

Measuring Conflicts of Interest: a Revolving Door Indicator

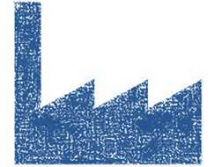
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Joël Cariolle, FERDI, France.

2015 EPCS meeting, Groningen.



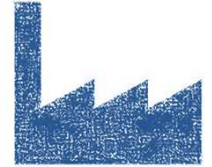
Introduction



In industrialized countries, where explicit bribes cannot be paid “safely”, the revolving door is becoming an important vehicle for corruption transactions.



Introduction

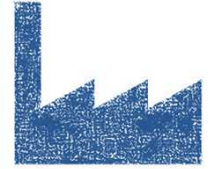


“Monetary bribes are feasible although not common due to their illegality. More pervasive are the hope for future employment for regulators with the regulated firms.”

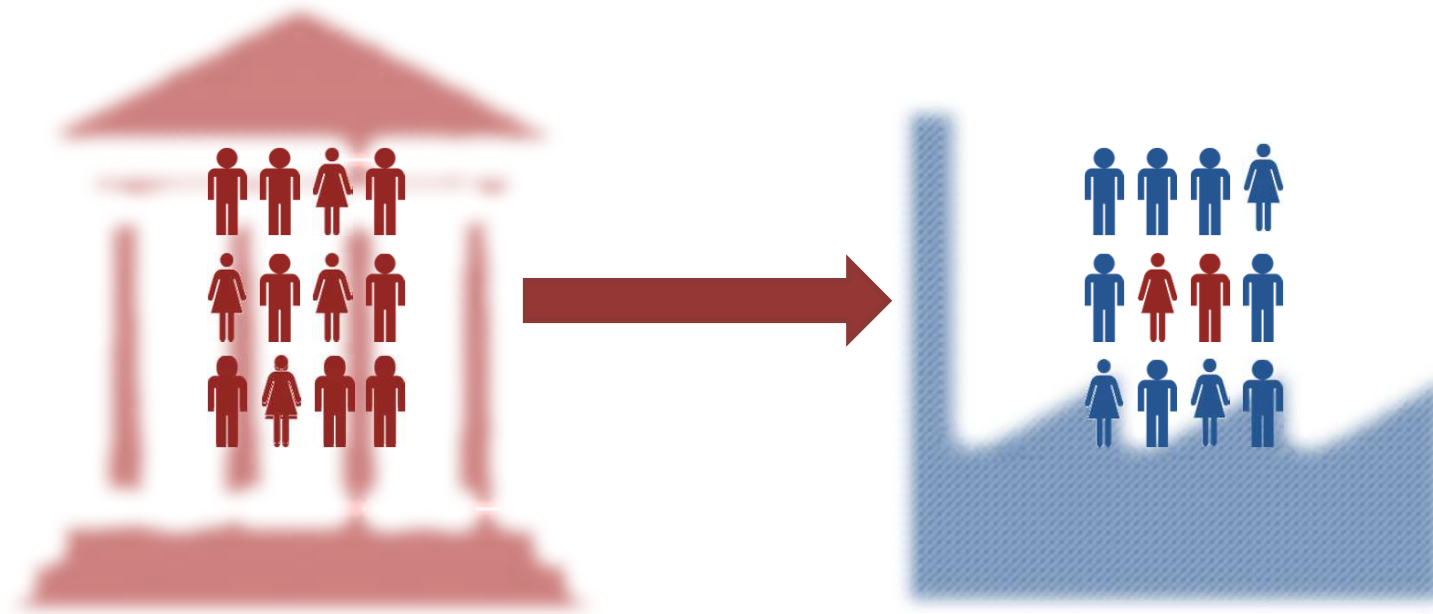
Laffont, J. J. et J. Tirole dans *A Theory of Incentives in Procurement and Regulation*, Cambridge, MA: The MIT Press, 1996.



Introduction



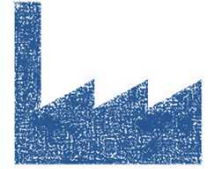
What is the revolving door?



