



Long Reads

The Wisdom of Whistleblowers

Nov 19, 2021 | DAMBISA MOYO

NEW YORK – In September 2021, the US Securities and Exchange Commission handed an anonymous whistleblower \$110 million. It was the second-highest single award to an informant whose actions have led to a successful prosecution since the SEC launched its whistleblowing program in 2012.

In one of the program's earliest cases, Sherry Hunt received a \$31 million payout in 2012 as a settlement for revealing that her employer, Citigroup, was buying mortgages from outside lenders with doctored tax forms, phony appraisals, and missing signatures. Later that year, the Internal Revenue Service awarded an even higher payout – \$104 million – to Bradley Burkenfeld for exposing many secrets of the Swiss banking system. All in all, since 2012, the SEC has awarded more than \$1 billion to more than 200 informants. Each received a payment of between 10% and 30% of all fines collected in cases where penalties are more than \$1 million.

The SEC's program therefore has been instrumental to encourage whistleblowers to come forward and report illicit, illegal, and corrupt behavior in the private sector, and many see whistleblowers as a crucial line of defense against bad actors. In a recent high-profile whistleblower case, Frances Haugen, a former product manager at Facebook, filed a complaint with the SEC that, while not pointing to a clear-cut case of illegality, raises questions about the social obligations of Big Tech companies.

Could whistleblowing play a transformative role in the fight against global corruption and reduce the cost of financial crimes such as bribery and money laundering?

Corruption spans the private and public sectors, is present in developed and

developing nations, and ranges from multi-million-dollar schemes to low-level, everyday bribery. While the damage that rampant corruption causes to a political system is widely recognized, its full and corrosive effect on economic performance is less appreciated. The United Nations estimates that the cost of corruption tops 4% of global GDP, or approximately \$3.6 trillion annually. Put another way, the cost of global corruption is the same as the GDP of France and the Netherlands combined.

But who should be responsible for policing corruption, and what is the best process for bringing bad actors to book? There have been many attempts to combat rampant corruption and rent-seeking – from rules binding government officials and restricting how public funds are used to harsh penalties against offenders (such as those rolled out in China). Yet, historically, the extent of draconian anti-corruption campaigns' success is unclear, and some have even harmed the economy by engendering fear, introducing red tape, and discouraging investment.

Does whistleblowing represent an effective middle way? While the practice has its limitations, measures to encourage more of it nonetheless could help to eliminate graft, which remains a key obstacle to economic progress in many countries. That is why whistleblowing could become regulators' tool of choice for exposing malfeasance and illegal activities.

The Corruption Trap

Corruption is dishonest or fraudulent conduct. It typically involves bribery and the skimming of an organization's funds for personal gain. But in some contexts, where institutions are weak and ineffective, bribery is seen as a way of overcoming complex bureaucratic constraints and inefficiencies. This kind of "positive corruption" offers a way to "grease the economic wheels." A public official might profit from a bribe in exchange for speeding up the construction of a new road that benefits all. In this case, the outcome is not immoral or economically detrimental, but the method for reaching it is.

Notwithstanding such examples, the potential harms from corruption outnumber the potential benefits. The many "negative" forms of corruption and rent-seeking lead to higher transaction costs and uncertainty, inefficient investments, and misallocation of crucial factors of production like capital and labor. This diversion of scarce resources can lead to significant losses in private-sector development and economic performance.

Corruption also can undermine confidence in public institutions, weaken management of government budgets, and limit the development of small and medium-size enterprises. Moreover, mass corruption correlates with reduced investment in health and education and higher rates of infant mortality, poverty, and inequality. There is little doubt that successfully fighting corruption can lead to better fiscal performance.

As a practical matter, detailed national and international estimates of the costs and scale of corruption do exist. Payment of bribes is estimated to exceed \$1 trillion each year. That is a staggering figure, representing 1.2% of global GDP, and it measures only one aspect of the problem. According to Global Financial Integrity (GFI), illicit financial flows cost the developing world \$5.86 trillion in the first decade of this century.

Nowadays, cross-country rankings like the Transparency International (TI) Corruption Perceptions Index serve as an essential guide to the corruption problem. But such indices can oversimplify the issue, creating the impression that corruption is a problem mainly in the developing world, which certainly is not the case.

Precise data on corruption are hard to estimate. But many indicators confirm that developed countries are responsible for a lot of it. For example, the United Kingdom's National Crime Agency estimates that £36-90 billion (\$49-124 billion) – representing up to 4.5% of the country's GDP – might be laundered through the country each year. And even these estimates do not reveal the whole picture, because they do not account for the considerable corruption-related opportunity cost of lost investment, which has knock-on effects on an economy's growth prospects.

