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

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THERE is little doubt that taxes create incentives for tax evasion. Illegal underground markets arise in the private sector, and today evidence is mounting that the tax-induced underground economy is very large and growing, in the United States and in other parts of the world.¹ It is also widely recognized that regulatory constraints, like taxes, induce private-sector underground activity. This is evidenced by the thriving markets in drugs, prostitution, gambling, stolen goods, and the labor of illegal aliens, all in the teeth of laws forbidding the sale or purchase of these goods and services. 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

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¹ Alexander Hamilton, for example, argued that one reason to set modest tariffs on imports is to reduce the incentives for smuggling. The Federalist No. 35. For recent analysis of tax evasion through illegal markets, see Rodney T. Smith, *The Legal and Illegal Markets for Taxed Goods: Pure Theory and an Application to State Government Taxation of Distilled Spirits*, 19 *J. Law & Econ.* 393 (1976); *The Underground Economy in the United States and Abroad* (Vito Tanzi ed. 1982); Carl P. Simon & Ann D. Witte, *Beating the System: The Underground Economy* (1982).

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, which serve as a foundation for parts of the analysis presented here, appear in Susan Rose-Ackerman, *The Economies of Corruption*, 4 *J. Pub. Econ.* 187 (1975); Bruce L. Benson, *A Note on Corruption by Public Officials: The Black Market for Property Rights*, 5 *J. Libertarian Stud.* 305 (1981).

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also face incentives to engage in illegal activities? If so, what influences the strengths of these incentives? Is political corruption likely to be caused by the same factors that encourage corruption in the private sector? In this analysis, we do not assume that all public officials are corrupt or even have a tendency toward corruption. For our purposes, it is quite sufficient that some portion of officials might be tempted to engage in corrupt activities. For parties who do engage in these activities, or for those who are close to the line, small shifts in the relative costs and benefits can have important effects on the willingness to participate in these activities, and the intensity with which they are pursued. As with all economic analysis, behavior at the margin is critical to understanding the overall situation. In the following pages, we delineate the opportunities for political corruption, examine the relative strengths of incentives to participate in corrupt activities, and make predictions about 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. 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 taking of an owner's right to the full value of his resources, followed by a corresponding reassignment of these rights to someone else (for example, a transfer recipient, such as a farmer receiving support payments).

Individuals and groups have strong incentives to influence the definition of property rights. The traditional analysis identifies three ways in which parties may seek to acquire desired assignments of rights. First, they can

³ The Economics of Property Rights 3 (Eirik G. Furubotn & Svetozar Pejovich eds. 1974).

accept the given structure of rights as defined by the public sector and thereafter acquire and dispose of resources through voluntary transfers under a rule of willing consent. The voluntary transfers are often lawful, but by the same token, where these transfers are declared illegal, they can continue to occur in an underground market, marked by the removal, in whole or in part, of any legal enforcement mechanism. 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 is to resort to theft. In this paper we will explore yet a fourth avenue for obtaining a rights modification that, in a sense, combines theft and governmental influence: a rights modification can be purchased from a corrupt government official who is endowed with appropriate discretionary control.

Illegal underground markets arise when the institutional structure precludes private owners from allocating their resources in a competitive market. For example, black markets occur whenever government prohibits sellers from setting their prices at the market-clearing level. Thousands of black markets exist, including the markets for illegal goods and services (for example, drugs and prostitution). Similarly, government restrictions on the right to lower prices, when the price floor is above a market-clearing price, generally lead individual suppliers to reduce prices illegally: illegal aliens typically supply labor services at a price below the minimum wage, and hard-pressed aliens may even make payments or bribes to willing buyers.

The emergence of an underground market in bartered goods and services—often inefficient modes of exchange—is in large part a private response to taxation that takes part of the private gain otherwise generated by private markets. To be sure, tax evasion can be wholly eliminated only if no taxes are collected. While this is not a viable possibility even in a minimal state, it does stress the social dangers courted by high marginal rates of taxation. All of these forms of illegal markets exist because the government has (whether wisely or foolishly) attenuated or eliminated private rights, thereby preventing or altering competitive market outcomes. We will show that illegal actions by government officials are also influenced by the way in which public laws entrench on private rights. While it is impossible to drive the level of government corruption to zero, one way to reduce it is to design systems of taxation and regulation that minimize the level of discretion, and with it the opportunity for misbehavior by government officials.

