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## **Abstract**

Corruption presents an assurance problem to businesses: all businesses are best off if none act corruptly but in the event that corruption occurs are better off if they act corruptly than if they do not, and because there is no assurance that other actors are not cheating a business does not know how to act. The usual solution to an assurance problem – criminal sanctions imposed on cheaters – does not work in a corrupt system. Integrative Social Contract Theory suggests a solution to the assurance problem. Application of Integrative Social Contract Theory to corruption demonstrates that in the case of corruption it has advantages over international law, and that the theory's elegance lies in its recognition of norms generated by multiple communities.

## **Keywords**

corruption, Integrative Social Contract Theory, international law, microsocial contracts

## **Disciplines**

Business Administration, Management, and Operations | Business and Corporate Communications | Business Intelligence | Business Law, Public Responsibility, and Ethics | Finance and Financial Management | International Business | Law | Organizational Behavior and Theory

## Multiple Communities and Controlling Corruption

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### INTRODUCTION

Tom Dunfee wrote, with David Hess, of a “paradox of corruption” (2000, pp. 595–600). They begin with a rather broad paradox: “corruption is universally disapproved yet universally present” (2000, p. 595). They move on to the more specific:

There is a growing movement against the practice, yet there is no hard evidence that the level of corruption is declining – and it may even be increasing. Firms aggressively seek to prevent the corruption of their own employees while simultaneously approving of attempts to corrupt the employees of potential suppliers. Firms from countries that have reputations for being relatively clean of corruption are thought to be major sources of corruption in other countries. (2000, p. 608)

Dunfee and Hess use the existence of this paradox as an expository tool to introduce their real interest – a framework for controlling corruption – and do not explore the paradox's nature or origins. Within that paradox, however, lies a problem that is critical to understanding corruption and to understanding how to control corruption. Interestingly, unraveling the paradox Dunfee and Hess describe leads to another body of Dunfee's research, and to the idea that norms generated within multiple economic communities may contribute substantially to controlling corruption.

### THE REAL PARADOX OF CORRUPTION

I have elsewhere described the predicament of businesses with respect to corruption as an assurance problem (Nichols, 2004). Briefly, an assurance problem exists when actors are best off if they cooperate with one another, but in the event of cheating by another actor are better off if they themselves also cheat than they would be if they continued to comply with the rules.

Because the actors cannot monitor one another, they face uncertainty as to which course of action will yield the best result. Jean Jacques Rousseau ([1775] 1983) compared these actors to a group of hunters who only by working together can hunt in such a way that makes likely the capture of a stag, which will provide bountiful meat for all. A hunter who neglects her responsibilities to the group in order that she may instead capture a rabbit that she spies will not enjoy the bountiful meat of the stag, but will still have some rabbit meat. Because she stopped cooperating, however, the hunters who fulfilled their responsibilities toward the group hunt rather than collecting rabbits on their own get nothing when the stag slips through the gap created by defection – the hunters who cooperated will starve. The hunters must maintain silence and thus are unable to monitor one another; in the absence of assurance that their comrades continue to cooperate each hunter faces a conundrum when a rabbit presents an opportunity to defect (Skyrms, 2004).

Corruption clearly presents an assurance problem for businesses. If all actors abide by the rules, if no business acts corruptly, then all will be better off. On the other hand, if defection occurs, then those that do defect – those that act corruptly – will at least survive, whereas those that attempt to abide by the rules will probably suffer and could be driven out of business. The assurance problem created by corruption is amply demonstrated through examination of the harms caused by corruption.

Many scholars and many scholarly pieces enumerate the damage inflicted by corruption. Corruption inflicts profound damage on society. Selçuk Akçay provides a powerful summary of the empirical research on the effects of corruption:

It reduces economic growth, retards long-term domestic and foreign investments, enhances inflation, depreciates national currency, reduces expenditures for education and health, increases military expenditures, misallocates talent to rent-seeking activities, pushes firms underground, distorts markets

and the allocation of resources, increases income inequality and poverty, reduces tax revenues, increased child and infant mortality rates, distorts the fundamental role of the government (on enforcement of contracts and protection of property rights), and undermines the legitimacy of government and of the market economy. (2006, pp. 29–30)

Susan Rose-Ackerman provides an equally powerful summary of the social effects of corruption:

