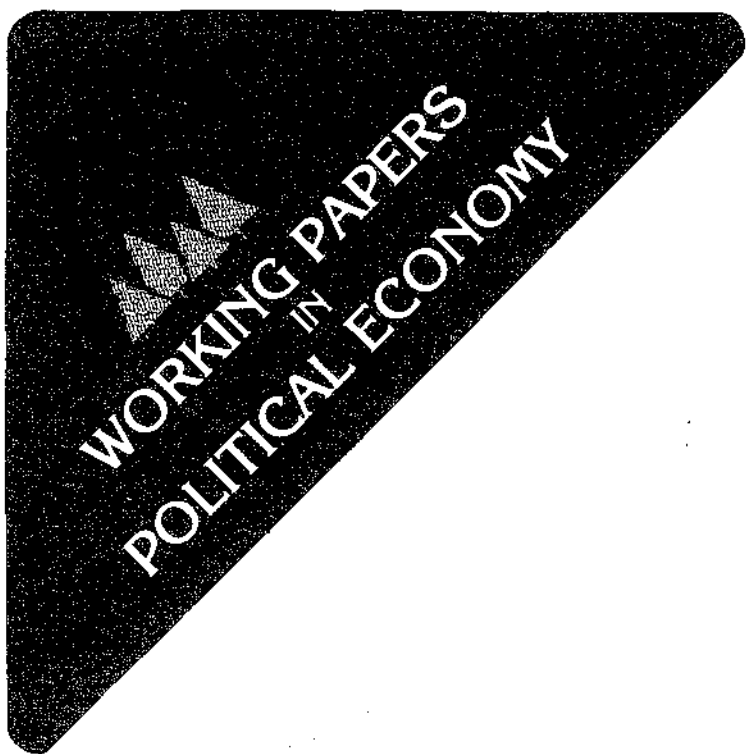


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THE POLITICAL ECONOMY OF GOVERNMENTAL
CORRUPTION: THE LOGIC OF UNDERGROUND
GOVERNMENT

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The Underground Market for Governmentally Controlled Property Rights

There is little doubt that taxes create incentives for tax avoidance. Illegal, underground markets arise in the private sector, and there is considerable evidence that the tax-induced underground economy is very large and is growing in the United States and in other parts of the world (Tanzi, 1982; Simson and Witte 1982).¹ It is also widely recognized that regulatory constraints induce private sector underground activity. This is evidenced by the thriving markets in drugs, prostitution, gambling, stolen goods, and the labor of illegal aliens despite laws against the sale or purchase of such goods and services (Simon and Witte, 1982). Thus, both taxes and regulation generate incentives for people to engage in illegal underground activities. People react accordingly.

Little attention has been paid, however, to the incentives faced by those doing the regulating and taxing.² Do regulators and tax collectors also face incentives to engage in illegal activities? If so, what affects the strengths of these incentives? Is political corruption likely to be caused by the same factors that encourage corruption in the private sector? And how influential are the taxes and regulations? In the following pages* we delineate the opportunities for political corruption, examine the relative strength of incentives to participate in corrupt activities, and make predictions about the future opportunities for corruption.

Underground Markets From a Property Rights Perspective

Governments operate by assigning, reassigning, modifying, or attenuating property rights. The concept of property rights refers to

. . . the sanctioned behavior relations among men that arise from existence of goods and pertain to their use. These relations specify

the norms of behavior with respect to goods that each and every person must observe in his daily interactions with other persons, or bear the cost of nonobservation. Thus, and this point is important, the concept of property rights . . . applies to all scarce goods. The concept encompasses both rights over material things (to sell my typewriter) as well as human rights (the right to vote, to publish, etc.). The prevailing system of property rights in the community is, then, the sum of economic and social relations with respect to scarce resources in which individual members stand to each other.³

Regulation can easily be described from a property rights perspective (Benson, 1981). Governments regulate by creating and enforcing property rights and by more or less continuously modifying and changing the allocation of previously existing rights. Taxation and resulting transfers also fit this paradigm. An income tax, for example, is a partial attenuation of a resource owner's right to the full value of his resources and a corresponding reassignment of these rights to someone else (e.g., a welfare recipient such as a farmer receiving support payments).

Since property rights provide the legal norms for behavior, they convey the right to benefit or to harm oneself or others (Demsetz, 1976, p. 348). The assignment of rights dictates whose interests are to count in regard to the use or nonuse of a particular resource. "Rights have a dual nature: the recognition of granting a right to A means exposure of B, and vice versa; the resulting A-B conflict is ubiquitous. In order for A to have a right, A's interests must count and B's interest must not, pro tanto" (Samuals and Mercurio, 1976, p. 50). Thus, individuals and groups have strong incentives to influence the definition and assignment of property rights.

