Effective Strategies for Addressing Corruption in the Americas

Political Incentives and Sting Operations

Luis Moreno Ocampo
March 11, 1999
David Rockefeller Center for Latin American Studies
Harvard University

Political Incentives and Sting Operations.

Objectives: For the present analysis I will use a real empirical case taken from a sting operation to illustrate the institutional incentives presented to enterprise managers as they interact with public officials. The case illustrates well how managers face strong incentives to participate in corruption and strong disincentives to challenge institutionalized bribe-exchanging practices. In the present case, a firm manager breaks with established bribing routines by seeking the assistance of an outside firm and exposing corruption publicly. At each phase of the case, the manager is confronted with a set of changing costs and benefits presented to him by the political institutions with which he operates. The case presents an interesting micro-view of the many ways in which the institutional arrangements between judicial bodies, political figures and public officials (bureaucrats) affect the propensity of managers to participate in corruption.

The Case

The main protagonist of this case is Mr. Carlos Visuara, CEO and majority stockholder of a 170-person refuse collection company called Predios Salta. From 1989 to 1996, Predios Salta had been contracted for refuse removal services for the city of Salta, the 700,000 inhabitant state capital of the Salta Province in northern Argentina. Since winning the original 4-year contract through a public bidding process in 1989, Predios Salta had continued providing refuse removal services through contract extensions that had been renewed every year since 1993. For the three years prior to the present case, the contract for services had been extended provisionally. In part because of Salta´s economic difficulties, payments for the refuse collection contracts in question had been delayed. These delays in the payment of over 2.0 million dollars which the municipality of Salta owed to Predios Salta began to pose problems. Total annual sales amounted to roughly 2.2 million dollars and the outstanding debt to the company began to threaten its viability. Prior to the events described here, payroll had been delayed for over two months.

Phase I

After attempting several other strategies to collect payment for his firm, Mr. Visuara finally met with Salta´s treasurer on April 22, 1996. When Mr. Visuara solicited payment, the treasurer informed him that by order of the Mayor, 33% of the contract ($660,000) would have to be paid in bribes in order for any payment to be made.

The request by the treasurer presents the first dilemma faced by this manager. At this point the manager has one of two general options: (1) to pay the bribe as solicited by the treasurer; or (2) to refuse to pay the bribe and seek an alternative route to payment. In choosing among the different alternative actions, the manager takes into considerations a series of factors that are determined primarily by state institutions and the actions of other players who participate in the event. For the present case, Mr. Visuara was able to calculate the best possible solution from the following choices:

(1) Option #1 entails the payment of the bribe. The greatest benefit to this option is the resolution of the problem, or, the payment of 67% of the contract. This option permits the manager, by securing payment, to insure the viability of his firm, to pay his employees and to continue operating with a network of public officials that will provide him with future contracts. The costs include any personal moral costs to participating in corruption and the possibility of being penalized legally for bribing.
(2) Option #2 entails non-payment of the bribe. The benefit of this option is restricted to the personal satisfaction of not participating in corruption, and some possibility in a long term of receiving 100% payment if legal action is successful. The costs are considerably higher. If the manager refuses to pay the bribe, he does not receive payment in the short term, placing the financial status of his firm in danger. He also faces a moral cost in terms of his professional responsibilities: by endangering the firm’s financial viability he could possibly put 170 persons out of work in a country with 17 % unemployment and no social security safety net. In addition he is also faced with possible exclusion from the institutionalized relationships with public officials that provide him with contracts for his firm. Finally, any future contract extensions would be lost.

The present case is very effective in illustrating the embedded nature of decision-making on the part of private sector managers. Calculations of a cost-benefit nature are fundamentally affected by state institutions. In the present case, Salta is characterized by low judicial autonomy, a high level of collusion between legislators and bureaucrats. The legislature and judiciary are governed more by personal loyalties than by official policy. As an example, the state prosecutor is the Mayor’s personal friend. In making the necessary estimation of the best possible solution for his problem, the manager takes into account the many institutional recourses that affect his possibilities for successful resolution.

Manager: “Yes, 33%. He said ´Two dollars for me and one dollar for you´.”

Mayor: (in anger) “He can not say that. He’s crazy. It’s abusive. That’s what he said?”

Manager: “Those were the boss’s instructions. To make a deal …”

Mayor: “Look, Visuara, I don’t like to include in these issues something so sacred and important like my family, but I swear on my sons that it’s not true.” (At this point the Mayor writes on a piece of paper “20” possibly trying to avoid being taped.).....Here it is. This is what I said to the treasurer, I swear by the light that shines on me… I am not a murderer, I am not a mugger, and I am not an extortionist.”

Manager: “I suppose this is an issue that we must discuss between us….”

With the meeting, the manager confirms that the Mayor is involved in requesting the bribe and obtains proof of his involvement in criminal activity. He now faced a new dilemma. His original cost-benefit calculation with regard to offering the solicited bribe begins to transform. After consulting with our firm, his personal moral cost in paying the bribe increased. He also increased his possibility of using the judicial recourse by collecting hard evidence of the Mayor’s involvement. But he also increased the costs of the political and economic consequences of challenging the Mayor. Some of those costs include: losing the extension to the contract in the future, and sacrificing his network of connections with state bureaucrats that provide him with business opportunities. Both of these consequences would lead to bankruptcy.