Corruption undermines the legitimacy of governments, especially democracies . . . Citizens may come to believe that the government is simply for sale to the highest bidder. Corruption undermines claims that the government is substituting democratic values for decisions based on ability to pay. It can lead to coups by undemocratic leaders. (2001, p. 44)

Corruption has been identified as a significant cause of dissatisfaction with economic and democratic reforms. When reformers announce economic and democratic changes in polities transitioning from repressive or authoritarian systems of governance, and persons living under those regimes then experience increases in systemic and often predatory corruption, those persons easily confuse democracy with corruption. This phenomenon has been particularly visible in Eastern Europe (Gray and Jarosz, 1995).

Corruption also affects business. Corruption increases costs, degrades the quality of administrative support and service, and decreases the enforceability of agreements (Nichols, 2004, pp. 1321–1326). The rusty theory that bribery benefited a business by allowing it to more quickly take advantage of markets and opportunities has largely been discredited; it describes a momentary (and only occasional) result of a bribe rather than the consequences over time of paying that bribe (Salbu, 1999, p. 49). Businesses are better off without corruption.

In a systemically corrupt system, however, a business that does not act corruptly may face extinction. A systemically corrupt system can be contrasted with an uncorrupted system. In an uncorrupted system, decision makers generally base purchasing decisions on how closely a good or service fits their needs and on price. A business that capably uses its resources to produce goods or services that satisfy the decision makers' needs and to lower the prices that it charges for those goods or services will be rewarded. In a systemically corrupt system, decision makers use an entirely different formula. Decision makers choose goods or services based on the quality of the bribe<sup>1</sup> rather than the intrinsic qualities of those goods or services. A business that competently uses its resources to provide the highest quality bribe will be rewarded (Bader and Shaw, 1983). A business that instead devotes a meaningful percentage of its resources to the quality of its goods or services cannot compete with a business that uses its resources to produce a higher quality bribe. In a systemically corrupt polity, therefore, businesses that do not cheat face extinction.

Clearly, corruption presents an assurance problem for businesses. Businesses will be better off if all (or almost all) businesses cooperate and if all

businesses abide by the rules regarding corruption. If, however, some businesses defect, then the defecting business – the business that enters into corrupt relationships – will be better off than those businesses that abide by the rules and continue to avoid corrupt relationships.

#### RESOLVING THE ASSURANCE PROBLEM

Amartya-Sen (1967, 1977) brought a great deal of attention to the assurance problem as a game theoretic. Studying assurance games does provide insights into the real world (Bruhl, 2003; Harsanyi, 1986). Economists and philosophers alike agree that in the real world criminal sanctions constitute the traditional solution for an assurance problem (Axelrod, 1984; Rawls, 1971). Criminal sanctions, however, rarely have effect in conditions of systemic corruption, for the fairly obvious reason that the defecting actor – the corrupt party – can purchase a favorable decision rather than suffer the actual penalty (Katyal, 2003, p. 1398; Reed, 2001, pp. 467–68; Richman, 2003, p. 825).

The transnational regime has responded. The United Nations agreed upon a Convention Against Corruption, which promotes cooperation among nations in combating corruption (United Nations, 2003). More concretely, the Organization of Economic Cooperation and Development requires all members to criminalize transnational bribery by persons or entities under their jurisdiction (Delaney, 2007). The Organization of American States imposes a similar requirement on its members, although members have not enacted legislation as rapidly as have the members of the Organization for Economic Cooperation and Development (Lacey et al., 2005). International Financial Institutions such as the World Bank and the International Monetary Fund blacklist contractors who have been involved in corruption in funded projects (Rogers, 2008). David Hess describes some of the measures taken by business regulators in his article in this volume (Hess, 2009).

These efforts in some ways correct the failure of the traditional solution to the assurance problem created by corruption. A defecting actor might purchase a favorable decision from corrupt decision makers in a systemically corrupt polity, but that actor is less likely to be able to do so in its presumably less corrupt home country, and thus transnationally corrupt actors do face penalties for not cooperating.

These efforts fall short, however, by reaching only those actors who act transnationally or who involve themselves in trans-national projects. These sanctions do not provide assurance to local actors who compete and cooperate with other local actors. As mentioned, local criminal sanctions do not provide assurance, because corrupt actors can purchase favorable treatment. The assurance problem created by corruption is not solved through the actions of the transnational regime.

