Economic Dimensions of Integrity

(WP16-17E)

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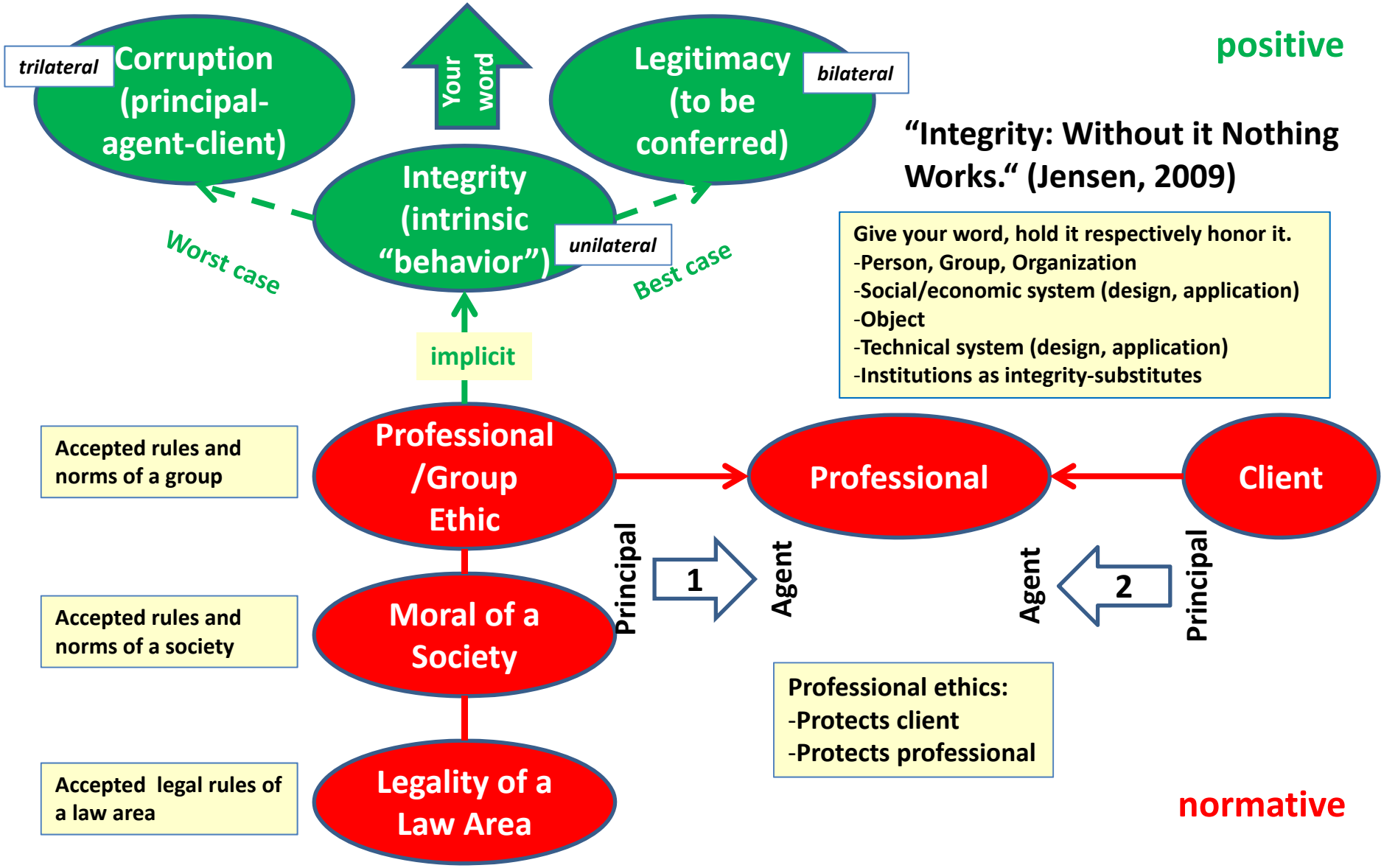
1.What You Said: Whatever you have said you will do or will not do.
2.What You Know: Whatever you know to do or know not to do.
3.What Is Expected: Whatever you are expected to do or not do.
4.What You Say Is So: Whenever you have given your word to others as to the existence of something or some state of the world.
5.What You Say You Stand For: What you stand for, expressed in the form of a declaration as well as what you hold yourself out to others as standing for.
6.Moral, Ethical And Legal Standards: The *social moral*, the *group ethical* and the *governmental legal standards* of right, wrong, good, bad.



