; a paid scholarship was no longer enough to make a living; and many faculty members had to find second and third jobs, or leave the universities or even the country in order to survive.

Since 1991, both Russian and Ukrainian universities have undergone some significant changes: the dramatic cuts in state financial support that accompanied the adoption of a market economy, the Bologna process and the integration into the European higher education system, as well as the replacement of the old entrance examinations with the Edinyi Gosudarstvennyi Eksamen (EGE) (in English, the Unified State Exam) in Russia and Vneshnee nezavisimoe otsenivanie (VNT) (in English, the External Independent Assessment) in Ukraine, respectively. None of the reforms are fully completed: universities are still dependent on the state,[1] there are more universities than needed, and the level of education they offer is sometimes questionable. Another challenge that many universities have to deal with is corruption in many forms, both in university admissions and in teaching at the undergraduate and graduate levels, including advanced degrees.[2]

An attempt to combine parts of the Soviet higher education system of centralization, state-ordered specialists and state-created curriculum with the new market-oriented system of higher education resulted in the weak performance of graduates on the job market.[3] Potential employers are concerned about the decreasing educational levels of their job-seekers. Job advertisements frequently name the universities whose graduates they are looking to hire. Some recruiters might not even consider candidates with distance-learning diplomas.

There is an urgent need for more applied, pragmatic remedies for corruption in academia. This was also recently stressed by Elena Panfilova, the chairwoman of TI Russia, who created some initiatives on the transparency and integrity of Russian universities.[4] Scholarly research seldom seems to translate into concrete tools and reform, however. One of the main reasons for this is the systematic, longstanding tradition of corruption in almost every area of society: business, politics, and everyday life. Corrupt behavior seems to be a norm rather than a deviation in both countries.

The other reason might be the universities' high dependence on maintaining a high student enrollment. A typical public university in both Russia and Ukraine receives half of its budget from state money calculated according to the number of students, and half from the students' tuition and fees. If they expelled underachieving students, the university would lose a substantial part of its budget, which might lead to a decline in its research activities and the laying off of professors and staff. Therefore, many universities and professors have a dilemma between being more tolerant with some students—and sometimes even watering down the course requirements to retain them—or potentially losing their jobs. As long as this dependence exists, any action regarding the transparency and integrity of Russian and Ukrainian universities would be difficult to implement.

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1. Ongoing reforms in Ukraine might change this dependence and make universities more self-contained. This is certainly a question, whether universities are ready for this responsibility or not.

2. John Round and Peter Rodgers, "The Problems of Corruption in Post-Soviet Ukraine's Higher Education Sector," International Journal of Sociology 39.2 (2009): 80-95; Elena Denisova-Schmidt and Elvira Leontyeva, "The Unified State Exam in Russia: Problems and Perspectives," International Higher Education 76 (2014): 22-23; Eduard Klein, "Ukraine's External Independent Testing Innovation," International Higher Education 75 (2014): 24-25; Ararat L. Osipian, "Transforming University Governance in Ukraine: Collegiums, Bureaucracies, and Political Institutions," Higher Education Policy 27.1 (2014): 65-84; and Jeremy Morris and Abel Polese, "Informal Health and Education Sector Payments in Russian and Ukrainian Cities: Structuring Welfare from Below," European Urban and Regional Studies, online first March 26, 2014, 1-16.

3. Michael Bastedo, Batjargal Batkhuyag, Eufrasio Prates and Yaroslav Prytula, "Educational Policies for Integrating College Competencies and Workforce Needs," Institute for Higher Education Policy Issue Brief, March 2009.

4. http://transparency.org.ru/v-rossii/vuzy-dolzhny-byt-prozrachnymi.

June 17, 2014

Should There Be Public Access to Data from Clinical Trials

Michelle Mello, reblogged from the Robert Wood Johnson Foundation

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For years, pharmaceutical companies have been lambasted in the media and government prosecutions for concealing information about the safety and efficacy of their products. In one particularly splashy example, GlaxoSmithKline (GSK) agreed to pay $3 billion in 2012 to settle criminal charges that it failed to report safety data concerning its antidepressant drug, Paxil, and its diabetes drug, Avandia, and engaged in unlawful marketing of these products and one other drug.

One mechanism proposed for avoiding such problems is to establish a system through which participant-level data from clinical trials, stripped of identifying information about patients, would be available to the public.