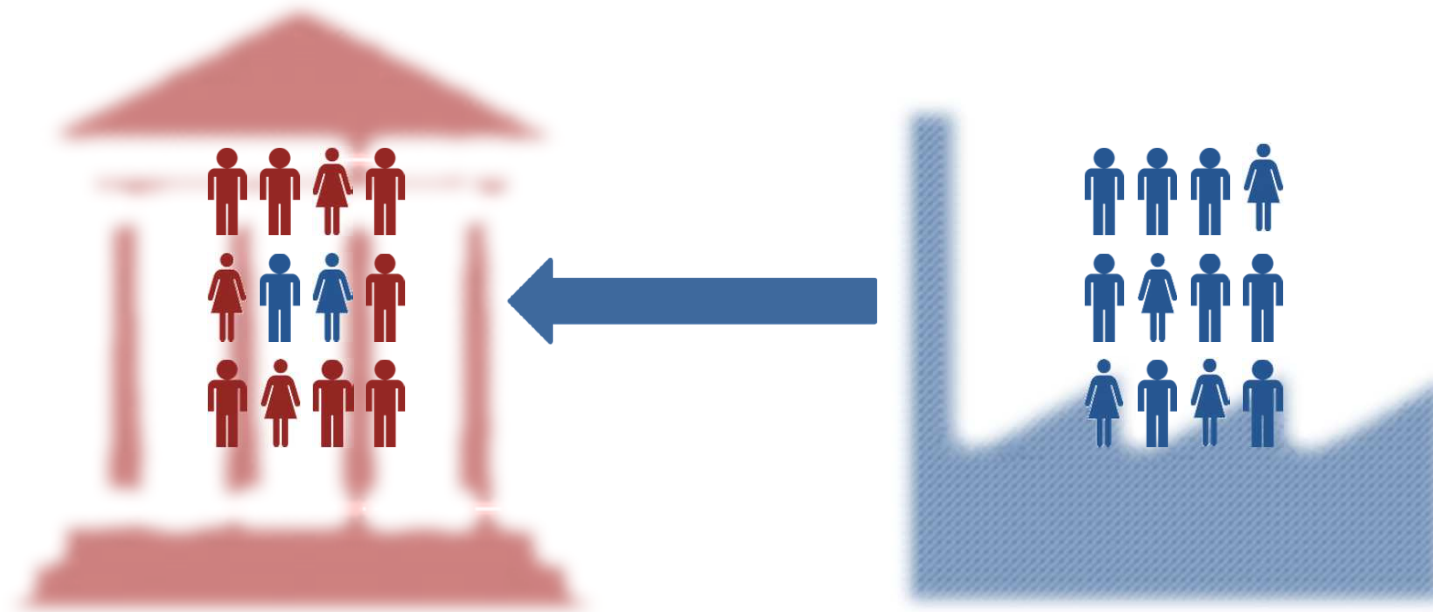
After completing their bureaucratic terms, heads of state agencies are entering the very sector they have formerly regulated.



Introduction



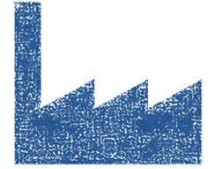
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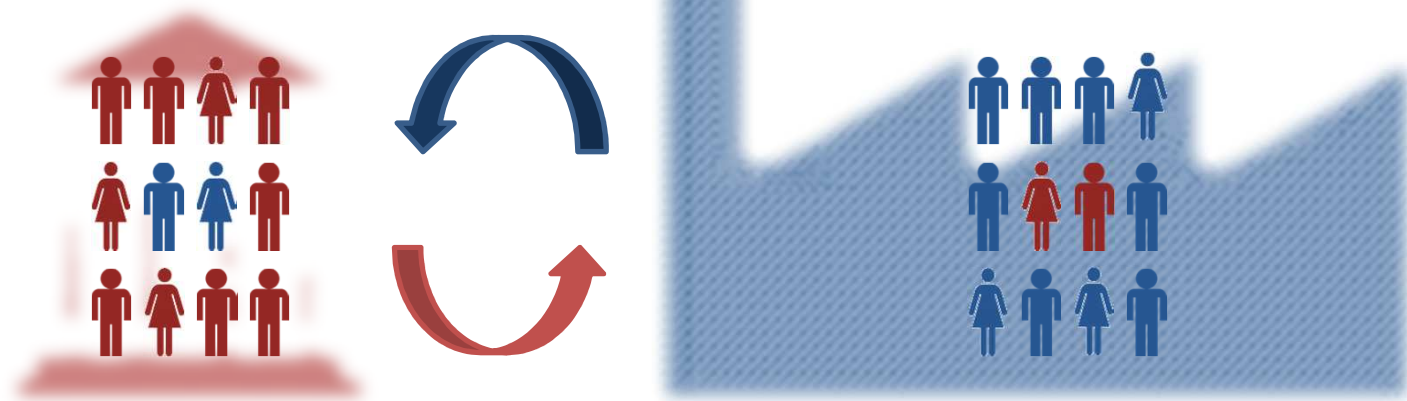
Conversely, it is also common to see private sector executives joining public sector agencies and exerting regulatory responsibilities over their industry of origin.