Once property rights are defined, they can be altered or reallocated through market transactions, theft, revolution, or governmental regulation and tax-transfer processes (Stubblebine, 1972). It should be stressed that those who wish to alter an existing rights structure can be altered in three ways. First is in accord with the rule of willing consent by private voluntary

exchange. This may occur either in legal transactions or, if the rights modification is illegal, in an underground market. Second, investments can be made in lobbying in an effort to influence government to alter the rights assignment through its regulatory or taxing powers. A third but more risky alternative option is to resort to theft (Stubblebine, 1972). We will explore yet another avenue for obtaining a rights modification—an avenue that, in a sense, combines theft and governmental influence: A rights modification can be purchased from a corrupt governmental official with appropriate discretionary control.

Illegal underground markets in the private sector arise when the institutional structure precludes owners from allocating their resources in a competitive market. For example, black markets apparently occur whenever government prohibits sellers from setting prices at the market clearing price. Thousands of black markets exist, including the markets for illegal goods and services (e.g., drugs and prostitution). Similarly, governmental restrictions on the right to lower prices, when the price floor is above a market clearing price, generally lead individual suppliers to illegally reduce prices (e.g., illegal aliens typically supply labor services at a price below the minimum wage) or to make payments to willing buyers (bribery). In addition, the large underground market that has developed as a consequence of tax avoidance is an attempt by resource owners to avoid losing their rights to the income stream generated in competitive markets. All such illegal markets exist because government has attenuated or eliminated rights, preventing or altering the competitive free market allocation of resources. We will show that illegal actions by governmental officials arise for precisely the same reason.

Becker (1968) explained that individuals are relatively more likely to commit a crime (e.g., participate in an underground market) when the potential payoff from the illegal act is high relative to the individual's other opportunities, when the probability of being caught is relatively low, or when the

severity of the potential punishment is relatively light. Consequently, it is not surprising to find thriving underground markets in goods and services such as drugs, liquor where prohibited, gambling, and prostitution. Potential participants in any of these markets may expect very high payoffs.⁴ Furthermore, the markets are difficult to detect and control because the goods are nondurable and easily transportable, while the services are immediately consumed. Thus, the probability of being caught is low. The severity of potential official punishment varies, but in each case it is relatively minor, given the large potential payoffs and the small chance of detection. There are many other examples of private underground markets that occur because the expected payoff is relatively large, the chance of being detected is small, or the punishments are slight (e.g., participation in markets associated with tax avoidance are all extremely difficult and costly to detect, and some, such as the underground market for cigarettes to avoid state excise taxes [Simon and Witte, 1982], involve very large payoffs). Our purpose, however, is to examine situations where public officials participate in illegal underground transactions. First, let us consider circumstances where there are opportunities for corruption, and then explore the incentives of governmental officials to participate in illegal activities.

Opportunity for Corruption

Corruption is a consequence of discretionary political authority. All governments have officials that have discretionary control over some property, and the amount of their discretion varies dramatically. The duties of both a military sergeant and a federal judge, for example, cannot be prescribed with precision: Time- and place-specific variables preclude such an outcome. Any official has the authority to allocate certain property rights. Given that his behavior cannot be perfectly specified, there is a necessary potential for him

to exercise his discretion over certain property rights so that the outcome disproportionately benefits certain individuals. Hence, the potential for corruption is a logical necessity of governmental allocations of property rights.

In many instances where government has modified or could modify a rights structure to prevent a competitive market allocation of resources and has, consequently, created incentives for an illegal market to arise, the potential illegal transaction (rights modification) can be easily detected.⁵ Thus, the high risk to private individuals prevents participation in an underground market unless the transaction can be made to appear legal. This may be because the property involved is highly visible, so that a change in use or user can be easily detected. Perhaps the property is durable and immobile (e.g., land subject to zoning or other use restrictions), or perhaps the property is subject to close scrutiny by governmental officials or private citizens (e.g., highly regulated industries, such as public utilities, where any change in resource use or prices requires regulatory approval). Under such circumstances, an illegal property rights modification must be accomplished through the actions of a governmental official. As a consequence, for example, land use and building regulations, for example, appear to generate considerable opportunities for political corruption (Gerdiner and Lyman, 1978).

There is another, closely related opportunity for corruption. In instances where illegal activities in the private sector could be prevented or severely limited through relatively inexpensive enforcement efforts, the public officials designated to prevent such activities are given a very valuable set of property rights that may be sold. These officials can allow certain individuals or groups to operate in the illegal market while preventing other potential participants from entering the market. In other words, they can sell monopoly rights in a private sector underground market and then enforce that rights allocation.