#### INTEGRATIVE SOCIAL CONTRACT THEORY

Tom Dunfee's body of work, particularly that conducted in

collaboration with Tom Donaldson, provides two insights into a possible solution to the dilemma noted by Dunfee and Hess. Integrative Social Contract Theory, described elaborately in this volume and elsewhere, focuses on behaviors and standards agreed to within self-constituted communities. Two important artifacts form boundaries around those agreements: a macro-social contract and hypernorms.

Integrative Social Contract Theory integrates two sets of contracts. The first is the implicit social contract of the sort that philosophers such as Locke and Rawls placed at the center of their own theories of ethics and social organization (Keeley, 1995, pp. 244–246). Locke, for example, famously suggested an implied contract binding governments to respect the rights of those governed. Macrosocial contracts are those rules that would be agreed to by the great majority of rational and educated members of a society; they are the principles that allow a large social organization to function, they are normative – what Dunfee and Donaldson refer to as “oughts” (1999, p. 24; see Donaldson and Dunfee, 1994, p. 254; 1995, p. 93). By necessity, therefore, they are relatively few and they are somewhat general in nature.

Dunfee and Donaldson suggest that, given this condition of generalized rules, one rule on which rational participants would agree is that economic actors within a society are free to form distinct communities, within which they may negotiate more specific rules (1999, p. 37). “A community is a self-defined, self-circumscribed group of people who interact in the context of shared tasks, values of goals and who are capable of establishing norms of ethical behavior for themselves” (1999, p. 38). Dunfee and Donaldson’s conception encompasses communities as large and as structured as the European community and as small and spontaneous as a handful of friends pooling resources to purchase lottery tickets (Dunfee, 1993, p. 68).

The rules negotiated among members of these smaller communities provide the detail and direction not provided by the macrosocial contract, they “fill in what macro contracts leave out” (1999, p. 20; see Donaldson and Dunfee, 1994, pp. 260–262; 1995, pp. 93–95). The directives, regulations, and rulings of the European Community constitute microsocial contracts, so too does an agreement among friends as to how to divide any winnings from a jointly purchased lottery ticket. While macrosocial contracts embody “oughts,” microsocial contracts manifest what “is” (1999, p. 24). Integrative Social Contract Theory, therefore, unites the ought and the is.

These two sets of social contracts, integrated through operation of the macrosocial norm that grants smaller communities the authority to create rules, are themselves bounded by incontestable, non-negotiated norms, denominated by Dunfee and Donaldson as hypernorms. Hypernorms constitute “a thin universal morality . . . principles so fundamental that, by definition, they serve to evaluate low-order norms . . . reaching to the root of what is ethical for humanity” (1999, pp. 43–44). A social contract of any sort that contravenes a hypernorm has no power or legitimacy.

Dunfee, and Dunfee and Donaldson discuss bribery in terms of these hypernorms. They begin with the observation that the universal condemnation of corruption probably constitutes a hypernorm (1999, p. 225; Dunfee, Smith and Ross, 1999, p. 24). Every polity in the world criminalizes bribery, every survey conducted indicates that even in polities

in which corruption is prevalent it is despised (Nichols, 1997, p. 318). Every major religion in the world condemns corruption: the Holy Qoran proclaims that “Allah loveth not the corrupter” (*sura* 28:77), the book shared by the Jewish and Christian faith directs “you must not accept a bribe, for a bribe blinds clear-sighted men” (*Exodus* 23:8). Bribery violates the second precept of morality prescribed by the Buddha (Dhammaratana, 1972, pp. 7–18), violates the “righteous rule” proscribed by Sikhism (Singh, 1986, p. 141), and incurred draconian punishment in ancient Hindu texts (Thakur, 1979, p. 14). The Confucians, predictably, censured corruption (Cleary and Higonnet, 1987, p. 669) and the Taoists, just as predictably, mocked it (Lao Tzu, [168 b.c.e.] 1989, p. 22).

This universal, and ancient, condemnation of corruption is not enough for Dunfee and Donaldson. What if, they argue, everyone in the world changes their mind and embraces corruption as a moral good (1999, p. 226)? In that case, they argue, both a macrosocial contract and a superior hypernorm militate against corruption.