What is Integrity?

Definition: *Webster's New World Dictionary*.
1. the quality or state of being complete; unbroken condition; wholeness; entirety.
2. the quality or state of being unimpaired; perfect condition; soundness.

Prisoner's Dilemma

		Prisoner 2	
		No confession	**confession**
Prisoner 1	**No confession**	**1 year for 1** A **1 year for 2**	**10 years for 1** **3 months for 2**
	confession	**3 months for 1** **10 years for 2**	**8 years for 1** B **8 years for 2**

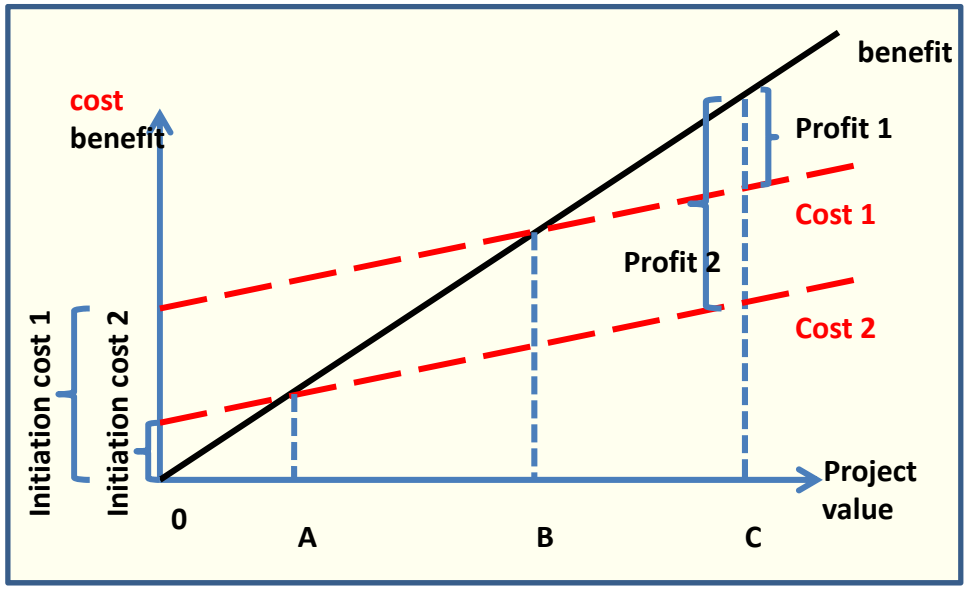
A **Deal with Integrity**

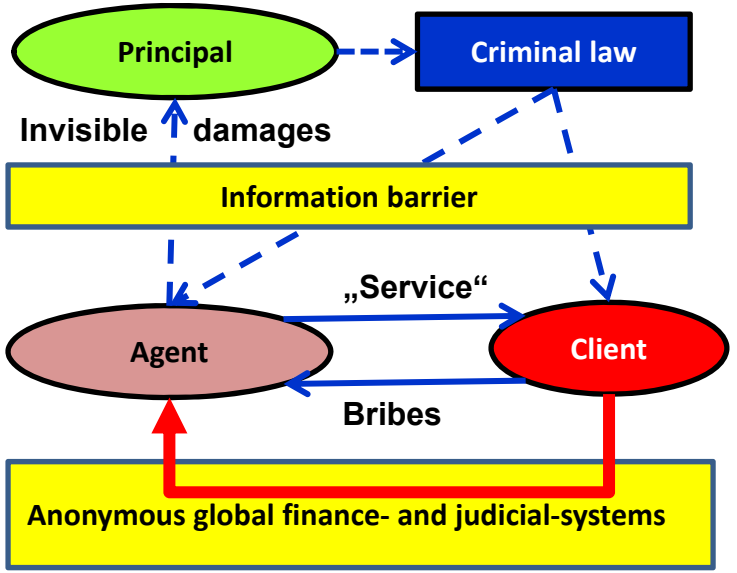
B **No deal, deal without Integrity**

The Law of Integrity states:
As integrity (whole and complete) declines, workability declines, and as workability declines, value (or more generally, the opportunity for performance) declines.
Thus the maximization of whatever performance measure you choose requires integrity.
Violating the Law of Integrity generates painful consequences just as surely as violating the law of gravity.
Put simply (and somewhat overstated) : "**Without integrity nothing works**"
If you or your organization operate in life as though this heuristic is true, performance will increase dramatically. **And the impact on performance is huge: 100% to 500%**

The "Integrity-Performance" Paradox
People & organizations while committed to performance systematically sacrifice integrity in the name of increasing performance and thereby reduce performance.