A potential benefit of sharing clinical trial data would be that independent scientists could re-analyze data to verify the accuracy of reports prepared by trial sponsors, which might deter sponsors from mischaracterizing or suppressing findings. Data sharing would also allow analysts both within and outside drug companies to pool data from multiple studies, creating a powerful database for exploring new questions that can't be addressed within any given trial because the sample is too small to support such analyses.

The potential value of shared data in improving our understanding of the safety and efficacy of drugs, medical devices, and biologics has sparked considerable discussion about how to make data sharing happen. Earlier this year, the European Medicines Agency—the counterpart to the U.S. Food and Drug Administration (FDA) in the European Union—decided to start making data from trials of approved products available in 2014. This begs the question, should the FDA follow suit?

In a paper published in *The New England Journal of Medicine* in October (available at http://www.nejm.org/doi/pdf/10.1056/NEJMhle1309073), I wrote with colleagues from Harvard and representatives from the pharmaceutical industry that "The question is not whether, but how, these data should be broadly shared." In our view, the benefits of data sharing are overwhelming. But at least three critical questions confront the United States as it considers how to move forward.

First, do we need a regulatory requirement like Europe's? Some companies argue that their voluntary initiatives obviate the need for a mandate. But there's a real collective-action problem to be considered: If data sharing is voluntary, and some companies perceive more downside than upside, what's to make everyone do it? Won't companies that step forward put themselves at a competitive disadvantage if others don't follow? Further, how can we assure that those who share data adhere to a set of minimum standards to ensure that what is shared is complete and useful? Perhaps there is some nongovernmental binding mechanism that could be used to make companies stick to voluntary commitments, but it isn't clear what it is.

Second, should data be available to anyone who wants them, or should there be some screening mechanism to vet requests? On the one hand, the spirit of transparency militates in favor of open access. Suggesting that there be some gatekeeper begs the question of who would take on this job, who would pay for their time, what criteria they should apply, and how we could keep the vetting process fair. On the other hand, gatekeeping means the ability to impose some quality controls on how the data get used. Drug companies worry that a competitor could produce or fund a flawed analysis of their product, and once the finding is reported in the media, it might be very hard for the manufacturer to dislodge public perceptions that the product is unsafe or ineffective. Completely open access would also make it harder to assure that analysts didn't try to use the data in ways that jeopardize the privacy of the clinical trial participants. These concerns are important, and justify having some type of screening system.

Third, how do we grapple with the problem of informed consent? Most research participants who participated in clinical trials in the past never contemplated that their individual data might be posted on a website or freely given out to groups all over the world. Stripping personal identifiers like birthdates and names out of the dataset doesn't completely solve the problem, because it's easier than one might think to re-identify people. In the future, we could state in informed consent forms for clinical trials that the data will be broadly shared, but some ethicists argue that research participants are scarcely able to imagine what this might mean for their privacy—especially since the information environment is constantly evolving, and what is "de-identified" today could be easily re-identifiable in the future. Without this understanding, giving consent to data sharing may not be meaningful.

These problems require thoughtful solutions, but shouldn't hold us back from pursuing data sharing. An expert committee convened by the Institute of Medicine is currently considering what a framework for responsible sharing of clinical trial data might look like, and will issue a preliminary report early in 2014. Whatever happens in the United States, the EMA's new policy means that, at least in terms of access to data for products approved for sale in the European Union, the proverbial cat is out of the bag. It remains to be seen what this will mean for trial sponsors, research participants, and the public's health.

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New Prescription Drugs: A Major Health Risk With Few Offsetting Advantages

Donald Light

Few people know that new prescription drugs have a 1 in 5 chance of causing serious reactions after they have been approved. That is why expert physicians recommend not taking new drugs for at least five years unless patients have first tried better-established options, and have the need to do so.

Few know that systematic reviews of hospital charts found that even properly prescribed drugs (aside from misprescribing, overdosing, or self-prescribing) cause about 1.9 million hospitalizations a year. Another 840,000 hospitalized patients are given drugs that cause serious adverse reactions for a total of 2.74 million serious adverse drug reactions. About 128,000 people die from drugs prescribed to them. This makes prescription drugs a major health risk, ranking 4th with stroke as a leading cause of death. The European Commission estimates that adverse reactions from prescription drugs cause 200,000 deaths; so together, about 328,000 patients in the U.S. and Europe die from prescription drugs each year. The FDA does not acknowledge these facts and instead gathers a small fraction of the cases.

Perhaps this is "the price of progress"? For example, about 170 million Americans take a prescription drug, and many benefit from the drug. For some, drugs save their life or keep them alive. About 80 percent of them are generic; that is to say, drugs whose benefits and risks are better known. If we suppose they all benefit, then 2.7 million severe reactions is only about 1.5 percent.