The macrosocial contract involves the duty of the bribe-taking actor to its principals. Public sector corruption is usually defined as use or abuse of public office or trust for personal rather than public benefit (Nye, 1967, p. 419); private sector corruption would have a similar definition. Corruption, therefore, essentially involves a betrayal of a trust relationship. The foundation for that trust relationship, the basic rules, would constitute part of the macrosocial contract of a polity. Corruption breaches this macrosocial contract.

Dunfee and Donaldson, however, are not content with this macrosocial norm. The general principle that one honors a trust relationship, they suggest, does not preclude corruption driven by a superior macrosocial norm or by a hypernorm, nor does it in their mind apply to the bribe-giver. They therefore turn to two more hypernorms. First, they point out that public corruption deprives honest persons of participation in government. “To the extent that one places a positive, transnational value on the right to political participation, large bribes of publicly elected officials damage that value” (1999, pp. 126–127). Even the application of this hypernorm, however, does not satisfy them, because it does not apply to all corruption.<sup>2</sup>

Dunfee and Donaldson therefore turn to a final hypernorm – a hypernorm to which they give special attention. Corruption, they argue, violates the fundamental hypernorm of necessary social efficiency (1999, pp. 229–230). Institutions and norms, they claim, should function to provide people with social goods. All actors who participate in the economic life of a polity, therefore, have a responsibility toward the provision of social goods. Corruption destroys social good rather than producing it; corruption violates the requirement embraced in this hypernorm.

Having gone through a thorough application of Integrative Social Contract Theory to the problem of corruption, Dunfee and Donaldson are able to conclusively say that their framework does provide instruction to a business manager. This conclusion, however, promises to be most dissatisfying to the manager. It tells the manager what the manager already knows, and does not provide a solution to the manager’s real problem. The manager already knows that laws and social norms prohibit the payment of a bribe – corruption is in fact universally proscribed and universally



condemned. The manager's real problem is ascertaining whether or not competitors will pay the bribe. The problem is one of assurance.

The solution to the assurance problem does not lie in Dunfee and Donaldson's discussion of hypernorms or in macrosocial contracts. Instead, the solution lies in microsocial contracts – in rules explicitly negotiated among self-constituted communities.

### THE MICROSOCIAL CONTRACT

Dunfee and Donaldson ignore the microsocial contract when speaking of corruption, yet it is the microsocial contract that offers the most promise in providing meaningful guidance to managers with respect to corruption. Dunfee and Donaldson recognize a world made up of multiple, overlapping economic communities. Groups of businesses affected by specific types of corruption could be described as a community. These communities may or may not recognize themselves as such; a first step toward resolving the assurance problem is acknowledgement that these businesses together form a band of hunters who can capture stag together or rabbits alone.

Precedents exist for businesses forming explicit communities. These range, as Dunfee and Donaldson might predict, from local professional clubs to global organizations such as the International Chamber of Commerce. Many of these organizations embrace discussion of normative issues. CentraRSE, for example, brings together more than one hundred Guatemalan businesses in twenty different sectors specifically for the purpose of developing standards for the social responsibility of business.<sup>3</sup> The International Chamber of Commerce, working with thousands of businesses, develops model codes of conduct including codes directed at social issues (Getz, 1990). It is important to note that many of these economic communities overlap political boundaries: the Caux Roundtable, for example, specifically brings together businesses of different cultures and particularly different faiths for the purpose of discussing and developing normative standards (Küng, 1997, pp. 24–25); Transparency International develops standards of behavior for business sectors regardless of the home country of the business (O'Higgins, 2006).

Proactive, explicit negotiation within these economic communities of rules regarding corruption has four advantages over simple reliance on the hypernorms or macrosocial contracts regarding corruption. First, the macrosocial contract will reinforce and reaffirm the hypernorm. The Holy Qoran, for example, straightforwardly states that Allah does not love those who corrupt, and yet rampant corruption flourishes in some piously Islamic countries. Corruption violates dharma, yet corruption flourishes in some devoutly Buddhist countries. The very nature of the paradox noted by Dunfee and Hess suggests that in the case of corruption the existence of a clear hypernorm is not enough to control corrupt behavior. Microsocial contracts can reinforce the "ought" of a hypernorm by posting an agreed-upon "is."

