ELSEVIER

Journal of Economic Behavior & Organization
Vol. 48 (2002) 221–241

JOURNAL OF
Economic Behavior
& Organization

www.elsevier.com/locate/econbase

Making corrupt deals: contracting in the shadow of the law

Johann Graf Lambsdorff

University of Göttingen, Department of Economics, Platz der Göttinger Sieben 3, D-37073 Göttingen, Germany

Received 4 May 2000; accepted 9 June 2000

Abstract

Because corruption must be hidden from the public, transaction costs arising are of a different type than those of legal exchange. Moreover, because of the ever-present threat of mutual denunciation partners of a corrupt agreement are "locked-in" to each other even after an exchange has been finalized. This results in corrupt agreements being primarily arranged by middlemen or emerging as a by-product of legal exchange. It is concluded that corruption has little do with free competition. Fighting corruption should focus less on individual moral attitudes or penalties and more on methods to destabilize corrupt relationships. © 2002 Elsevier Science B.V. All rights reserved.

JEL classification: L14; K42

Keywords: Corruption; Secrecy; Transaction costs; Lock-in; Opportunism; Reputation; Trust

1. Introduction

> Virgo: All round improvement but not without strings, which you must be able to recognize and accept .... If paying a bribe to anyone, see that the job is done. [1]

Despite a growing interest in the economics of corruption the tools of New Institutional Economics have hardly been applied to this topic. Noteworthy exceptions are Husted (1994), Lambsdorff (1999), della Porta and Vanucci (1999) and Rose-Ackerman (1999, pp. 91–110). This study argues that an institutional viewpoint can enrich our understanding of corrupt agreements. Central to the analysis are transaction costs, including the costs of searching for partners, determining contract conditions, and enforcing contract terms. Transaction costs of corrupt agreements differ from those of legal deals because there is a need to camouflage

E-mail address: jlambsd@uni-gottinger.de (J. Graf Lambsdorff).

[1] Hindustan Times, New Delhi, October 1985. Cited from Oldenburg (1987: 508).

PII: S0167-2681(01)00217-7

and because partners to such a deal end up with potentially damaging information about each other. For these reasons, corrupt agreements are more likely to employ middlemen or result as a by-product of legal exchange and social structures.

Two different forms of corruption should be distinguished, *market corruption* and *parochial corruption* (Husted, 1994; Scott, 1972). Market corruption is defined as a competitive type of corruption with a high degree of transparency. For contractors in a corrupt exchange, in this case, the identity of the partner is irrelevant. Such market relationships can indeed occur, particularly in the case of petty corruption, e.g. the issuance of driver's licenses and permits for village market stalls or the acquisition of seats or freight space on railway cars (Husted, 1994, p. 20). Also illustrative of a kind of market corruption is a multitude of "coyotes", who wait outside the department of motor vehicles in Mexico to expedite the processing of a driver's license, alongside with the payment of speed money (Husted, 1994, p. 21). A similar case is reported from El Salvador, where "tramitadores" can be hired to deal with cumbersome bureaucracies and pay "additional fees" when required. [2] Those demanding illegal services are confronted with a transparent price system and the opportunity to choose between suppliers of the adequate service.

Parochial corruption is defined as a transaction with few potential contractors, and thus, restricted competition. Due to limited entry and exit the identity of partners can matter. Crucial to the difference between these two types of corruption are transaction costs. As market opportunities are investigated, typically, the total transaction costs arising as a result of exchanging goods or services increase with the total number of potential contractors sought. This increase results from the efforts required to search for potential contractors, evaluate the quality and adequacy of each of their products as well as their individual capacity and willingness to comply with corrupt contracts. The number of contractors sought can be assumed to be optimal once the marginal transaction costs of searching for another partner are equal to the expected gains resulting from a potentially better deal with another competitor. Taking this into account, it becomes evident that the higher the (marginal) transaction costs the fewer potential partners are sought.

When we assume that in reality transaction costs of corruption are high, parochial corruption becomes the dominant form of corruption. Examples of *market corruption* must then be regarded the exception (Cartier-Bresson, 1997). They require that prosecuting authorities either abstain from investigation, reflecting public approval, or at least a broadly permissive attitude towards corruption. Or the market has already developed institutional mechanisms which help to lower transaction costs, as in the case of the "coyotes" and the "tramitadores". This study argues that in most cases corrupt agreements are characterized by a high degree of secrecy, little transparency, and limited participation.

Various costs arise for those who offer and exchange corrupt services. For example, bureaucrats may expend resources so as to have sufficient discretion for illegal activities. But such types of costs should rather be regarded production costs. Since they do not arise as a matter of exchange, they will not be further considered here. Also, this study will not elaborate on aspects of cooperation between suppliers of corrupt services. Such a

[2] See taz, die Tageszeitung, Berlin, Germany, 12 July 1999: "Die diskrete Kunst der Korruption. Warum 'tramitadores' ewig leben". Other cases of market corruption are reported by Rose-Ackerman (1999, pp. 15–16).

cooperation can at times be necessary, particularly to bypass controls and overcome barriers imposed by a division of responsibilities.