Introduction



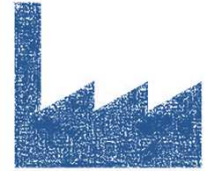
What is the revolving door?



In both cases, there is a **conflict of interest**, i.e. a risk that public responsibilities held by these “**revolved regulators**” be undermined by concomitant private interests (as emphasized by the Council of Europe and OECD).



Introduction



The revolving door has been denounced by the press worldwide

***Washington Post* (US):** “Fed up with Wall Street Revolving Door”

K. vanden Heuvel, July 30, 2013.

***The Telegraph* (UK):** “Whitehall's revolving door speeds up: ex-ministers and civil servants seeking jobs in private sector doubles”

C. Hope, December 14, 2013

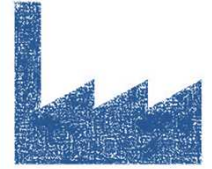
***Le monde* (FR):** “A New York, la Fed en plein conflit d'intérêt avec Goldman Sachs”

M. Damgé, October 11, 2013

What about academics?



Literature review

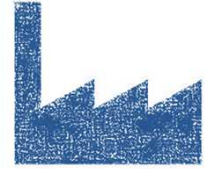


Considering the revolving door as a problem of talent allocation (Murphy et al., 1991), it leads to a tradeoff between:

1. **increased economic efficiency**, by attracting talented/experienced individuals and enhancing public and private sectors' productivity;
- and
2. **increased distortions** by fostering rent-seeking and corrupt behaviors from politically-connected firms.

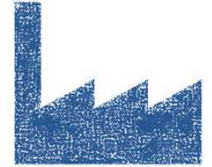


Literature review



Empirically, the revolving door is found to:

- ✓ to **increase firms' market value** (Faccio 2006; Luechinger and Moser 2014),
- ✓ **not by increasing productivity** (Cingano and Pinotti, 2013; Kramarz and Thesmar, 2013, Bertrand et al., 2006),
- ✓ **but by fostering rent-seeking and corruption** in law enactment (Slinko et al, 2005), public procurement (Cingano and Pinotti, 2013), external funding (Boubakri et al, 2012), tax exemption and subsidy allowance (Faccio, 2010).

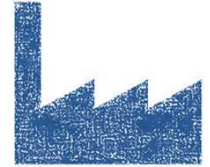


Why a Revolving Door Indicator?





Why a revolving door indicator?

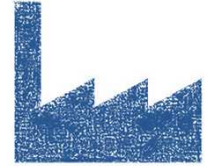


- **The revolving door indicator (RDI)** is designed to meet the need for a proxy measure of the distortions created by the revolving door process.
- Interestingly, the literature on state capture and political influence (Hellman and Kaufmann, 2004; Hellman et al. 2003; Slinko et al. 2005) supports that it is the **concentration of political power in few private firms' hands** which creates the conditions for such distortions.

Thus, the RDI intends to proxy the **economic distortions** generated by **over-influential firms concentrating revolving-door movements**, at the sector level.



The RDI

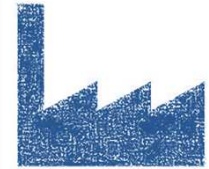


Formula

- The RDI is an (adjusted) Herfindhal index measuring the sector concentration of revolved regulators among private firms:

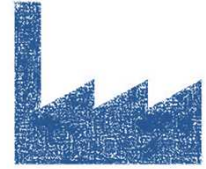
$$RDI_s = \frac{\sqrt{\left(\sum_{i=1}^K \left(\frac{r_i}{R_s}\right)^2\right)} - \sqrt{1/K_s}}{1 - \sqrt{1/K_s}}$$

- The RDI is between 0 and 1. R_s is the total number of revolved regulators in sector s , r_i is the number of revolved regulators in firm i , and K_s is the number of firms in sector s .
- The higher the index in sector s , the stronger the concentration of revolved regulators, and in consequence, the more likely the distortions in sector s .