<u>Phase III</u>

Against our opinion, he decided to explore a new way meet with the Governor, trying to find a political solution to his case. The Governor, who is also a member of the same political party, offered to mediate between the parties, in order to avoid a public scandal. This recourse failed since the Governor was involved in internal power struggles that prevented him from forcing the Mayor to pay the outstanding debt.

An interesting twist to the story occurs when the Mayor charges Mr. Visuara with extortion. The district attorney (a close personal acquaintance of the Mayor) files a suit against Mr. Visuara alleging extortion through his use of the hidden camera to film the solicitation of the bribe. At this point the manager is forced to leave Salta and becomes a fugitive when the courts issue a warrant for his arrest. Not only is the judiciary not useful to the manager in securing a payment for his debt, but it is used against him by the public officials who elicited the bribe in the first place. Here the importance of judicial independence is illustrated through the concrete interaction between the Mayor, the district attorneys and the judges responsible for this case. The political use of the judiciary presents a strong incentive to managers for participation in corruption by denying any official, legal recourse.

In response to the Mayor's actions, our firm filled a claim before the same judge against the Mayor and showed the video on a nationally-televised program hosted by a respected Argentine journalist. On this show the Mayor presented his side of the story, alleging that Mr. Visuara was out to extort him by using a videotape. When confronted by the videographic evidence of his bribe request, he alleged that such a tape was evidence of the extortion.

On the Friday following the presentation of the video on television, the story was carried in most national and local newspapers, occupying the nation's media spotlight for the entire weekend. On Monday, the political scandal reached its climax. The Governor convoked a special session of the State Legislature in Salta and, *in one day*, passed a law to intervene in the case, fired the Mayor, and had him jailed by nightfall.

Resolution

Since the beginning of the case in 1996, Mr. Visuara the charges of extortion against him have been dropped, but he has not yet been paid the 2.0 million owed to his firm by the municipality of Salta. In 1997 a provisional Mayor was appointed by the Governor who proceeds to contract another refuse collection firm through sole source procurement (direct contracting). The Mayor was indicted, and his reputation was ruined, but is currently seeking re-election in Salta. Polls indicate that only 1% of the province's citizens plan to vote for him. One year following the scandal, a member of the opposition party was elected as Mayor of the city of Salta.

Conclusion

The present case permits a rare glimpse into the micro-level interactions that, on an aggregate scale, make up the socio-political structure in which private sector players operate. At each stage of the conflict between the manager and the public officials that solicited the bribe, the costs and benefits of participating in corruption change depending on the players involved in the conflict and the institutional avenues open to managers. But what remains consistent at each phase of the case is the disproportionate benefit to engaging in corruption without resorting to official means to resolve the conflict. The same set of disincentives that prevent wide-scale participation in the provision of public goods (free rider problem), prevent enterprise managers from challenging the system. While reporting instances of corruption helps to expose the guilty parties and corrupt institutions, the costs associated with whistle blowing prevent the wide-scale participation in anti-corruption efforts by firms. Essentially, most managers will satisfice by receiving a percentage of the payment rather than pay the substantial costs associated with not paying bribes.

In Argentina, as in the majority of developing countries, weak institutions construct a market environment in which firms perceive incentives that clearly make participation in corruption favorable in economic and political terms. According to Freedom House rankings, Argentina is placed squarely among the ´free countries´ with favorable ranking in terms of political and civil liberties. Over 80% of all countries in the world are categorized as less "free" than Argentina in terms of rule of law, electoral freedom, freedom of the press and accessibility to political figures.[1] The present case, more that a simple anecdote, can be analyzed as a paradigmatic example of interactions between politicians and public officials. According to a 1992 Gallup survey over 87% of businessmen indicated the use of bribery in interactions with public officials was common. If the present case is characteristic of business interactions in a "free" country, we can assume that business-state interactions in the other 80% of the developing world are similar or worse to the present case in terms of institutional incentives presented to the private sector.

[1] Freedom House. 1996. Freedom in the World: The Annual Survey of Political Rights and Civil Liberties, 1995-1996. Maryland: University Press of America.

	To Pay Bribe	Not to Pay
Benefits		
Financial Benefits	• 1.37 million Dollars	• No short-term financial benefits for firm.
Personal Moral Benefits	• None	• Personal moral satisfaction
Professional Moral Benefits	• Payment of salaries • Profit for stockholders • Inclusion in public contracting networks (future contracts) • Financial viability of firm, including the provision of employment for workers	• None
Costs		
Financial Costs	• 660,000 Dollars	• 2.0 million Dollars
Personal Moral Costs	• Personal moral cost in participating in corruption	• None
Professional Moral Cost	• None	• Loss of financial viability of firm • Loss of profits for stockholders • Loss of employment for 170 workers • Exclusion from networks of public contracting (no future work) • Loss of contract
External (Legal) Penalties	• Possible legal sanction if caught paying bribe.	• None