While the full extent of global corruption is difficult to quantify, we know that cracking down on the problem yields far-reaching benefits. Based on World Bank data, if countries effectively combatted and reduced corruption, the global economy could recoup roughly the annual amount that the International Energy Agency estimates is needed to fund the global energy transition to net zero by 2050.

But unlocking this “good-governance dividend” is not simple. There are essentially three ways that an economy can rid itself of corruption and rent-seeking behavior.

One method is to apply conditionalities, such as constraints on cash transfers designed to prevent their being redirected for fraudulent use. This is a compelling idea, in principle, because it seems to parallel the covenants in bank loans. A country receiving funds would, in theory, be bound by conditionalities to spend the loans and aid grants it receives on projects, such as schools and hospitals, that would provide clear benefits to the public. But a World Bank study found that as much as 85% of aid flows were used for purposes other than what was intended.

Poor enforcement of conditionalities reflects perverse incentives, both on the donor and the recipient side. The donor is motivated by the desire to win votes at home, or simply to be seen to be doing good in the world. For the recipient, unfettered cash is a means to consolidate power or win re-election by offering inducements to various political stakeholders.

Conditionality is great in theory, but there is a limit to what it can achieve in practice, because political expedience often trumps it. That is why TI's Corruption Perceptions

Index routinely indicates that the world's most corrupt countries tend to be the largest aid recipients.

The Great Purge?

A second option is to launch an aggressive anti-corruption drive. Over the last decade, China's well-publicized efforts to stamp out abuses of power for personal gain have seized the world's attention. Chinese President Xi Jinping's top-down campaign to root out "corruption and malfeasance" in the Communist Party of China (CPC) is the largest anti-corruption effort in the history of the People's Republic.

But the campaign has not been perfect, owing to the complications presented by "positive corruption." Following Xi's reforms, many Chinese officials arguably have been slower to approve projects, and there have been growing concerns that the risk of punishment is discouraging investment. Wealthier citizens are increasingly avoiding purchases of luxury goods for fear of prosecution.

The effects are not negligible. According to one estimate, China's anti-corruption campaign cost the Chinese economy as much as \$100 billion in 2014, as hesitant government officials scaled back on investment decisions to avoid unwanted scrutiny. And, despite China's years-long anti-corruption campaign, its ranking in TI's index has barely budged, rising from a rank of 80 and a score of 39/100 in 2012 to a rank of 78 and a score of 42/100 in 2020.

Once corruption has become deeply entrenched, it is hard to uproot. Xi is right to worry that a failure to deal with corruption could threaten the CPC's rule. There remains an ongoing debate about whether, when graft is endemic, only a full-scale civil war or economic collapse can eliminate it.

But China is not alone. Brexit, the election of Donald Trump as US president, and other eruptions in the developed West in recent years were driven by a populist backlash against what is perceived to be a corrupt establishment. Many citizens believe that corruption is deeply rooted in political and financial institutions, from the European Union to Wall Street. The more widespread this perception becomes, the greater the threat of political and economic instability.

The Whistleblower Option

If conditionalities and crackdowns are ineffective, whistleblowing offers an attractive third way to fight corruption. Protected by several international conventions and national laws, it is becoming an important component of corporate governance as more firms rely on it to root out malfeasance and expose unethical behavior. Whether a program to encourage and protect whistleblowing succeeds depends on three factors: guidelines for what constitutes corruption; a process by which complaints and accusations can be levied and evaluated; and the payments or rewards for flagging misconduct.

There need to be clear and explicit definitions of corrupt behavior. These might specify the misappropriation of public funds; the use of an official position to extract bribes; conflicts of interest in contracting and procurement; and nepotism in hiring, compensation, and promotion.

Likewise, the process of whistleblowing must establish standards concerning how complaints of alleged transgressions are reported to the appropriate authorities, who themselves must be independent and perceived as such. The process should include assurances that the complainant will retain anonymity and protection in their employment and position.

Of course, this is easier said than done. The process – whether it is through a hotline, an app, or some other secure channel – must be deftly handled, both to protect identities and to prevent abuse of the system. If whistleblowing is seen to offer job security, it could become a perverse incentive for underperforming staff who suspect they may soon be terminated.