How can this occur? → Veil of Invisibility! (Integrity can't be seen or watched.)

„Corruption is a Crime of Calculation, not Passion.“ (Klitgaard, 1996)





Citizen	Politician	Public Agency	Top Manager	Capital Markets
Political elite	Public Agency	Red-tapist	Middle Manager, Procurer	Ratings, Analysts, Auditors
Business elite	Industry	Firm	Sales	Top Manager

Calculation:

- **Benefit of corruption**: Gaining business deals or avoidance of cost expenditures on one side and bribes on the other side.
- **Possibilities of corruption**: The agent must be corrupt and the client must be willing to bribe (*initiation*). Organizational and technical conditions must be available to realize the bribing and the service in return. (i.e., *CH-Banks, Panama, Lichtenstein-Trusts, London City*)
- **Costs of corruption**: The *probability* „to become caught“ multiplied with the expected punishments resp. fines.

Big question: Treatment of Whistle Blower?

„At the beginning of order is integrity.“ (Foerster, 2016)

Jensen a.o.

At the beginning of order is integrity. ***Rule*$_1$**: Give your word to comply with rules and keep resp. honor your word.

Rawls Popper

Constitutional principles of the society under ***Rule*$_2$**: objective knowledge, veil of ignorance, low time preference. ***Rule*$_3$**: Justice and political liberalism.

Buchanan a.o.