Becker demonstrated that individuals are relatively more likely to commit a crime (that is, 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.⁴ 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.⁵ 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. Similarly, the same constellation of costs and benefits is often found with various forms of tax evasion, such as the thriving underground market to exploit the substantial differences in state excise taxes on cigarettes.⁶ The transactions, however, need not involve only private actors, and our purpose here is to expand the analysis 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 government officials to participate in illegal activities.

OPPORTUNITY FOR CORRUPTION

Corruption is a consequence of discretionary political authority.⁷ All governments vest in officials discretionary control over some property, and the amount of discretion varies dramatically. The duties of a military sergeant or a federal judge, for example, cannot be prescribed with precision: the specific demands of time, place, and uncertainty preclude such a

⁴ Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 *J. Pol. Econ.* 169 (1968).

⁵ "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 leads to entry. Furthermore, even with barriers to entry (for example, monopolists in legal markets), the competition to establish and maintain monopoly positions will require substantial investments in resources, which could reduce the ultimate payoff to something quite close to a normal return. See Gordon Tullock, *The Welfare Costs of Tariffs, Monopolies, and Theft*, 5 *W. Econ. J.* 224 (1967). 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.

⁶ Simon & Witte, *supra* note 1.

⁷ See Benson, *supra* note 2.

prescription. Given that official behavior cannot be perfectly specified, there is an unavoidable potential for a public servant to exercise his discretion over certain property rights so that the outcome disproportionately benefits certain individuals. Hence, the potential for corruption is a constant danger when government officials allocate property rights.

The dangers for abuse are heightened whenever some general law bars voluntary transactions and hence creates the background conditions for the rise of illegal markets. In some cases, the violation of the public law is easily detected, so that private parties who wish to participate in these markets desire to reduce their risks by cloaking the transaction in a garb of apparent legality, as by "laundering" illegal receipts through legal businesses. The property involved may be highly visible, so that a change in use or user can be easily detected, it may be durable and immobile (for instance, land subject to zoning or other use restrictions), or it may be under close scrutiny by government officials or private citizens (for example, 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 requires the participation of a government official. It is not surprising, therefore, that land use and building regulations, for example, appear to generate considerable opportunities for political corruption.⁸

There is another, closely related opportunity for corruption. Where illegal activities in the private sector could be prevented or severely limited through relatively inexpensive enforcement efforts, the public officials in charge of policing these activities control a very valuable set of property rights—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 those rights allocations against third parties. The illegal activities of the policeman on the beat are a common theme in fiction and a common occurrence in fact. Schelling, for example, argued that organized crime is really monopolized crime,⁹ and Rubin and Anderson contended that criminal firms possess market power because there are economies of scale in buying corruption from police and other governmental officials.¹⁰

⁸ John A. Gardiner & Theodore R. Lyman, *Decisions for Sale: Corruption and Reform in Land-Use and Building Regulation* (1978).

⁹ Thomas C. Schelling, *What Is the Business of Organized Crime?* 40 *Am. Scholar* 643 (1971).

¹⁰ Paul Rubin, *The Economic Theory of the Criminal Firm*, in *The Economics of Crime and Punishment* (S. Rottenburg ed. 1979); Annelise Graebner Anderson, *The Business of Organized Crime* (1979).

Demsetz, however, pointed out that economies of scale are not sufficient for such monopoly pricing.¹¹ 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 no good private-sector substitutes are available at prices comparable to what a corrupt official might charge. In such cases, the desired alteration in property rights cannot be achieved solely through either legal or illegal private-sector transactions. The rights allocation must involve public officials. We find corruption in the form of patronage, for example, where relatives or supporters are given public service jobs that many others want, which can lead to even more corruption.

Rose-Ackerman detailed the possibilities for corruption that arise when government buys goods or services from the private sector.¹² 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 sellers' market, produce and sell the good to the government. Clearly, when government chooses to buy from only one seller the rights granted to that 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 government officials have the power to allocate them. Opportunities for underground transactions involving purchases of those rights from government officials are a consequence.

Second, Rose-Ackerman observed that a bilateral monopoly situation arises when a seller is already the only supplier.¹³ Willingness to pay a

¹¹ Harold Demsetz, *Why Regulate Utilities?* 11 *J. Law & Econ.* 55 (1968).

¹² Rose-Ackerman, *supra* note 2.