Finally, there is the issue of rewards. Whereas a figure that is too high creates another perverse incentive, potential whistleblowers might not think the rewards outweigh the risks if it is too low. Ideally, the reward would reflect the level of personal risk taken, rather than just the dollar values involved in the case. A member of a corporate board, for example, might be taking on less financial and career risk than a junior employee in the same organization. And when should the reward be paid – when corruption charges are brought, or only after a conviction or settlement is secured? Equally important are the details and design of *who* should pay the reward.

As every economist knows, incentives matter. If properly designed, monetary payments from whistleblowing programs can act as a powerful deterrent of bad behavior, discouraging people from engaging in graft and other corrupt practices for fear of being exposed. Such incentives have met with some success in countries ranging from Mexico and Brazil to the US. In these cases, monetary inducements have influenced macroeconomic variables such as school attendance and vaccinations, all of which can contribute to better growth outcomes.

That said, relying on whistleblowing to eradicate corruption has risks. Beyond the possibility of the system being abused, whistleblowing programs can erode social trust and solidarity. During the McCarthy era in the US and under the Nazi regime in Germany, everyone was expected to monitor his neighbor and blow the whistle on anything that seemed suspicious.

Tuning the Whistle

Today, technological innovations promise to make whistleblowing safer, easier, and more anonymous than in the past, according to recent research from the Brookings Institution. IPaidABribe.com, now active in more than 25 countries, enables citizens

to report petty bribery and “track the market price” of corruption anonymously. Unveiled in India in 2010, the site had collected nearly 49,000 reports from 645 Indian towns and cities by 2015.

Chinese authorities also are increasingly relying on private citizens to help tackle corruption. A whistleblowing platform within WeChat, the popular Chinese messaging platform with more than one billion active monthly users, helps bring to light complaints and accusations. All reports of alleged wrongdoing by Party members are encrypted to protect the identity of the user.

These programs have demonstrated the enormous potential of such methods. But it remains to be seen what works best for each locale. Policymakers will need to compare and contrast approaches to determine whether it is better to focus more on carrots, sticks, or some combination of the two.

Consider the difference between the approaches taken by the US and the UK. In the US, whistleblower programs – whether administered through the SEC or the IRS – have tended to rely on claims by individual citizens who stand to receive monetary rewards. By contrast, the UK’s Serious Fraud Office offers *compensation* for losses incurred for whistleblowing (such as lost employment or earnings), but it does not offer a monetary reward.

That difference has far-reaching consequences both for how payments to whistleblowers are funded and for the longer-term viability of anti-corruption efforts. In the US, the Department of Justice obtained more than \$2.2 billion in settlements and judgments from civil cases involving fraud and false claims against the government in the fiscal year ending September 30, 2020, of which \$1.6 billion (around 74%) came directly from whistleblowing programs.

Recoveries since 1986, when Congress substantially strengthened the civil False Claims Act, now total more than \$64 billion. And from 2012 to the end of August 2016, the SEC, with the assistance of whistleblowers, had ordered \$504 million in sanctions and paid out \$107 million in rewards.

This success in retrieving stolen money suggests that some form of monetary inducement does indeed encourage individuals to come forward and report transgressions. But much depends on the design of the program. In the US, stolen money that is recovered is returned in *full* to the organization that lost it, while the payment made to the whistleblower (in the case of the SEC) is paid out of a pot of fines imposed on corrupt parties. Harmed parties do not pay whistleblower awards.

In the UK, where policymakers made a conscious decision not to offer financial rewards to whistleblowers, the Financial Conduct Authority recorded a 19% decline (from 1,367 to 1,104 cases) in whistleblowing reports between 2014 and 2015, despite having launched a new whistleblowing initiative. By contrast, individuals

throughout the US as well as from 67 other countries provided more than 4,200 tips to the SEC in 2016, an increase of approximately 40% over the number of tips received in 2012.

The problem of false claims poses a considerable operational hurdle, but it is not unique to reward-based programs. Any whistleblowing program will attract false claims, because they offer an open channel through which people can create trouble for others. As a practical matter, frivolous reports can prove costly.

But the problem is not insurmountable. Whistleblower-style models have long been used successfully to elicit the public's help in prosecuting criminals. Programs such as Crime Stoppers in the US offer small rewards of up to \$1,000 for information relating to less-serious offenses. The police pursue criminals through leads obtained from informants who in many cases are promised some form of payment or reward offered by aggrieved parties (in these cases, the police agencies merely act as a conduit for reward payments). And, of course, counterterrorism efforts rely on private citizens to help identify suspicious activities. In each case, government authorities have successfully leveraged the power of individuals to combat crime.