But as far as we can tell (very little research is funded on prescription drugs as a health risk compared to less deadly risks like diabetes or Alzheimer's disease), millions who take new, patented drugs experience only modest benefits over established drugs. Only a small percent of new drugs provide significant advantages for patients to offset these risks of harm. Independent reviews over the past 35 years have found that only 11 to 15 percent of newly approved drugs have significant clinical advantages over existing, better-known drugs. These contribute to the large medicine chest of effective drugs developed over the decades. But the 85 to 89 percent with little or no clinical advantage flood the market. About four-fifths of the additional $70 billion spent on drugs since 2000 in the U.S. (and another $70 billion abroad) have been spent on these minor new variations rather than on the really innovative drugs.

In a recent decade, between 2002 and 2011, independent reviews by clinical expert teams in France, Canada, and the Netherlands have concluded that only eight percent of 946 new products were clinically superior, down from 11 to 15 percent in previous decades (see

Figure, below). Only two were breakthroughs and another 13 represented a real therapeutic advance.

Spokesmen for the pharmaceutical industry point out that therapeutically similar drugs have advantages. First, physicians need some choice within a therapeutic class because some patients do not respond well to a given drug. This is true, but after about three choices, there is little evidence to justify a 4th, 5th, or 6th drug in a class. Second, a sub-group of patients may benefit from new drugs that seem similar. This may be true or not, and we need to identify that sub-group so the effectiveness of the drug can be tested on them. The point of testing drugs for approval is to identify which patients might benefit and see if they do, not to assume that some patients somewhere might. Third, industry spokespersons argue that every incremental development contributes to larger improvements. This might be true, but most significant clinical advances occur through major discoveries. Yet most major scientific discoveries do not significantly improve patients' health and some may prove deadly. Silvio Garattini, a leader in pharmacological research told me, "When a major discovery actually helps patients, we feel very lucky."

The Hidden Business Model of R&D

Flooding the market with hundreds of minor variations seems to be the hidden business model of drug companies, to exploit patent and other IP protections for profits, not for significant advances for patient health. Looking back, Jerry Avorn, an authority on pharmacoepidemiology, wrote that "laws designed to encourage and protect meaningful innovation had been turned into a system that rewarded trivial pseudo-innovation even more profitably than important discoveries."

Despite fewer superior drugs, Marc-André Gagnon has shown that sales and profits soared. Net return on revenues (ROR) rose from about 10 percent in the 1970s to 12.5 percent by 1990, then to 16 percent by 2000, and to 19 percent in 2010. Pharmaceutical ROR has increased from about 2.5 times to 3.2 times the return for the Fortune 500 giants, largely as a result of raising prices and getting more physicians to prescribe more drugs.

Risk for the major companies is much less than claimed for several reasons. First, they spread risk over many projects. Second, once inflators and public subsidies are taken out, net research costs are a fraction of the $1 billion to $5 billion per new drug claimed, and big companies largely invest after the public and others have paid for the high risks of research to discover new drugs. As new drugs enter clinical trials, their risks are just 1 in 5. Third, companies cut losses by stopping development of drugs whose profit potential is not as high as they want. We never will know how many beneficial drugs never get approved because companies estimated they would not be profitable enough.

Over the past 35 years, this hidden business model based on marketing power and prowess more than innovation has caused an epidemic of harmful side effects. Given estimates that about 30 adverse reactions occur for every one that leads to hospitalization, about 81 million adverse reactions are experienced by the 170 million Americans taking drugs. The elderly and those taking multiple drugs experience more than others. Most are medically minor, like muscle aches, gastro-intestinal discomforts, slower reactions, or sleepiness. But they reduce productivity and cause many falls and road accidents.

The Trial-Journal Pipeline

The pharmaceutical industry refers constantly to its "R&D pipeline" of new drugs under development. But there is a second, parallel pipeline—the trial-journal pipeline. It consists of randomized clinical trials designed with the marketing departments to produce evidence that their drugs are more effective and safer than unbiased trials would show. Commercially funded clinical trials are at least 2.5 times more likely to favor the sponsor's drug than non-commercially funded trials.

The FDA accepts these biased trials and uses them to approve drugs. Congress strongly supports having companies fund the division that reviews new drugs rather than having the FDA be a publicly funded, independent reviewer and regulator. Financially, the FDA is an extension of the pharmaceutical industry and plays a major role in expanding markets for more people to take more drugs.