¹³ *Id.* at 198.

bribe then depends on the relative bargaining strengths of the buyer (government 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. The problem can arise in acute form whenever an original supplier has been accepted, for then problems of contract renegotiation involve a heavy element of bilateral monopoly, as it is typically considered to be far too costly to go to another firm. For example, the inflated prices in parts contracts that follow from the initial procurement also give rise to opportunities for abuse, as the original supplier has an inside track on the subsequent deal. In all these cases some bribe (however disguised) to the individual government official promises large gains to both the briber and the official. Similar problems can arise in private markets, but their frequency and intensity should be less because of the stronger incentives of private firms to monitor losses and their superior ability to make quick changes in business policy relative to public bodies. In a recent interview, for instance, Joseph H. Sherick, the Defense Department's inspector general, explained that his criminal investigative division had referred about 17,000 cases of fraud for prosecution or administrative action during the past two and one-half years. In his "battle against fraud," he reported "I keep turning over rocks, and every rock I turn over I find new things."¹⁴

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, thereby creating opportunities for illegal markets designed to evade the taxes and regulations. Under some circumstances, these illegal markets will have to involve corrupt government 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 delineated in his economic theory of crime: the size of expected payoffs

¹⁴ Pentagon Finds 17,000 Cases of Fraud, *Billings Gazette* 1A, col. 1 (September 27, 1984) [hereinafter cited as *Pentagon*].

relative to a public official's alternatives, the likelihood of being detected and punished, and the severity of the punishment.¹⁵

The Payoffs to Corruption

The expected payoff to public officials from corruption depends on a number of factors. Initially, the potential returns from corruption will be weighed against returns from other forgone activities if the official chooses to participate in an illegal market. Because they are not residual claimants, government 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 move 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 in the types of outside employment they are permitted to pursue and the level of outside income that they are allowed to accept. 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.¹⁶ Similarly, if an official has allocative power over a large portfolio of different rights, the payoff could be large even though no single right has tremendous value. It has been estimated, for example, that the Tweed organization made more than \$60 million through graft and corruption during the decade following the Civil War because it controlled virtually all the taxing and regulatory powers in New York City (and, to a degree, in the state).¹⁷ Some of those powers clearly involved the allocation of tremendously valuable rights, but others did not.

¹⁵ Becker, *supra* note 4.

¹⁶ Gardiner & Lyman, *supra* note 8.

¹⁷ Lawrence M. Friedman, *A History of American Law* 462 (1973).

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, so that the payoff to any one police officer will be relatively small and less coveted. 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 downward sloping. Substitute means of achieving a rights allocation (for example, lobbying) 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—prices increase while output is reduced, 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, as the seller sets a high price for those who obtain large benefits from corruption and is able to reduce the charges made for those parties who are not prepared to pay much more than the competitive price. In principle, the outcome with perfect discrimination could be identical to that under competition, but here (as with legal markets) the buyers of illegal services have incentives to conceal their true preferences, so that the rational discriminating monopolist will lose out on some transactions because it has set the price too high. Accordingly, the number of corrupt transactions should be smaller even if price discrimination is practiced, as we would expect it to be. (Of course, if there are scale economies in

corruption, the monopolist could even generate a greater output than the uncoordinated market.) The highly visible corrupt political machines may not have generated any more corrupt transactions than a nonmachine government would, *ceteris paribus*, even if the machine receipts exceeded those obtained by corrupt officials in a nonmachine government.¹⁸ Eliminating the political machines did not eliminate the *incentives* for underground sales of government-controlled property rights.

Perhaps it should be noted that coordinated (monopoly) corruption did not necessarily die with the end of the big city machines. There have, for instance, been a few major scandals that have resulted in fairly careful investigations of police departments—investigations that uncovered widespread corruption. Lawrence Sherman examined four such incidents (Oakland, California, in 1955; New York City in 1970; Newburgh, New York, in 1972; and a “Central City” in 1974, which he did not name).¹⁹ He found that prior to the scandal, police corruption had been highly organized in all four cities. Most corruption arrangements involved more than one officer, high-ranking officers (including the chief in Newburgh), a diverse range of corruption activities (for instance, vice protection, police burglary, and extortion or theft from arrested citizens occurred in all four cities), and strong linkages between corrupt politicians and corrupt police. In fact, “[p]oliticians in all cities but New York were reportedly arranging for police protection of vice operations. . . . Political influences on assignments and promotions were the basis of political control of police corruption.”²⁰

An obvious determinant of the payoff to corruption is the private buyer’s willingness to pay for an illegal governmental rights allocation. Naturally, buyers in the underground market for government-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

¹⁸ The *ceteris paribus* assumption may not hold; there may be scale economies in corruption. The likelihood and severity of punishment may 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 most U.S. cities suggests the opposite, however. The high visibility of 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.