WhistleLeaks

The fight against corruption could take a similar form at the level of individual nation-states. But an even more ambitious approach would be to establish an international watchdog agency, possibly under the auspices of the World Bank. The proliferation of cross-border financial flows in today's interconnected world makes this an attractive proposition.

GFI estimates that about 45% of illicit flows end up in offshore financial centers, 55% of which are in developed countries. Outflows from developing countries ultimately end up in banks in rich countries like the US and the UK, as well as in tax havens like Switzerland, the British Virgin Islands, and Singapore. And GFI's calculation is regarded as highly conservative, because it does not include movements of bulk cash, the mispricing of services, or many other types of money laundering.

These forms of cross-border corruption are currently policed by a ragtag collection of international agencies, such as Interpol, national regulators, and individual banks and other financial institutions (largely focused on self-policing). Perhaps not surprisingly, the system is proving woefully unequal to the task of combating global terrorism, money laundering, bribery, and illicit financial flows.

In 2012, researchers at Griffith University in Australia showed just how susceptible global financial institutions are to corruption. Posing as consultants, the researchers sent more than 7,400 emails requesting to purchase shell companies to more than 3,700 Corporate Service Providers in 182 countries. Nearly half of the replies they received failed to ask for proper identification, and 22% never asked for any identity documents at all to acquire a shell company. Even more surprising, the study found

that providers in poorer, developing countries and those selling shell companies from tax havens were significantly *more* likely to comply with the rules than were providers in developed countries like the US and Britain.

Internal audits by large institutions in the developed world simply are not sufficient. A 2016 report by the Association of Certified Fraud Examiners concluded that tip-offs account for 40% of initial detection of occupational fraud (defined as asset misappropriation, corruption, and financial statement fraud). By contrast, internal audits, the next most effective mode of detection, account for less than 17%, and law enforcement detects a mere 2.4% of fraud cases. The ACFE report also showed that organizations that lack anti-fraud controls tend to suffer a greater average loss per fraud. Organizations with a whistleblowers' hotline lost an average of \$100,000, whereas those without a reporting mechanism lost \$200,000.

Going Global

But it is one thing to administer a whistleblowing program within a single organization; it is quite another thing to do it at the global level. The costs and complexities of the task should not be underestimated. We are in the era of big data and cryptocurrencies. The challenges posed by technologies such as Bitcoin could prove daunting if they arise in the grey areas where nation-states and national regulators have no defined jurisdictional authority. As capital flows and corruption become increasingly international and mediated by new technologies, so must the fight against corruption.

A form of whistleblowing on an international scale has been taking place in recent years through investigations like the Panama Papers and Pandora Papers. The release of the Pandora Papers in October revealed that former Austrian Chancellor Sebastian Kurz spent government money to fund his political campaigns, leading to his resignation. The papers also revealed that the Czech prime minister, Andrej Babiš, had used offshore companies to buy a luxury property in France. He was voted out of office the same month.

But this form of whistleblowing relies on dissemination by media – and trial by public opinion. It does not appear to use a systematic legal process to put perpetrators on trial and issue penalties and sanctions, nor does it reward or incentivize whistleblowers to come forward.

We need a global response with technology at its heart. A global whistleblower agency would need the resources and the operational independence to its job properly, with neither fear nor favor. The key components of institutional success should be straightforward.

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Because individual whistleblowers need to be protected from reprisals, the organization itself also would need to be protected from malign external influences or political pressure. Technology can help here, by offering genuine confidentiality through encryption. This is particularly important in more hierarchical societies where people can be culturally deterred from reporting their superiors' crimes. China's bottom-up social-media model already ensures that all reports are encrypted to protect identities. Moreover, the process to evaluate and substantiate the validity of charges must be transparent and independent. And last but not least, a global whistleblower agency would need to be equipped to offer monetary inducements (aligning rewards to the risks taken).

How the program is sold to the public also matters. The agency should not be presented as a panacea or wholesale solution to corruption that supplants other strategies, such as the use of conditionalities on aid programs. Each of these approaches complements the other, reinforcing the case for a global agency. Conditionalities can work only if there are additional protocols in place to expose violations of the agreed terms of aid. If you are an official in an aid-receiving country and you don't have confidence in your superiors, to whom should you blow the whistle?

A robust international whistleblower agency would help to keep corruption top of mind, reminding people of their duty to keep an eye out for signs of a problem that affects them directly. After all, corruption, especially when it is widespread, deters much-needed investment, reducing the tax base and thus limiting the government's ability to provide the public goods and services – including health care, education, infrastructure, and security – needed to ensure long-term economic growth and prosperity.

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