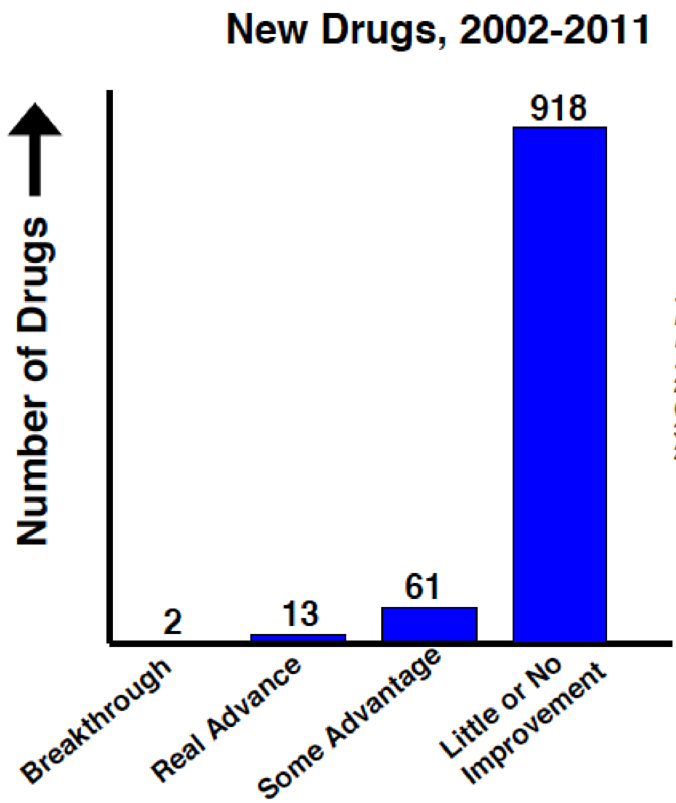
Closely coordinated in the trial-journal pipeline, pharmaceutical companies retain teams of statisticians, science editors, and science writers to select which results will go into the medical literature and which will not. They switch end points and other details in the data submitted to the FDA so that physicians read twice-biased medical articles that understate risks of harm and overstate benefits. Negative results are much less likely to be published than positive results, and companies publish positive results more than once, a further bias that distorts clinical practice and guidelines as well the medical knowledge that underlies it. Marc Rodwin concludes, "scholarly studies have revealed that drug firms design trials that skew the result and that they distort the evidence by selective reporting or biased interpretation."

This published literature goes into clinical guidelines and protocols, once established to provide an unbiased, evidence-based way to practice good medicine. But Lisa Cosgrove and Emily Wheeler document how they have become "essentially marketing tools for drug companies." They create "the potential to expose many patients to harm from unnecessary treatment or from treatment that is not evidence-based." The situation is worse because the evidence is twice-biased and corrupts medical science. Companies then employ what Sergio Sismondo describes as "a two-step model of influence by hiring and otherwise enrolling some physicians and researchers who will, in turn influence many others" to prescribe the new, patented drugs.

New FDA policies to get more drugs reviewed faster so that they can reach patients sooner in fact mean that drugs are approved with less evidence of being safe or effective. A systematic study of shortened reviews found that each 10-month reduction results in an 18 percent increase in serious adverse reactions, an 11 percent increase in hospitalizations, and a 7.2 percent increase in deaths. The risk of serious adverse reactions occurring after approval increases from 1 in 5, to 1 in 3—a huge risk that nobody is telling the public about.

In response to drug disasters like Vioxx, which experts say caused about 120,000 traumatic cardiovascular events and 40,000 deaths, Congress and the FDA have set up monitoring and safety systems. But a review of results so far found little evidence they are identifying serious risks or altering prescribing practices.

One key reform that would make new drugs safer and more effective would be to require that the FDA have evidence that new drugs are clinically effective. A top team at the London School of Economics concludes that requiring comparative evidence before approval informs all decision makers of the relative merits of new treatments. Also, it "could encourage manufacturers to concentrate on the development of new drugs in therapeutic areas with few or no alternatives." While changing legislation is difficult, the FDA could use its administrative powers and guidelines to get more evidence that new drugs actually help patients before reviewing them.



SOURCE: New Drugs and Indications in 2011: France Is Better Focused on Patients Interests After the Mediator Scandal, But Stagnation Elsewhere, 21(126) La Revue Prescrire 106, 107 (Apr. 2012) (table) (translated from 32(340) La Revue Prescrire 134 (Feb. 2012) (in French))

June 30, 2014

A Tale of Two PACs

Robert Lucas

2012: For campaign finance, it was the best of times; it was the worst of times.