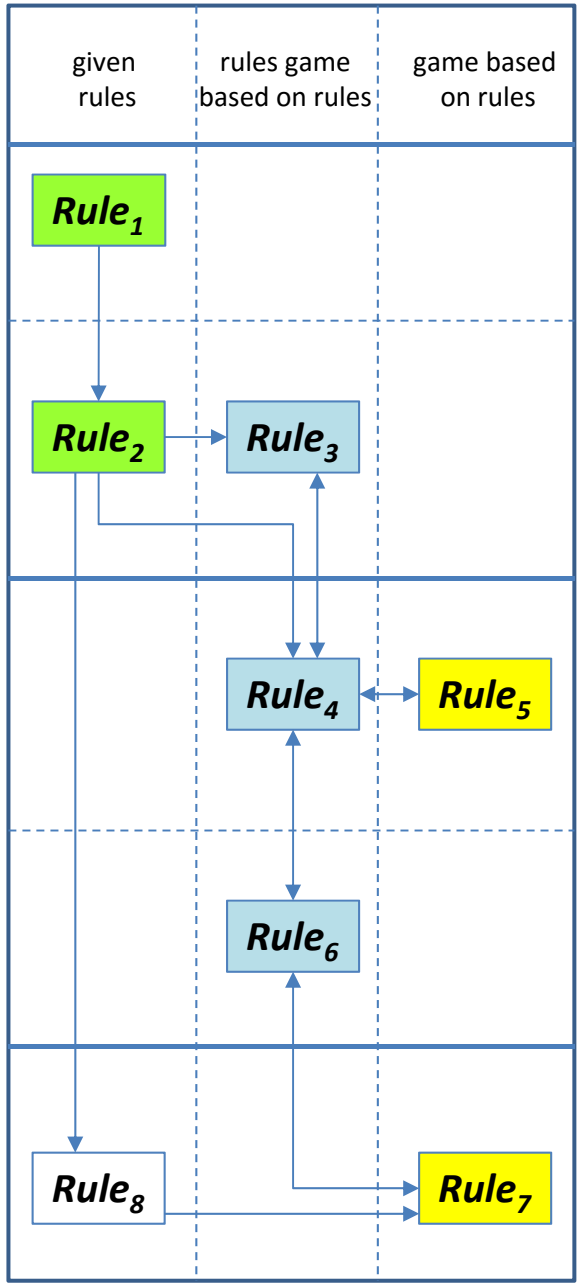
Working constitution of the society. ***Rule*$_4$**: The limits of liberty (rules, property rights). ***Rule*$_5$**: Calculus of consent (public goods).

Eucken a.o.

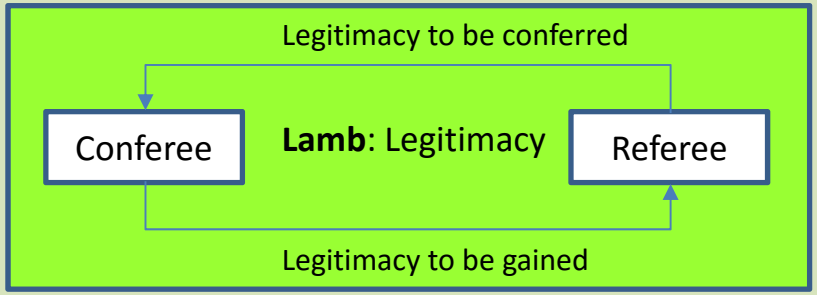
Order of competition of the society. ***Rule*$_6$**: Freiburg school of Ordo Liberalism.

v. Hayek a.o.

Spontanous Order of the society (Katallaxie). ***Rule*$_7$**: Usage of the knowledge of the society (free markets with efficient price mechanisms). Rules of just behavior (***Rule*$_8$**).



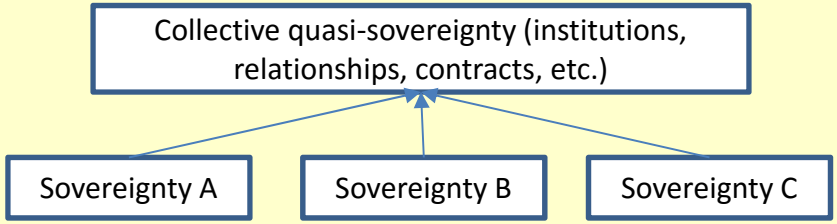
“Legitimacy: Without it nothing is good and right; predictable, justifiable, equitable, accessible, respectful.” (Lamb, 2014)



1. Worthiness to support
2. Broadly applicable
3. Multidimensional
    1. predictable
    2. justifiable
    3. equitable
    4. accessible
    5. respectful
4. Multilevel
    1. Individual level
    2. Group level
    3. System level
5. Bilateral: Reciprocity
6. Directly unobservable
    1. Causes possible
    2. Impacts possible

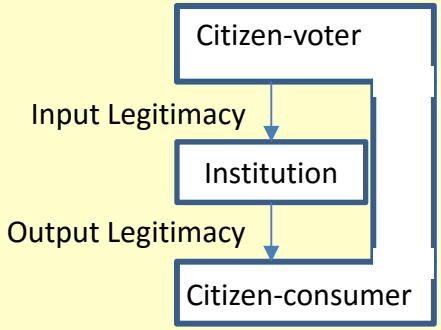
Schmelzle: Legitimacy in the sense of governance resp. public goods→ Governments, NGOs, etc.