¹⁹ Lawrence W. Sherman, *Controlling Police Corruption: The Effects of Reform Policies* (1978).

²⁰ *Id.* at 6.

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 high relative to the risk to offer enough to induce corruption.²¹

The Probability of Detection

The higher the probabilities of detecting an illegal rights allocation and of identifying and prosecuting a corrupt official, the lower the likelihood of official corruption. 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 deterrent, 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 that may pose some threat to potentially corrupt officials, but it is likely that these collective efforts will be relatively limited because of the free-rider problem. It is unlikely that these groups will be able to attract sufficient resources (contributions of time and money) to mount persuasive attacks against corruption. Such organizations often claim to represent large constituencies (for example, all consumers), but they receive active support from only a small part of those constituencies, typically less than 1 percent. The general citizenry does not constitute a major threat to a corrupt official.

The news media are 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

²¹ See Blair Bolles, *How to Get Rich in Washington* (1952); *Before Watergate: Problems of Corruption in American Society* (A. Eisenstadt, A. Hoogenboom, & H. L. Trefouse eds. 1978); Gardiner & Lyman, *supra* note 8; *Theft of the City: Readings on Corruption in Urban America* (John A. Gardiner & David Olson eds. 1974); *Political Corruption in Canada* (Kenneth M. Gibbons & Donald C. Rowat eds. 1976); *Political Corruption: Readings in Comparative Analysis* (A. Heidenheimer ed. 1970); *Police Corruption: A Sociological Perspective* (Lawrence Sherman ed. 1974).

private watch efforts. Nonetheless, it is doubtful whether the news media will 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, so 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, newspaper investigations 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 corrupt because the potential payoffs are large (for example, 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 newsworthy.²²

Professional peers, that is, other public officials, constitute a second source of potential monitoring of corrupt activities. Thus, bureaucracies and legislative organizations have their own systems for self-monitoring. The police have their internal affairs division, and Congress has its ethics boards. These systems of review have been highly publicized, but one of their most important effects may be to increase the costs of external monitoring by neutral parties. For example, Alan Bent, in his study of police, notes that "the police have long practiced bureaucratic secrecy to the exacerbation of relations with the community." "True to the bureaucratic practice of maintaining barriers between itself and the public, police officials have resisted investigations of their internal affairs and attempts to impose controls over their activities."²³ Bent points out that the se-

²² The discussion of the news media might imply to some readers that either (1) the news media are misallocating resources and thus not providing what their 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 (for example, detection and exposure to 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.

²³ Alan E. Bent, *The Politics of Law Enforcement: Conflict and Power in Urban Communities* 6, 11 (1974).

crecy that characterizes police operations clearly impedes accountability and obscures illegal acts. In addition, there is reason to believe that most internal monitoring is likely to be erratic and ineffective and thus to pose little threat to a corrupt official. No matter what the goal of a government official, he has strong incentives not to expose corruption (or inefficiencies) within his government unit. Suppose that a public official derives his satisfaction by working for what he believes is the "public interest" and is convinced that his bureau, agency, department, commission, or committee is doing vital work. 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. To be sure, a public-spirited individual would not 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, would make only modest monitoring efforts, directing his attentions elsewhere.

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 potential for corruption in his position. It is not very surprising, therefore, to find that in the relatively few instances where an official has reported the corrupt activities of his colleagues, the official has been ostracized by colleagues and superiors, denied promotions, and ultimately forced to resign, with the dubious consolation of some legal action, such as a suit in defamation, against public officials who are protected by a wide array of official immunities.²⁴ Corrupt officials probably have little to fear from their peers.