Citizens United and Speechnow.org were taking effect in their first full federal election cycle. Deregulators won an unprecedented victory—a near revolution, for some—and the reformers were looking for a way forward. Media coverage for Citizens United reached its zenith since January 2010. According to Google Trends, January 2012 has the highest "interest" for the term "Citizens United" at any point after the holding was issued. The two-year anniversary and the beginning of a presidential election year was perfect for media coverage: CNN ran several small articles comparing the Watergate scandal to *Citizens United*; Stephen Colbert's satirical super PAC, Americans for Better Tomorrow, Tomorrow, had raised over $1 million; and students across the country were gaining attention for their super PACs.

So I thought: Why can't I start my own super PAC? After all, student-led super PACs had a particular focus, such as "Cats for a Better Tomorrow, Tomorrow" and "Everyone's Favorite Group of Socially Acceptable People Who Have Happy Funtime Ideas and Team." I chose, "Committee for the Re-Election of the President," the name of the 1972 Nixon re-election campaign that bankrolled the Watergate Burglaries. Known as CRP by supporters, opponents cleverly dubbed it CREEP.

Not surprising, CREEP Super PAC presented a number of marketing challenges, from a logo to a web domain. To lighten things up, I devised its mission—to "raise voices not dollars"—and a website, raisevoicesnotdollars.org. I rented a PO Box through the post office at the Watergate Complex and set up a separate Georgetown credit union checking account. After filing several documents with the Federal Election Commission, CREEP Super PAC was born. At the time, I was a public policy graduate student and an intern for the Civil Rights Division at the Department of Justice. With no media experience, I wasn't expecting—or prepared for—the media response.

Within a day or two after filing my papers, Kim Barker, a reporter for ProPublica, contacted me after tracking FEC filings. She wrote an article, "The Return of CREEP." Shortly after, Bill Moyers Online ran a comparable story. Within several weeks, Eliza Newlin Carney, the lead reporter covering campaign finance for *Roll Call*, called me for a quote on an article, "Using Super PACs to Get Rid of Super PACs." The day that article was published, I received a call from a producer for MSNBC's Jansing & Co. to appear the next morning on the show. Even after the two-minute appearance on MSNBC, I received calls and emails from students, individuals and regional reporters, and even an Austrian reporter covering super PACs; I was even invited to give a guest lecture to an undergraduate class at St. Mary's College of Maryland. Of course, I was not expecting most of this when I founded CREEP Super PAC.

One of the issues I grappled with then, and now, was defining the vision and mission for a super PAC. CREEP Super PAC had two stated goals: increase disclosure and strengthen the presidential campaign finance system. However, this was through online advocacy only, with the hopes of a larger grassroots organization using the concept of CREEP Super PAC to mobilize its membership.

Using a relatively obscure political reference was, for many, an obstacle in itself. (Although, it makes for great conversation with activists and politicos!) If the goal is to educate, then I had to move beyond the reference to an obscure re-election campaign named CREEP. In 2013, I renamed my super PAC, Raise Voices Not Dollars Super PAC. I successfully registered a mark, Raise Voices Not Dollars®, under the stated goal to educate the public about campaign finance reforms. With a redesigned website, new branding, Raise Voices Not Dollars Super PAC promotes campaign finance reform with two chief objectives: (1) increase participation and (2) reduce the amount of money in campaigns. Yet, few proposals prioritize only these two goals.

One of the most novel ideas in campaign finance reform is the application of environmental economics to how campaigns raise contributions. A Yale Law Review note reviews the theory but not the implementation of such a system. While matching grants, vouchers, and tax credits are the usual solutions for campaign finance, such a system—with an imaginably large set of market protections—could reasonably limit and, over time, slow the overall amount of money in politics. It's a provocative proposal, likely unconstitutional in several aspects, yet it's one of the only proposals that, at its core, emphasizes Raising Voices Not Dollars®. With a Supreme Court majority that supports deregulation, an effective means to reform campaign finance with both parties is to trade sacred cows, including contribution limits.

Nearly two years after Stephen Colbert's super PAC raised over $1 million, Prof. Lawrence Lessig aims to raise 12 times that amount with his MayDay PAC. His PAC is a completely different breed: well-funded and well-connected, with its boots-on-the-ground approach poised to have a profound impact on our politics.

There may be two tales in 2014: we are all going to reform our politics; we are all going direct the other way.