The illegal activities of the policeman on the beat is a common theme in fiction and a common occurrence in fact. Schelling (1971), for example, argued that organized crime is really monopolized crime, and Rubin (1979) and Anderson (1979) contended that criminal firms possess market power because there are economies of scale in buying corruption from police and other governmental officials. Demsetz (1968), however, explained that economies of scale are not sufficient for such monopoly pricing. Exploiting a monopoly position requires entry restrictions, typically arising from governmental policy. In the case of underground markets, all entry is illegal; but if enforcement is easy, corrupt public officials can sell the right to produce to selected illegal firms. In this instance, an underground market for governmentally controlled property rights may be required for a private sector underground market to operate.

The potential for political corruption also exists when government precludes market allocation through direct, public ownership of property rights for which there are no good private sector substitutes at prices comparable to what a corrupt official might charge. In such cases, the desired property rights alteration cannot be achieved through either legal or illegal private sector transactions. The rights allocation must involve public officials. Thus, we find corruption in the form of patronage, for example, where relatives or supporters are given jobs that many others want, which can lead to even more corruption.

Rose-Ackerman (1975) detailed the possibilities for corruption that arise when government buys goods or services from the private sector. She observed that there are no opportunities for corruption when the government is just one of many competitive buyers. Corruption is possible, however, when the government is a large and important buyer. A private sector seller may be willing to bribe a public official for two reasons. First, buyers may willingly pay for the right to be the exclusive supplier of some product consumed by government.

Willingness to pay a bribe implies that there are other potential suppliers who would, in a competitive seller market, produce and sell the good to the government. Clearly, when government chooses to buy from only one seller the rights granted to the seller may preclude a competitively determined allocation of resources. The rights are valuable (that someone is willing to pay for the exclusive right implies that the expected returns must be at least high enough to cover the bribe and compensate the buyer for the risk incurred), and governmental officials have the power to allocate them. Opportunities for underground transactions involving purchases of those rights from governmental officials are a consequence.

Second, Rose-Ackerman (1975, p. 198) explained that a bilateral monopoly situation arises when a seller is already the only supplier. Willingness to pay a bribe then depends on the relative bargaining strengths of the buyer (governmental unit) and seller. If the seller is in a relatively strong bargaining position and expects to extract most of the potential surplus, he is not likely to pay a bribe. If the government is in a superior position, however, the seller has incentives to bribe an official in order to obtain the right to set a monopoly price. This is not as obvious an instance of a potential underground transaction arising as a result of governmental restrictions that preclude a competitive solution, but we must ask how a seller became the only supplier.

It is said that monopoly occurs because of market failure. Demsetz (1974) explained, however, that in practice monopoly power arises because of governmental rights modifications that prevent free entry (e.g., patents, licenses, exclusive contracts possibly resulting from an illegal transaction, and regulatory limits on entry). Consequently, corruption that can be characterized by Rose-Ackerman's bilateral monopoly argument also occurs because governmental rights modifications prevent a competitive allocation of resources.

The potential for governmental corruption arises for precisely the same reason that underground private markets can exist. Rights modifications, either in the form of taxes or regulations, prevent a competitive allocation of resources, creating opportunities for illegal markets designed to avoid the taxes and regulations. Under some circumstances, these illegal markets will have to involve corrupt governmental officials in order to exist.

Incentives for Political Corruption

Decisions are made on the basis of information and incentives, and public officials react to incentives just as private individuals do. Thus, relatively strong incentives to become corrupt are likely to result in relatively more corruption. The relevant incentives are those that Becker (1968) delineated in his economic theory of crime: the size of expected payoffs relative to a public officials alternatives, the likelihood of being detected and punished, and the severity of the punishment.

The payoffs to corruption. The attractiveness of the expected payoff to the individual public official from corruption depends on a number of factors. First, it must be emphasized that the potential returns to corruption will be weighed against returns to other activities that may have to be foregone if the official chooses to participate in an illegal market. Because they are not residual claimants, governmental officials cannot capture profits when they abstain from corruption and concentrate on improving efficiency. Of course, they may be able to move to a better paying public sector job because they perform their tasks well, but few public officials, no matter how high up they may be in the hierarchy, receive extremely large salaries. Officials may also gain satisfaction from the prestige they have and the power they wield, but at the higher levels, the monetary rewards are small relative to comparable private sector employment. Furthermore, many public officials are severely constrained

as to how and how much they can legally obtain above their public salaries. Thus, assuming that public sector employment was chosen because it was an official's best alternative (he or she is not likely to find a more attractive job in the private sector), any reasonably large expected payoff from corruption may be tempting.