Second, as Dunfee and Donaldson point out, the microsocial contract will have more detail than the macrosocial contract or a hypernorm. Corruption involves complex behaviors.<sup>4</sup> Dealing with complex behaviors

requires more than a simple proscription. The absurdity of a simple proscription is amply demonstrated by an edict proclaimed by former Philippines dictator Ferdinand Marcos, who forbid government employees from accepting any gifts from any persons at any times, including holiday or birthday gifts from family members. This draconian policy was almost certainly ignored by most government employees, and did little to prevent Marcos's Philippines from being perceived as one of the most corrupt polities in the global economy. Indeed, a simple proscription on corruption provides almost no guidance to an actual actor; the lack of real guidance translates into a lack of assurance that other actors will cooperate with the rules and leaves that actor facing a conundrum when he or she is presented with an opportunity to act corruptly.

The microsocial contract should establish a minimum level of conduct, whether by rule or by value. The United States' Foreign Corrupt Practices Act, for example, prohibits all transnational business-related bribery except bribes paid to facilitate non-discretionary clerical acts. While most ethical frameworks would find the payment of facilitating bribes morally reprehensible, and while those bribes do inflict social and economic damage, the Foreign Corrupt Practices Act as a microsocial contract does establish a minimum standard of behavior – actors are free to comply with higher standards but all have agreed to at least behave in this way.<sup>5</sup>

Third, local communities can agree upon methods of reporting cheating that do not rely on corrupt government institutions. The conventional response to an assurance problem – enforcement of rules by the state – does not solve the assurance problem created by corruption because corruption renders the state ineffective. Self-constituted communities, on the other hand, can develop other methods of enforcing standards or can create channels for conveying information about the behavior of other actors. Methods of enforcement could include measures such as affecting the reputation of businesses that engage in corruption, reporting corrupt businesses to international agencies, excluding corrupt businesses from preferential arrangements, or imposing private penalties and fees. Methods of conveying information could include measures such as corruption audits, reporting mechanisms for members of the public, and decision-making certifications similar to those used to ensure capable accounting processes or compliance with human resources or labor laws.

Fourth, the process of negotiating rules and norms regarding corruption could help to reduce corruption and to engender trust within a community of businesses. Martin Sandbu (2007) has written of the value of process. Sandbu demonstrates that actors find value in process distinguishable from the outcome of that process. With respect to corruption, the very act of discussing openly and negotiating standards for a practice usually hidden in shadows can begin to generate trust and understanding among the parties.

## INTEGRATIVE SOCIAL CONTRACT THEORY IS SUPERIOR TO INTERNATIONAL LAW IN SOLVING THE ASSURANCE PROBLEM

Controlling corruption will require many tools; law and international law will play an important role. Integrative Social Contract Theory, however, highlights deficiencies of international law; law alone cannot resolve the damage inflicted by corruption.

Integrative Social Contract Theory integrates two sets of contracts: the aspirational macrosocial contract – the “ought” – and the far more tangible microsocial contract – the “is.” International law also, inadvertently, integrates an “ought” and an “is.” The “ought” consists of a highly idealized notion of the only relevant international actor: nations. Although international law has undergone a healthy dose of transformation, at its core it remains the law of nations. The nations envisioned in international law, however, are more idealization than reality. International law envisions self-contained nations with impermeable borders, their equality sacrosanct. In reality, nations are highly interdependent, the people who reside in those nations form multitudinous relationships across the political boundaries of nations, and nations do not exist in a state of organizational equality.<sup>6</sup> Indeed, parts of the world are not even organized into nations.

Integrative Social Contract Theory is not bounded by political borders. Although one can—if one desires read Dunfee and Donaldson as implying that macrosocial communities consist of nations, that need not be the case. Moreover, microsocial communities explicitly can exist without reference to political borders. International law envisions communities that stop at the border, with nation acting as the proxy or representative when negotiating norms across or between borders. Integrative Social Contract Theory gives expression to natural human communities.

Integrative Social Contract Theory also takes into account the multiple communities to which one business or person may belong. International law recognizes but one community; all other communities are subsumed or are extensions of the nation. As a result, Integrative Social Contract Theory reaches levels of human organization not reached by international law. While political science’s discussion of “devolution” of policymaking authority has to some extent entered the jurisprudential dialogue (e.g., Koch, 2007), doctrinal international law continues to consider nations the cardinal form of organization. International law does not reach subgroups within those states, or across states, and has no method of accounting for quasi states or polities that exist outside the recognized state system.