A third source of potential detection comes from other government units. One function of elected representatives is to monitor bureaucracies to see that they are doing what the representatives' constituencies want them to do. This monitoring could conceivably be very effective (assum-

²⁴ See, for example, *Fitzgerald v. Nixon*, 457 U.S. 731 (1982); *Harlow v. Fitzgerald*, 457 U.S. 800 (1982). Both cases grew out of Fitzgerald's efforts to expose the cost overruns in the C-5A program. In consequence of his testimony before a congressional committee, he was relieved of his job as a management analyst in the Air Force and was left, with the knowledge of the President and his key advisors, to "bleed, for a while at least," without any job at all. His suit against Nixon was blocked by a doctrine of absolute immunity for the President, and his suit against Nixon's advisor Harlow was limited by a doctrine of qualified privilege which could be overcome only by a showing of an "objective" knowledge in the defendant that they had violated the plaintiff's known and established constitutional rights. The incident shows that while some branches of government may favor disclosure, others could well be set against it.

ing that the representatives themselves are not corrupt) if there are relatively few officials to monitor and if there are relatively few rights those officials can allocate. 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, some price must be paid. Fewer resources are available for such things as determining the nature and strength of constituencies' demands.²⁵ Furthermore, the likelihood of meeting those demands through legislative enactments is decreased, since reaching agreement in a legislature can consume time and resources.²⁶ And there is less time for taking advantage of outside income sources and benefits associated with legislative service, such as political junkets.²⁷ So even if only relatively few officials and rights modifications had to be monitored, it would not necessarily follow that legislative oversight would effectively reduce corruption. Clearly, if large numbers of government officials have substantial discretion to allocate rights by taxing and regulation, legislative monitoring is likely to be an ineffective deterrent to corruption.

A legislature may choose to delegate a monitoring function to some other government 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 the resources devoted to them. 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 (for example, 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 evasion, but there is nevertheless a large and growing tax-induced underground economy.²⁸

When a government official has the authority to enforce a law that may

²⁵ Bruce L. Benson, *Why Are Congressional Committees Dominated by "High Demand" Legislators?—a Comment on Niskanen's View of Bureaucrats and Politicians*, 48 *So. Econ. J.* 68 (1981); Bruce L. Benson, "High Demand" Legislative Committees and Bureaucratic Output, 11 *Pub. Finance Q.* 259 (1983).

²⁶ Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rule-Making*, 3 *J. Legal Stud.* 257 (1974).

²⁷ W. Mark Crain, *Cost and Output in the Legislative Firm*, 8 *J. Legal Stud.* 607 (1979).

²⁸ Simon & Witte, *supra* note 1; *Underground Economy in the United States*, *supra* note 1.

generate a private-sector underground market, that official has a valuable right to sell: the right to operate in the underground market without 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 the possibility of bribery to prevent exposure exists even when they are detected.

A fourth source of detection involves political candidates who run on a “good government” ticket. Thousands of candidates have obtained office with a “throw the rascals out” theme. The key point here, however, is that the election of new officials to fill old offices does not address the fundamental question of institutional structure, the information held by and incentives created for persons in and out of government. The new broom may sweep clean, but not for long. Corrupt groups may have sufficient cohesion to prevent the election of reformers, by funneling campaign funds to the incumbent, for example. Yet even if the challengers win, the chain may only be as strong as its weakest link, so that the persistence of old institutional structures makes it likely that the practices of the new officials may degenerate to that of their predecessors. After a detailed study of police in the United States, for example, Smith wrote: “[t]here has been a whole series of police reforms. . . . There are campaigns to ‘turn the rascal out,’ and other campaigns to put them in prison. What has been the net result of all these excursions and alarms? Most of them have proved futile and quite without effect upon the ills which they were intended to cure. As often as not, law enforcement reformers have succeeded only in replacing one set of corrupt or incompetent officials with another set of the same or similar stripe.”²⁹ Indeed knowledge that this can happen may explain the widespread public suspicion of reform candidates, and thus helps to contribute to the uphill struggle they so often face.

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

²⁹ Bruce Smith, *Police Systems in the United States* 5–6 (2d ed. 1960).

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 officials tend to downplay corruption within their own organization, 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 (for example, legislators and private-sector government-watch groups), thus minimizing the attention that exposure might attract. Witness, for instance, the reluctance of Congress to go beyond formal reprimand when one of its members commits an illegal act. For another example, after the publicity of the New York City police scandal of 1972 died down, high-level or long-term officers who had been involved were pressured to retire. There was a 90 percent turnover in the ranks of captain or above during the next three years.³⁰ In contrast, punishment may be relatively more severe when corruption is detected by another organization or a private government-watch group, which does not suffer any reputational losses from disclosure. In Newburgh, New York, after the 1970 police scandal, new police executives were appointed by outside authorities and criminal charges were brought against several officers. Criminal convictions removed 23 percent of the force.³¹ In fact, one might even expect such punishment to be severe relative to the punishment of private-sector participants in comparable underground market activities, since the dominant strategy employed in policing corruption is to make examples of those few officials who are caught in order to deter other potential corruption. This deduction must be tempered however, if the same strategy is used to deter participation in private-sector underground markets (for example, it appears that the IRS employs a similar strategy, perhaps with the same frequency and intensity). 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. And when we go beyond the prosecution of top-ranking officials, and the publicity impact becomes relatively insignificant, prosecutors may be very reluctant to pursue the case. After all, they have opportunity costs too. The Defense Department's inspector general, in the interview mentioned above, explained that he is

³⁰ Sherman, *supra* note 19, at 7.