Typology of revolved regulators

- Revolved regulators are ranked according to their **position in the private sector** :
 - ✓ *Category I*, for CEO;
 - ✓ *Category II*, for members of the Board of Directors;
 - ✓ *Category III* for other key positions: local directors, lobbyists, analysts.
- and their **exposure in the public sector**:
 - ✓ *Publicly exposed regulators* (category E) are individuals who hold or have held top-level position in the government/parliament, or in a relevant administration.
 - ✓ *Unexposed regulators* (category NE) are individuals who hold or have held unexposed positions in the government or in a relevant administration



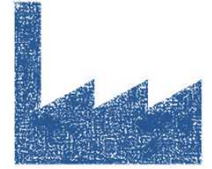
Typology of revolved regulators

Then, **three types of revolving door flows** are identified:

- ✓ **Type 1, public-to-private:** Former members of a relevant ministry, administration, or legislature currently hold responsibilities in a regulated company.
- ✓ **Type 2, private-to-public:** Former executives of a regulated company are currently members of a relevant ministry, administration, or legislature.
- ✓ **Type 3, private-to-public-to-private (two-sided):** Executives have engaged in both type 1 and type 2 movements and are therefore prone to favor firms both during and after their term in public office



The Data



Data sources

- The RDI requires matching information on **company officers** with information on **public regulators**.
- **Data sources** are national registries of private companies, international business databases, companies' official websites, business-focused websites, official government and public sector commission websites, social networks, and websites focused on public actors and conflicts of interest.

Table 1 presents data we gathered for **three major US financial firms: Goldman Sachs, Citigroup, and Fannie Mae**.



Empirical illustration

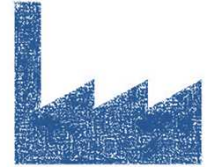


Table 1a. The revolving door at Goldman Sachs

Revolving door flow	Number of revolved regulators by category					
	Total	I	II	III	E	NE
Goldman Sachs (GS)						
1. Public to GS	19 (5)	0 (0)	0 (0)	19 (5)	5 (1)	14 (4)
2. GS to Public	12 (3)	1 (0)	0 (0)	11 (3)	10 (2)	2 (1)
3. GS to Public to GS	6 (1)	1 (0)	1 (0)	4 (1)	4 (0)	2 (1)
Total	37 (9)	2 (0)	1 (0)	35 (9)	19 (3)	18 (6)



Empirical illustration

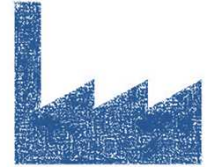


Table 1b. The revolving door at Citigroup

Revolving door flow	Number of revolved regulators by category					
	Total	I	II	III	E	NE
Citigroup (CG)						
1. Public to CG	20 (10)	0 (0)	0 (0)	20 (10)	3 (0)	17 (10)
2. CG to Public	1 (0)	0 (0)	0 (0)	1 (0)	0 (0)	1 (0)
3. CG to Public to CG	5 (2)	0 (0)	0 (0)	5 (2)	4 (2)	1 (0)
Total	26 (12)	0 (0)	0 (0)	26 (12)	7 (2)	19 (10)



Empirical illustration

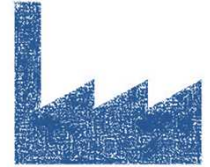
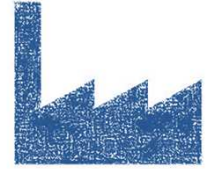


Table 1c. The revolving door at Fannie Mae

Revolving door flow	Number of revolved regulators by category					
	Total	I	II	III	E	NE
Fannie Mae (FM)						
1. Public to FM	11 (6)	1 (1)	1 (0)	9 (5)	2 (1)	9 (5)
2. FM to Public	3 (2)	1 (1)	0 (0)	3 (2)	0 (0)	3 (2)
3. FM to Public to FM	12 (4)	2 (1)	0 (0)	9 (2)	6 (3)	6 (1)
Total	25 (12)	4 (3)	1 (0)	20 (9)	8 (4)	17 (8)



Empirical illustration



- If we compute a “**standard RDI**” for these three firms, without differentiating between categories of revolved regulators and types of revolving door flows, we get:

RDI standard = 0.024



Empirical illustration

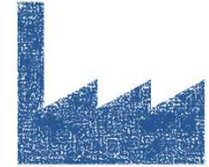
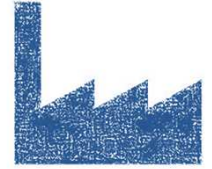