The magnitude of the potential payoff from corruption is determined by several factors. The expected value of the rights that the official is able to allocate is a prime determinant. Thus, the greater the market distortion created by a tax or regulation, the greater the potential payoff to officials who are to enforce the tax or regulation. Strict building codes or rigorous and geographically expansive zoning laws, for instance, generate the potential for large payoffs to corrupt officials (Gardner and Lyman, 1978). Similarly, if an official has allocative power over a number of different rights, the payoff could be large even though no single right has tremendous value. It has been estimated, for example, that through graft and corruption the Tweed organization made more than \$60 million during the decade following the Civil War (Friedman, 1973, p. 462) because it controlled virtually all the taxing and regulatory powers in New York City (and, to a degree, in the state). Some of those powers clearly involved the allocation of tremendously valuable rights, but others did not.

When the power to allocate rights is concentrated in the hands of one or a few officials (or in the hands of an organization, such as the political machines that dominated large cities in the late nineteenth and early twentieth centuries), the corruption payoff to those individuals can be extremely large. On the other hand, if the power to influence a rights assignment is widely dispersed and, therefore, difficult to coordinate, the payoff to any one official is likely to be relatively small. Organized crime may have to bribe several police officers, for instance, to assure the relatively unmolested

operation of their underground markets in drugs and prostitution, but this means that the payoff to any one police officer will be relatively small and less acceptable. Similarly, if a buyer of illegally allocated rights has several alternative sources (competitive corruption, if you will), then the return to any one corrupt seller is likely to be small. A housing developer, for example, may be indifferent as to whether land is developed in one or another of several geographically contiguous political jurisdictions with separate zoning commissions.

It should be stressed that even though the magnitude of payment to a corruption monopoly may be large, the total amount of corruption transactions need not be relatively large. The demand for rights allocated through corruption is down sloping. There are substitute means of achieving a rights allocation (e.g., lobbying) that are available for many of the potentially illegally obtained rights. Further, there is always an income effect: Higher bribes mean reduced consumption of other goods and services. Thus, a corruption monopolist may require relatively high bribes and, in doing so, may restrict the actual quantity of illegal transactions to something less than would exist in an uncoordinated (or competitive) market for corruption. The standard monopolist argument applies, but with reversed implications.

Alternatively, a corruption monopolist may be able to practice price discrimination. Different bribes can be charged as the monopolist moves down along the demand curve. In this case, the monopoly output of corruption is likely to approach the uncoordinated or competitive corruption level, assuming that the monopolist's marginal cost of providing corruption is identical to the competitive corruption supply curve. The point is that the highly visible corrupt political machines may not have generated any more corrupt transaction than a non-machine government would, ceteris paribus (although the receipts from cor-

ruption were probably substantially higher for the machine than the aggregate corruption receipts would have been for officials in a non-machine government).⁶⁶ Eliminating the political machines did not eliminate the incentives for underground sales of governmentally controlled property rights.

An obvious determinant of the payoff to corruption is the private buyer's willingness to pay for illegal governmental rights allocation. Naturally, buyers in the underground market for governmentally controlled property rights react to the same kind of incentives that participants in any illegal activity do. Is the potential return large or small? Is the action likely to be detected? How severe might the punishment be if the activity is detected? Given the evidence of corruption, a substantial number of private sector individuals find the potential returns from illegal dealings with officials to be sufficiently higher relative to the risk, to offer enough to induce corruption (e.g., Belles, 1952; Eisenstadt et al., 1978; Gardner and Lyman 1978; Gardner and Olson, 1974; Gibbons and Rowat, 1976; Heidenheimer, 1970; and Sherman 1974). With that in mind, let us move to a second factor that influences the likelihood of corruption.

The probability of detection. If there is a high probability that an illegal rights allocation will be detected and that a corrupt official will be identified and prosecuted, then an official is less likely to become corrupt. There are several possible ways to monitor governmental activities. Individual citizens in general, and taxpayers and voters in particular, might make efforts to monitor individual officials. This is far from the major threat because of rational ignorance and the free rider problem. An individual citizen's share of the benefits derived by eliminating one corrupt official is so small relative to the costs that the citizen may bear that he has virtually no economic incentive to act independently. Furthermore, the citizen has little incentive to join in a collective effort to monitor government because he can share whatever benefits

such a collective action may generate without bearing any of the costs. There are several fairly active government watch organizations, of course, and they may pose some threat to potentially corrupt officials, but it is likely that these collective efforts will be relatively unsuccessful because of the free rider problem. They simply will not be able to attract sufficient resources (contributions of time and money) to be effective. These organizations often claim to represent large constituencies (e.g., all consumers), but they receive active support from only a small part of those constituencies, generally less than one percent. Thus, the general citizenry does not constitute a major threat to a corrupt official.