Holsti: Horizontal Legitimacy



Olson-groups: UN, IWF, NATO, etc. How far do these institutions own legitimacy and with it acceptance and worthiness of support?

Scharpf: Vertical Legitimacy



Rawls: Hierarchical power relationship

Luhmann: Legitimacy through procedures and through equality of chances creates satisfying results which again lead to a general appreciation and in addition to the acceptance and the following of binding decisions.

Basis: Premises of decisions procedures on one side and concrete decisions on the other side.

Necessary: Social learning processes, procedures as social systems, cooperative search for truth, conciliation of divergent points of view.

„At the beginning of crises is out-of-integrity“

Financial crises 2008:

- Abolition of the Glass-Steagall-Act:
  → Mixing business philosophies.
- Investment Banking Boom up to 2001, Bust beginning 2001.
- Inv. Banking expropriates Comm. Banking
  → Strategy change Investment Banking.
- Credit risks: From ‚take it and hold it‘
  to ‚take it and trade it‘
  (Angermüller, Chairman Citibank 2003)
- Loans securitization up to 100%: **Out-of-Integrity** of loans systems (Krahnen), Bank as Delegated Monitoring (Diamond)
- **Moral Hazard** by Real Estate Broker, Mortgage Banks (no income, no doc.)
- **Corruption** by Rating Agencies (R.A.) (Partnoy).
- Global sales of CDOs: **$-creation**

2008 cannot be sufficiently explained by Traditional theories (Hayek, Keynes, a.o.).
→ **Integrity, corruption, legitimacy sufficient**

Integrity and Order.

Systems
- Banking system
- Loan system
- Monetary systems
- Capital market
- Patent system
- Juridical system
- Professional system (R.A.)
- Education/science
- Commons-Systems, etc.

Politics
- Competition politics
- Commons-Politics
- Tax politics, etc.

Organizations (Leadership)
- Supranat. Gov. Org.
- NGOs
- Universities
- Firms, etc.

Institutions
- Gov. monop. of violence
- Parliaments (Rawls, Buchanan),
- Supranat. Institut., etc.

2008
Missing Integrity of Banking-/ Capital Market-Systems.

Thesis
Theory of cause of crises is not the traditional theory but Integrity-Theory

Integrity and Prisoner's-Dilemma

		Player 2	
		No confession	confession
Player 1	No confession	Cooperation $Integrity_{12}$	Cooperation $Integrity_1$ no $Integrity_2$
	confession	Cooperation $Integrity_2$ no $Integrity_1$	no Cooperation no Integrity

Cooperation with (without) Integrity is (not) sufficient.

Cause of Prisoner's-Dilemma

- Incomplete contracts
- Incomplete rules
- Incomplete institutions
- Incomplete market systems

→ **Integrity as solution**

Problem

- Evolution of Integrity? (Axelrod)
- ***Exit-costs*** (Vanberg/Congleton) ***for Whistle Blower are too high.***

Transparency of Integrity, corruption and Legitimacy as objective knowledge

Kant: What can we really know?
Popper: Objective knowledge!
Lambs: Legitimacy not directly observable. Causes and consequences of legitimacy observable. Based on theory legitimacy is observable indirectly.
Gerhardt: General public. The political form of consciousness. (conscious of knowledge).
Lambsdorff: Democratic Lobbyism.

Proposal

Integrity, corruption and legitimacy are not observable directly. **Theories** on causes and consequences of integrity, corruption and legitimacy are required (research assignments for economics and economists). Then respective knowledge has to be **institutionalized (TI)** in order the general public gets notice of it.
Rational/artificial (AI) Whistle Blower with ***low Exit-costs***.
Art. Int. (AI) as „battle field" of the future.
→ **Evolution** of Integrity is possible based on democratic Lobbyism and transparency.