Integrative Social Contract Theory is also far more democratic than international law. As Robert Jackson has pointed out, international law no longer even requires that a nation be nominally representative of its people (Jackson, 1987). Under modern principles of international law the most despotic nation is accorded equal rank and privilege with all other nations; and its internal rules accrue equal measures of respect and deference. Integrative Social Contract Theory, on the other hand, imposes tests of authenticity on purported rules. Moreover, communities that may be

minorities within a larger macrosocial community are still accorded freedom to negotiate rules within their own economic community and these rules may survive challenges by the larger community. The same is not true of international law.

#### THE USE OF INTEGRATIVE SOCIAL CONTRACT THEORY

Dunfee and Donaldson's application of Integrative Social Contract Theory to corruption is interesting, but ultimately does not provide sufficient guidance to managers working in corrupt systems. Nonetheless, Integrative Social Contract Theory itself ultimately proves a far more useful norm-generating mechanism than does international law. The application of Integrative Social Contract Theory to corruption illustrates two aspects of the theory that may have use for managers faced with other, similar decisions.

First, hypernorms do little to assist a manager who needs specific guidance when faced with a specific problem. In the case of corruption, the hypernorms identified by Dunfee and Donaldson at most tell a businessperson not to pay bribes; this does not help the businessperson facing the assurance problem created by corruption. Regardless of whether the controlling hypernorm is the universal condemnation of corruption or a hypernorm of efficiency, the businessperson already knows not to pay and instead needs direction as to *how* not to pay and how to rust that others will not pay.

Hypernorms, like macrosocial contracts, are by their very nature likely to be general in nature and lacking in detail. They provide signposts rather than maps. Instrumentally, hypernorms may be more useful in validating or invalidating locally created norms than in directing specific action. If a local community, for example, of businesspersons negotiated among themselves a norm accepting or promoting bribery, the hypernorms condemning corruption would disqualify their microsocial contract.

Such an instrumental purpose does have value. As Dunfee (1999, p. 146) himself noted, it is likely that a hypernorm exists prohibiting the use of torture: numerous international instruments prohibit torture, cultural consensus condemns torture, and most people are repelled by torture (Koh, 1991, p. 2376). In the United States, a small group of people suggested that the President of the country could abrogate international law and authorize torture; the ensuing debate has asked among other things whether such a regime *should* be allowed. A hypernorm against torture would suggest that this microsocial contract is not legitimate.

Second, although some critics may suggest that Integrative Social Contract Theory is too cumbersome, in that it requires managers to discern microsocial contracts before making decisions, those critics would miss the true elegance of the theory. The elegance of the theory lies in its recognition that multiple communities do exist and that they do negotiate rules among themselves. Integrative Social Contract Theory recognizes that the vast bulk of the world's norms are not preceded by the phrase "hyper," even though those might be the norms that receive the most scholarly attention.

Corruption will not be eradicated through the simple observation that corruption is wrong and should not be engaged in – the paradox noted by

Dunfee and Hess indicates that the universal proscription sometimes has no effect. Real control requires that communities explicitly address corruption and generate trust and assurance through the negotiation of specific rules. As Tom Dunfee's theory suggests, control of corruption requires the integration of a universal ought with a clearly articulated local is.

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#### Notes

- 1 The quality of the bribe refers not only to its size but also to the bribe-taker's ability to use a particular bribe.
- 2 The hypernorm does not speak to petty corruption, nor does it address corruption in undemocratic polities.
- 3 Information on CentraRSE can be found at <http://www.centrase.org>.
- 4 Corruption certainly is not unique in this respect – indeed, many of the behaviors contemplated under the rubric of business ethics involve complex decisions and relationships.
- 5 The facilitating payment exception of the Foreign Corrupt Practices Act is a particularly apt example of a microsocial contract, because it resulted from lengthy deliberations between the United States legislature and domestic businesses.
- 6 This is not to say that nations are inherently unequal. Rather, organizationally some nations subordinate functions to other nations, Switzerland, for example, includes the nation of Lichtenstein within its customs territory; some nations subordinate their governing process to other nations, France and Spain, for example, appoint the heads of state of the nation of Andorra.

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