Table 1. The revolving door in three major US financial firms

Revolving door flow	Number of revolved regulators by category					
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Goldman Sachs (GS)						
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1. Public to FM	11 (6)	1 (1)	1 (0)	9 (5)	2 (1)	9 (5)
2. FM to Public	3 (2)	1 (1)	0 (0)	3 (2)	0 (0)	3 (2)
3. FM to Public to FM	12 (4)	2 (1)	0 (0)	9 (2)	6 (3)	6 (1)
Total	25 (12)	4 (3)	1 (0)	20 (9)	8 (4)	17 (8)



Empirical illustration



- If we compute a RDI focused on “**publicly exposed revolved regulators**”, the diagnosis may change slightly, and the concentration increases:

RDI Powerful = 0.150



Empirical illustration

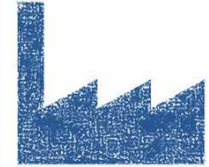
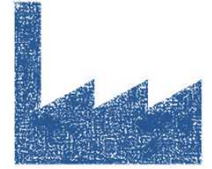


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2. CG to Public	1 (0)	0 (0)	0 (0)	1 (0)	0 (0)	1 (0)
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2. FM to Public	3 (2)	1 (1)	0 (0)	3 (2)	0 (0)	3 (2)
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Total	25 (12)	4 (3)	1 (0)	20 (9)	8 (4)	17 (8)



Empirical illustration



- if one considers that **private-to-public sector flows** of revolved regulators are more damaging to the economy than public-to-private sector flows, as suggested by Luechinger and Moser (2014) – then it is possible to compute a “**type-2 RDI**”:

$$\text{RDI Type 2} = 0.560$$



Empirical illustration

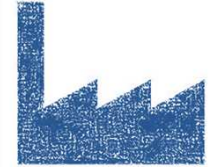
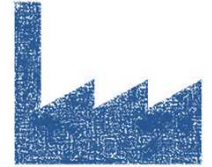


Table 1. The revolving door in three major US financial firms

Revolving door flow	Number of revolved regulators by category					
	Total	I	II	III	P	NP
Goldman Sachs (GS)						
1. Public to GS	19 (5)	0 (0)	0 (0)	19 (5)	5 (1)	14 (4)
2. GS to Public	12 (3)	1 (0)	0 (0)	11 (3)	10 (2)	2 (1)
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2. CG to Public	1 (0)	0 (0)	0 (0)	1 (0)	0 (0)	1 (0)
3. CG to Public to CG	5 (2)	0 (0)	0 (0)	5 (2)	4 (2)	1 (0)
Total	26 (12)	0 (0)	0 (0)	26 (12)	7 (2)	19 (10)
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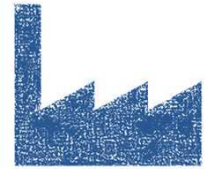
Empirical illustration



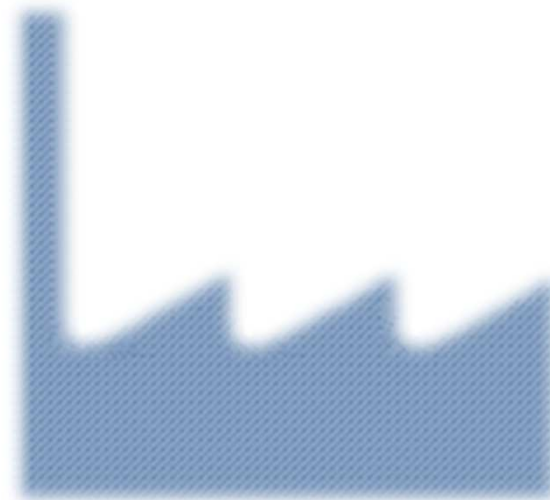
Therefore, although our sample is confined to three major US financial firms, the RDI shows a **high concentration of private-to-public revolving door flows...**

...from which **Goldman Sachs** appears as the prime beneficiary:

A sort of “kingmaker”?

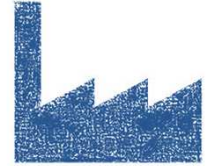


Conclusion

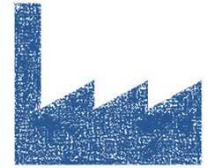




Conclusion



- The revolving door has been pinpointed lately as having bad effects on the economy, and even as being **one major cause of the 2008 crisis** (OECD, 2009).
- Therefore, there is a strong need to identify institutional configurations under which the revolving door damages the economy, and to set appropriate and effective rules to control it.
- By measuring the sectorial concentration of the revolving door, the RDI is a first step to size up the distortive power of the revolving door,
- and to compare progresses made by countries in implementing safeguards against conflicts of interest generated by promiscuous public and private elites.



Thank you for your attention.