A New Model of Leadership." (Scherr/Jensen, 2007)

"In our **model leadership** consists of four critical elements:
1. The creation of a **vision** for the future that represents a significant departure from the past, one that requires breakthroughs for its realization.
2. The creation of a system that facilitates **enrollment** into and elicits voluntary **commitment** to the vision by the critical mass of people required to discover and implement the breakthroughs required for realization of the vision.
3. The creation of a system that ensures both the timely identification of **breakdowns** (and the dissemination of information about them) that, if unresolved, would prevent the successful realization of the vision.
4. The creation of a system for managing breakdowns that causes people to voluntarily recommit to the vision and maintain these commitments through to the implementation of the **breakthroughs** required for the realization of the vision." (Abstract)

„**We define "leader"** as an *ordinary* human being with both a commitment to produce a result whose realization would be *extraordinary* given the current circumstances as seen by the participants, and the integrity to see this commitment through to its realization." (S. 5)

„**An individual commits himself or herself by a declaration.** Such declaration includes both the substance of the future state (vision) that is to be attained and the individual's personal commitment to the realization of that vision. The power of declaration is not widely understood. Just as in the case of Kennedy's declaration to put a man on the moon when no one at the time knew how to do it, the declarations of any person create risk and uncertainty. Such declarations are generally associated with uncomfortable feelings on the part of most human beings. In an almost magical way declarations create a future which shifts the world in very important ways." (S. 12)

Breakdowns, Breakthroughs, Fallouts, Integrity

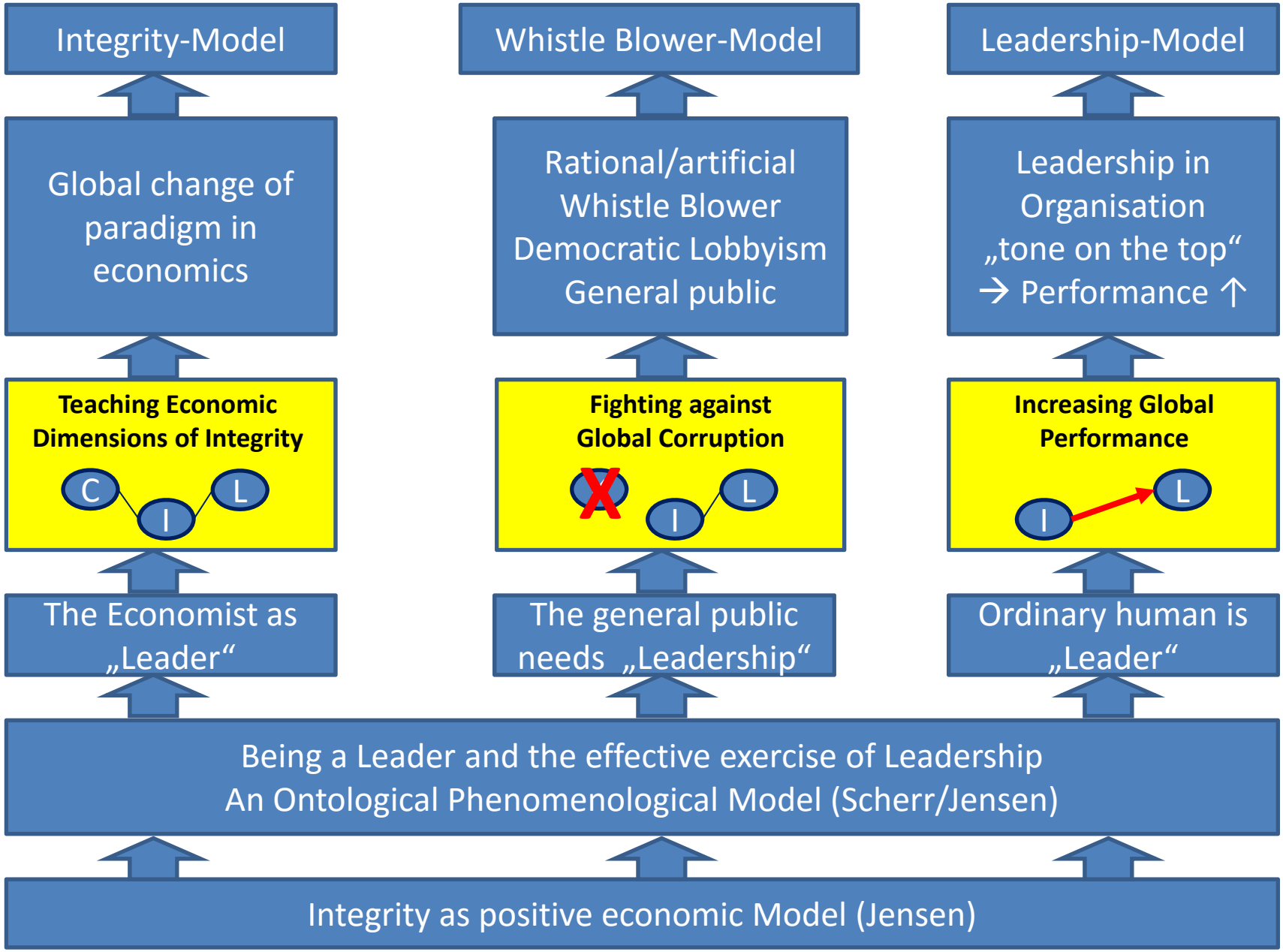
". „Contrary to what people generally believe, **breakdowns** are the driving force behind innovation and the **breakthroughs**." (S. 17)