The news media is one potential source of monitoring that does not necessarily fit the preceding discussion. News does have some public good (or, more accurately, externality) characteristics, so there is a potential free rider problem. But since consumers of news pay for much of what they consume indirectly through advertising, the undersupply of news services is not likely to be a significant problem, as it is with other private watch efforts. Nonetheless, there are reasons to expect that the news media will not be a major threat to most corrupt officials. Few members of the media devote much time to trying to ~~detect~~ political corruption. Corruption exposed by others is certainly reported, but there are relatively few instances in which news personnel have actively sought out illegal activity. This is partly because newspapers and other media require daily (or perhaps weekly) output, and most reporters must concentrate on news that can be obtained easily and quickly. Detecting corrupt officials and proving their guilt are generally difficult and time consuming. Consequently, such efforts are likely to take place only when the potential payoff is substantial. A reporter might be willing to spend considerable time trying to demonstrate that an important public official is cor-

rupt because the potential payoffs are large (e.g., front page headlines, recognition by peers and citizens, and greater income opportunities), but he is unlikely to invest much time and effort to detect corruption by a low level bureaucrat. The resulting news story is simply not sufficiently.⁷

Peers constitute a second source of potential monitoring. Most governmental institutions have established self-monitoring systems and have actually discouraged (and in some cases even prevented) monitoring from external sources. This is true for both bureaucracies and legislative organizations (police departments have their internal affairs division and Congress has its ethics committee). Such internal monitoring is not likely to be very effective, however, and poses little threat to a corrupt official. No matter what the goal of a governmental official's goal might be, any official has strong incentives not to expose corruption (or inefficiencies) within his governmental unit. Suppose that a public official derives his satisfaction by working for what he believes is the "public interest" and is convinced that what his bureau, agency, department, commission, or committee is doing is vital. If he reveals that his colleagues are corrupt, the unit's effectiveness may be jeopardized, since the corruption may reflect badly on the organization and lead to reductions in the unit's budget and discretionary powers. It is not to say that such a public spirited individual would condone corruption; he may try to suppress corruption internally. But it seems likely that such an official would prefer not to know about corruption and, therefore, makes only modest monitoring efforts.

A similar argument applies to the public official for whom power and prestige are major sources of satisfaction. Corruption within that official's organization may lead to reductions in budget, discretionary power, and prestige. Finally, an official who may be corrupt or who wishes to keep the corruption option open obviously will not want to attract attention to the corruption potential of his position. It is not very surprising, therefore, to find that

in the relatively few instances in which an official has reported the corrupt activities of his colleagues, the official himself has often been ostracized by colleagues and superiors, denied promotions, and ultimately forced to resign. Corrupt officials probably have little fear from their peers.

A third source of potential detection comes from other governmental units. One function of elected representatives is to monitor bureaucracies to see that they are doing what the representatives' constituencies want them to do. Such monitoring could conceivably be very effective (assuming that the representatives themselves are not corrupt) if there are relatively few officials to monitor and if there are relatively few rights over which those officials have allocative powers. Of course, the incentives to monitor faced by elected representatives depend on the opportunity cost of monitoring. As more time and resources are spent in monitoring, less are available for such things as determining the nature and strength of constituencies' demands (Benson, 1981 and 1983), meeting those demands through legislative enactments—since reaching agreement in a legislature can consume time and resources (Ehrlich and Posner, 1974)—and taking advantage of outside income sources and benefits associated with legislative service (e.g., political junkets [Crain, 1979]). So, even if there were only relatively few officials and rights modifications to be monitored, it would not necessarily follow that legislative oversight would effectively reduce corruption. Clearly, if large numbers of governmental officials have substantial discretion in the allocation of rights arising from the taxing and regulatory process, legislative monitoring is likely to be an ineffectual deterrent to corruption.

A legislature may choose to delegate a monitoring function to some other governmental unit. Results of the Federal Bureau of Investigation's corruption detection efforts, for example, have been quite visible. Similar efforts by state or local police departments are also possible. How effective such efforts

are depends on how many resources are devoted to detecting corruption. Police officers are expected to enforce a wide range of laws with limited budgets, so resources devoted to corruption detection generally should not pose a great threat to the overwhelming majority of corrupt officials. Police efforts are likely to involve a few, possibly spectacular arrests (e.g., Abscam) in the hopes that the visibility of these actions will lead potentially corrupt officials to overestimate the risk of detection. This may have the desired impact over the short term, but it may not work for long. The Internal Revenue Service uses this tactic to try to prevent tax avoidance activities, but there is nevertheless a large and growing tax-induced underground economy (Simon and Witte, 1982; Tanzi, 1982).

When a governmental official has the authority to enforce a law that may generate a private sector underground market, that official has a valuable right to sell: the right to operate in the underground market without reduced fear of arrest or punishment. The same argument applies when one official has the responsibility of preventing corruption by other officials. The official with the power to enforce laws against corruption also has a potentially valuable right to sell: the right to be corrupt. Furthermore, he faces the same kinds of incentives as officials who are supposed to prevent private sector underground activities. Thus, it should not be surprising that public officials pay off police officers in order to practice corruption. Of course, this means that potentially corrupt officials may be relatively less concerned about detection than they would be otherwise, since there is at least the possibility of bribery to prevent exposure even when they are detected.