³¹ *Id.*

trying to win conviction in fraud cases regarding overpriced parts, but federal prosecutors to whom the cases are referred are very reluctant to take them on: "After all, we're competing. When we take a young U.S. attorney and hand him a six-week trial on a cost mischarging with thousands of documents, you know all he gets out of it is one conviction, whereas, he can run three bank robbers to jail in one day."³² Even if punishment is extremely severe, it need not be a significant deterrent if the likelihood of detection is extremely small. Sherman's study of cities that have had major police scandals found the deterrent effect of the scandal to be very short-lived. In the most recent of the scandals, for instance (his "Central City"), he estimated that corruption was back at its prescandal level within two years.³³

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.³⁴ One can predict that political corruption will rise as a consequence. At first glance, such a prediction may appear to be trivial: government growth means more government employees, so that if some percentage of public officials are corrupt, corruption should increase. But this prediction goes beyond this linear relationship. Based on the preceding account 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 government officials through expanding regulatory activity or greater taxation. As a consequence, there are greater possibilities for the illegal sale of such rights. Incentives for participation in private-sector underground markets increase, 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 government growth implies that there will be increasing opportunities for accepting bribes in return for exclusive

³² Pentagon, *supra* note 14, at 8A, col. 1.

³³ Sherman, *supra* note 19, at 12.

³⁴ See Terry L. Anderson & Peter J. Hill, *The Birth of a Transfer Society* (1980); and Bruce L. Benson, *Land Use Regulation: A Supply and Demand Analysis of Changing Property Rights*, 5 *J. Libertarian Stud.* 435 (1981) for discussions of historical trend in governmental rights transfer activities.

contracts to sell goods and services to the government, and thus for sellers to set monopoly prices. If the incentives to commit corrupt acts do not change with government growth, we would still predict increasing corruption simply because of the expanded number of opportunities for corruption. However, the growth of government also leads to stronger and stronger incentives to become corrupt.

Consider the impact of an expanding governmental role for the potential payoff to corruption. Government 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 have shown 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.³⁵ 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 about 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, by expanding existing bureaucracies, by creating new agencies, or all of these.

The tendency to greater delegation of powers as a response to governmental growth has three implications for corruption. First, an expansion in the number of government 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

³⁵ Erlich & Posner, *supra* note 26.

to government 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, its size does not grow. The relatively fixed legislative monitoring resources must be spread, therefore, over more and more potentially corrupt governmental employees. In fact, legislators' monitoring efforts are likely to decline in total as well as per official as its decision-making workload grows. The legislature might choose to delegate monitoring to another government organization, such as police, but there is no indication that this pattern has occurred 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 this reduced monitoring is the second implication of the greater delegation of powers; detection of corruption becomes less likely. Accordingly, the risk of detection to individuals paying bribes falls concurrent with a reduction of risk to those receiving bribes. Individuals become more willing to enter into underground transactions with public officials to take advantage of the increased opportunities for corruption. 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 government 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 government-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.³⁶

³⁶ This need not result, however, if a corruption monopolist is able to price discriminate.

There does not appear to be any major relationship between government growth and the severity of punishment. If, in the process of growth and delegation 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 government growth. Evidence of this claim is difficult to produce, since successful underground activities go unrecorded and the likelihood of detection declines as government 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 work of many economic and trade organizations, in institutions of higher education, in various state organizations and enterprises, and even within the party."³⁷

If the historical trend of government 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.

CONCLUSION

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 official corruption increases and incentives to practice corruption are created, just as these government actions generate the potential for increased participation in private-sector underground markets. Yet one implication is in part normative. When government 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 ignored, the estimated net benefits from the tax or regulation will be biased upward.

A discriminating monopolist could conceivably enter into as many transactions as would be made in a competitive market for corruption.

³⁷ Roy A. Medvedev, *On Socialist Democracy* 25 (Ellen de Kadt trans. & ed. 1975).