„**First**, the leadership must choose whether to remain committed to the vision or to give it up or modify it. **Secondly**, and somewhat counter-intuitively, all participants in a breakdown must be given the formal opportunity to choose to recommit to the outcome or vision. The **third** step, as we explained in the previous section, is to broadly communicate the existence of the breakdown. The **fourth and most difficult** step is to remain committed in the face of circumstances that are inconsistent with the realization of the commitment. There is a **fifth** step that is often omitted, particularly if the breakdown is resolved with a breakthrough — to get to the source or root cause of the breakdown and correct it so that the breakdown never occurs again." (S. 23ff)

„**Whenever a vision is abandoned there is fallout** — the plans of other organizations may be impacted, revenue or budgets may have to be adjusted, organizational downsizing may be called for, and so on. Dealing with this fallout is another leadership responsibility. The mess that was made by reneging on the original commitment must be cleaned up. To do otherwise compromises **the integrity of the leadership and their organizations** and will reduce future performance." (S. 28)

Leadership is based on Integrity

„When an individual or an organizational unit commits to the realization of a vision **it has given its word**. And, in the context of that vision, when an individual or organizational unit commits to produce one or more elements necessary to the realization of that vision it is critical **that the individual or unit honor that word**. Widespread **out-of-integrity behavior**, i.e., not honoring one's word means that the productivity and likely realization of the vision will fall dramatically." (S. 31)


Integrity-Model
Whistle Blower-Model
Leadership-Model
Global change of paradigm in economics
Rational/artificial Whistle Blower Democratic Lobbyism General public
Leadership in Organisation „tone on the top“ → Performance ↑
Teaching Economic Dimensions of Integrity
C
I
L
Fighting against Global Corruption
I
L
Increasing Global Performance
I
L
The Economist as „Leader“
The general public needs „Leadership“
Ordinary human is „Leader“
Being a Leader and the effective exercise of Leadership
An Ontological Phenomenological Model (Scherr/Jensen)
Integrity as positive economic Model (Jensen)