A fourth source of detection involves political candidates who run on a "good government" ticket. The thousands of such cases in America's political history have been oriented toward a "throw the rascals out" theme. The key

point here, however, is that any alternative regime that does not address the fundamental institutional issues, the information and incentives generated, is unlikely to be successful over the long run. First, those who are corrupt can appeal to a concentrated constituency for campaign funds. Second, even if the reformers win, if the fundamental institutions are not changed the reform faction is likely to degenerate into a form similar to its predecessor's.

The severity of punishment. The impact of punishment is difficult to assess since severity is a subjective concept. An official who obtains satisfaction from a prestigious position may view the embarrassment of public exposure for corruption and the loss of a job as severe punishment, while another with attractive outside alternatives might view such a response to be a minor inconvenience. The same can be said of punishment as a deterrent to private sector underground activity, so at least some inferences can be drawn from a comparison of the types of punishment that corrupt officials face relative to punishment given criminals in the private sector.

If it is correct that the incentives of officials who detect corruption within their own organization are to suppress information and downplay the significance of the corruption in order to avoid embarrassment and the potential loss of discretionary power or prestige, then any internally generated punishment is likely to be relatively mild. Mild punishment should make the corruption appear to be relatively less significant to those outside the organization (e.g., legislators and private sector government-watch groups), thus minimizing the attention that exposure might attract. Witness, for example, the reluctance of Congress to go beyond formal reprimand when one of its members commits an illegal act.

Punishment may be relatively severe as compared to that generated within a corrupt official's governmental organization when it arises as a consequence of detection by another organization or a private government-watch group. One

might even expect such punishment to be severe relative to the punishment of private sector participants in comparable underground market activities, since the strategies employed by corruption policing efforts is to make examples of those few officials who are caught in order to deter other potential corruption. This is not an appropriate deduction, however, if the same strategy is used to deter participation in private sector underground markets (e.g., it appears that the IRS employs a similar strategy). Although there is no statistical evidence, public officials (particularly high-ranking officials) seem to receive relatively short prison terms and to be paroled relatively quickly. Even if punishment is extremely severe, it need not be a significant deterrent if the likelihood of detection is extremely small.

Corruption in the United States; What Can We Expect?

If historical trends continue, increasing governmental (as opposed to market) allocation and transfer of property rights can be expected in the United States (Tullock 1980).⁸ One can predict that political corruption will rise as a consequence. At first glance, such a prediction may appear to be trivial: Governmental growth means more governmental employees so that if some portion of public officials are corrupt, corruption should increase. But this prediction goes beyond such an obvious relationship. Based on the preceding explorations of the opportunities for and the incentives to commit corruption, we can anticipate that the number of officials involved in political corruption should rise at an increasing rate as government grows.

The relationship between governmental growth and the opportunities for corruption is obvious. Greater government involvement in society means that more property rights are controlled by governmental officials through expanding regulatory activity or more taxation. Thus, there are greater possibilities for the illegal sale of such rights. Incentives for participation in private sector

underground markets increases, so officials have opportunities to accept bribes in return for altering rights structures or for allowing some individuals or groups to operate in a private illegal market without fear of punishment. Higher taxes also mean greater expenditures, so governmental growth implies that there will be increasing opportunities for accepting bribes in return for exclusive contracts to sell to the government and rights for sellers to set monopoly prices. Thus, if the incentives to commit corrupt acts does not change with governmental growth, we would still predict increasing corruption simply because of the expanded number of opportunities for corruption. However, governmental growth also leads to stronger and stronger incentives to become corrupt.

Consider the impact of an expanding governmental role for the potential payoff to corruption. Governmental growth really means that private sector or market activities are increasingly constrained as property rights allocations gravitate toward public officials. The more severe the legal constraints on private markets, the more valuable become the rights controlled by public officials. Correspondingly, the payment likely to be forthcoming to a corrupt official increases. Furthermore, as the power to make ever greater numbers of rights allocations is placed in the hands of public officials, the potential returns to corruption expand even if no single right has tremendous value. Since an expansion of government's power to tax or regulate leads to greater potential payoffs to corruption, the incentives to be corrupt become stronger as the government grows.

Ehrlich and Posner (1974) have explained that an increase in the size and power of government in a representative democracy must lead to a greater delegation of discretionary powers to bureaucrats. Elected legislators could, in theory, make all rights allocations by passing statutes. Instead, however, they delegate increasing discretionary rule-making (rights-assigning) powers to

bureaucratic agencies. Legislative decisions on property rights assignments and modifications must involve negotiation among a large group (legislators), which implies high transactions costs. The cost of making decisions rises sharply as the number of bargainers increases, so a legislature cannot respond efficiently to a growing workload by increasing its size. Therefore, as government grows, the legislature responds by delegating greater property rights allocation powers to bureaucratic agencies. This in turn requires expanding existing bureaucracies or creating new agencies or both.

The tendency for greater delegation of powers in the face of governmental growth has three implications for corruption. First, an expansion in the number of governmental employees with some rights allocation powers means that monitoring for corruption should become increasingly ineffective. Monitoring efforts must be spread over more and larger agencies. Thus, detection of any particular corrupt public official becomes less likely, and each official's incentive to avoid corruption is reduced. Of course, if resources devoted to monitoring are expanded proportionately to governmental growth, corruption incentives need not increase. It is doubtful that this will occur. Clearly the legislature must become less effective in monitoring, since aside from congressional staff, it does not grow, assuming that Enrich and Posner's scenario is correct. Thus, the relatively fixed legislative monitoring resources must be spread over more and more potentially corrupt governmental employees. In fact, legislators' monitoring efforts are likely to decline in total as well as on a per official basis as its decision-making workload grows. The legislature might choose to delegate monitoring to another governmental organization (e.g., police), but there is no indication that this is the case in the United States. We are aware of no legislation that delegates power to allocate property rights and simultaneously provides resources to monitor for possible corruption. The incentives for private citizens to become involved with government-watch organizations

should increase, so private sector monitoring efforts may expand as government does. However, the free rider problem is still likely to stand in the way of any effective monitoring. Thus, detection becomes less likely as government grows and as incentives to become corrupt increase.

Directly related to reduced monitoring described above is the second implication of the greater delegation of powers; detection of corruption becomes less likely. This implies that the risk of detection to individuals paying bribes falls concurrent with a reduction of risk to those receiving bribes. Thus, individuals become more willing to enter into underground transactions with public officials, while more opportunities for corruption become available. Furthermore, the reduced risk to bribe payers is likely to make them willing to pay larger bribes for any right that a corrupt official offers for sale. The payoff to corruption increases, and corruption becomes even more attractive.

A third consequence of expanding legislative delegation of powers is that rights allocation powers become more widely dispersed. Thus, coordinated (or monopoly) corruption becomes more difficult. The political machines of the nineteenth century were able to monopolize corruption in several cities partly because there were fewer governmental employees whose corruption had to be coordinated and far fewer potential areas of corruption. During that period, there were fewer property rights over which some governmental official had allocative power. We have argued that monopolization of corruption could actually lead to fewer illegal sales of governmentally controlled rights than a system of uncoordinated or competitive corruption would generate. Therefore, as government grows and monopolization of corruption becomes increasingly difficult, there is a possibility of relatively more illegal transactions.⁹

There does not appear to be any major relationship between governmental growth and the severity of punishment. If, in the process of growth and dele-

gation of powers? legislators delegate increasing authority to monitor-employees to the agencies themselves, then punishment for corruption may become less severe (and the probability of detection decline), but it is not clear that this occurs. Nonetheless, greater payoffs and a reduced likelihood of detection imply that corruption should increase at an increasing rate as a result of governmental growth. Evidence of this claim is difficult to produce, since successful underground activities go unrecorded and the likelihood of detection declines as governmental power expands. Note, however, the African and Latin American countries that are controlled by military dictatorships or other totalitarian regimes where bribery appears to be a well-established and accepted practice. Similarly, one writer on crime in the Soviet Union concluded that, far from "being eliminated, bribery and corruption increased [under communism and the resulting government control of virtually all property rights] particularly in the works of many economic and trade organizations, in institutions of higher learning, in various state organizations and enterprises, and even within the party" (Medvedev 1975, p. 25).

Conclusion

This examination of political corruption serves three purposes. First, we have demonstrated that the potential for political corruption arises for precisely the same reason that the potential for private sector underground markets occur: Property rights structures established through governmental regulation or taxation prevent or alter the competitive market allocation process and create opportunities for illegal tax or regulation avoidance activities. Many of these illegal activities are achieved through private underground transactions, but others must involve governmental officials. Thus, political corruption can be described as an underground market for governmentally controlled property rights.

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Second, we have delineated the factors that provide the incentives to be corrupt. The payoff to corruption depends on the value of the rights that an official has the power to allocate, the number of governmental officials who have some allocative or enforcement powers for any particular right, the degree of coordination (monopolization) achieved among corrupt officials, and the willingness of potential buyers of illegally allocated rights to pay given the risks and potential returns. The likelihood that corruption will be detected appears to be relatively small, since high monitoring costs relative to individual benefits (free rider problems) prevent effective private sector government-watch efforts. Furthermore, governmental officials have strong incentives not to expose corruption within their own organizations because they fear repercussions in the form of reduced budgets and discretionary power. Monitoring by legislators or police agencies also tends to be relatively ineffective given the wide-ranging functions that legislators and police are expected to perform with limited resources. The punishment that a corrupt official might face is not expected to be severe if he is detected by someone within his organization, since the employee's incentives are to avoid embarrassment for the organization in order to diminish the chances of losses in budget or discretionary power. Punishment might be relatively severe if a corrupt official is detected by a private sector government-watch organization or another governmental unit, but since detection is highly unlikely such punishment may not be a significant deterrent.

Finally, if the historical trend of governmental growth continues, we can predict that corrupt transactions will expand at an increasing rate. The opportunities for corruption are clearly enhanced as government precludes more and more market control over the allocation of ever greater numbers of property rights. Furthermore, the incentives for corruption become stronger as the potential returns from illegal sales of governmentally controlled rights rise

while the likelihood of detection declines. Thus, we should expect increasingly larger numbers of public officials to react to these incentives.

This analysis of political corruption is positive in nature. Our intent is only to point out that any time government raises taxes or adds regulation the potential for corruption arises and incentives to practice corruption are created, just as such governmental actions generate the potential for and the incentives to participate in private sector underground markets. Thus, when governmental officials and their constituencies are considering a tax or regulation, the likelihood of political corruption and the cost associated with allowing it to occur or trying to prevent it should be entered into their cost-benefit calculations. If such considerations are not made, the estimated net benefits from the the tax or regulation will be biased upward.

NOTES

1. Alexander Hamilton, for example, argued in the Federalist, No. 35 that one reason to set modest tariffs on imports is to reduce the incentives for smuggling. For recent analysis of tax avoidance through illegal markets, see Smith (1979), Tanzi (1982), and Simon and Witte (1982), among others.

2. A large literature on political corruption exists, of course, but little has been written on the sources of the economic incentives for corruption. Some thoughts on the subject appear in Rose-Ackerman (1975) and Benson (1981a), however, which serve as a foundation for parts of the analysis presented here.

3. Furubotn and Pejovich (1974, p.3).

4. "High payoffs" is used in an absolute rather than a relative sense. High payoffs need not be supranormal in the long run, given the opportunity cost of the resources used in the illegal market and the risk of detection and punishment. In fact, in the absence of barriers to entry, such as those discussed later, we would expect only normal profits to prevail in the long run. As with any competitive model, however, it is the expectation of supranormal profits that lead to entry. Furthermore, even with barriers to entry (e.g., monopolists in illegal markets), the competition to establish and maintain a monopoly position described by Tullock (1967) will require substantial investments in resources, which could reduce the ultimate payoff to something quite close to a normal return. That return still could be a high dollar value relative to normal returns in many legal markets because of the risk premium participants in such markets may require. The risk of detection is likely to be small, but it is a risk that participants in legal markets do not face.

5. Parts of this section paraphrase Benson (1981a).

6. The ceteris paribus assumption may not hold; there may be scale economies in corruption. The likelihood and severity of punishment might be greater in a competitive environment than for participants in a political machine, meaning that the expected cost of production, in aggregate, is greater in a competitive environment. Such factors would imply that the corruption monopolist might generate more illegal transactions than an uncoordinated market for corruption. The demise of the political machine in roost D.S. cities suggests the opposite, however. The high visibility of the machines and their corrupt practices made detection easy and the cost to citizens obvious. The fact that corrupt machines tend ultimately to be destroyed implies that the long-run marginal cost of monopolized corruption may be relatively high. Corrupt practices by individual unorganized officials, on the other hand, are likely to be difficult to detect. This point is examined below.

7. The discussion of the news media might imply to some readers that either (1) the news media is misallocating resources and thus not providing what its customers want, or (2) since the news business appears to be quite competitive and competitive industries produce what consumers want, the citizenry must not care about political corruption. Neither of these implications should be drawn. The discussion indicates that some kinds of news (e.g., detection and exposure of political corruption) are very costly to produce relative to other kinds of news. Thus, it is possible that consumers of news have equally strong (or even much stronger) demands for news exposing political corruption but that these demands are not met because they still are not strong enough to generate

sufficient revenues to cover the cost of producing such news. In this case, the news industry does not misallocate resources because it is producing the kind of news for which consumer demands are strong relative to production costs, but the news produced does not imply that citizens do not care about corruption. In other words, a competitive industry produces what consumers demand as long as that demand is strong enough to cover costs.

8. See Anderson and Hill (1980) and Benson (1981b) for discussions of historical trends in governmental rights transfer activities and Tullock (1980) for predictions of continually increasing governmental transfer activity in the context of rent-seeking theory.

9. This need not result, however, if a corruption monopolist is able to price discriminate. A discriminating monopolist could conceivably enter into as many transactions as would be made in a competitive market for corruption.

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