Transaction costs of a corrupt agreement can be categorized according to the sequence in which they arise. Usually, the exchange of services and the returns cannot take place simultaneously. As a devotion of resources usually precedes collection of the return, three stages exist where transaction costs can arise. First, to initiate a contract necessary information with respect to the required service and the appropriate partner must be gathered and contracts specified. This will be dealt with further in Section 2. Second, since the proceeds cannot be collected at the moment when resources are committed, strategies must be developed to enforce contracts and avoid opportunism. Section 3 investigates this. Third, after finalizing the exchange, corrupt agreements differ from legal contracts because the partners have placed themselves at the mercy of the other. Both carry information which can impose damage on the counterpart; their relationship is not terminated with the exchange of service and return. This situation will be studied in Section 4. Section 5 concludes and indicates avenues for future research.

Theoretical considerations are largely supported by case studies. Owing to the fact that evidence from academic papers is still scarce, these are partly taken from the international media. As newspapers tend to scandalize more than report trustworthy details, several thousand articles from various press archives had to be screened over a period of 4 years to arrive at the few case studies which provided sufficient details to allow for theoretical conclusions. Reports were cross-checked against reports from other newspapers and when cases did not end in convictions it is made clear that these represent allegations.

2. Contract initiation

2.1. Seeking the partner

Potential partners must find each other. Seeking a corrupt service requires information with respect to the capability of the potential partner to actually provide the required service. Corruption provides opportunities for fraudulent offers. For example, avoiding the payment of speeding tickets by offering bribes often results in people pretending to be policemen, seeking bribes without having the authority to give speeding tickets. Such cases are numerous in many less developed countries.

In the event that a partner is found who is capable of providing the service, it must be discovered whether he[3] is also willing to do so, and whether his criminal capabilities are sufficient to provide the requested service in return for a favor. Direct inquiry can be dangerous, since potential counterparts who are not inclined to corruption may prefer to denounce the request. Take the example of an employee at a police station in Germany who was in charge of processing speeding tickets and was alleged to have offered to suppress such tickets in exchange for a bribe. The deal was offered to the car owners via middlemen. Two car owners approached in this manner reported the case to the prosecuting authorities, who

[3] Throughout this study, the male pronoun will be used for businesspeople and public servants and the female one for brokers and middlemen.

arrested a middleman when he attempted to pocket the bribe.[4] Endeavors by prosecuting authorities or internal audit controls may further threaten those who are seeking corrupt partners. Such institutions may employ an "Agent Provocateur", someone who only pretends to offer a bribe, but is really seeking to compromise the counterpart. This appears to be a common practice of the FBI.[5]

Offering a corrupt service cannot be done by public advertising. Those seeking or spreading such pieces of information cannot rely on regular sources such as the media, written advertising material or the recommendations of industrial bodies. Information on corrupt opportunities cannot create a transparent market where comparisons between potential partners can easily be made. Instead, other means for exchanging information must be sought: first, by attempting some public distribution of the relevant information in a disguised form, second, by organizing "advertisement" via middlemen, or, finally, by providing the information only to well acquainted business partners.

Of course, in the case of a public distribution of information, it is evident that the likelihood of detection is drastically increased (Rose-Ackerman, 1998, p. 97; Alam, 1990, p. 90; Borner and Schwyzer, 1999, p. 32). One way of overcoming this problem is by spreading the information in a disguised form, e.g. by spreading rumors about the potential corruptibility of oneself. Such rumors should be understood by potential partners as an offer. A lavish lifestyle can be one way to spread such rumors, since living beyond the official sources of income is an apparent hint for one's corruptibility (della Porta and Vanucci, 1999, pp. 56–59). Advertising corrupt services by spreading rumors is also described by (Heymann, 1995, p. 51), formerly the deputy attorney general of the USA. But he stresses that such rumors can also be a worthwhile indicator to prosecuting authorities of actual corruption.

Another means of spreading information is obtained by engaging a broker, who may not have to fear sanctions for publicly advertising the corrupt service.[6] She then serves as a front for those who offer their services. This seemed to be the case with operations of Nigeria's state oil company. Each contract specified a "commission" to be paid to a specific beneficiary. Traders had noted that sometimes the beneficiary was a well-known Nigerian, and at other times was a completely unknown person who traders believed was a front for someone else.[7] The advantage of making use of such a front is obvious—while the actual supplier of corrupt services cannot be identified, the service can be offered to a larger audience.

Even if the distribution of information on corrupt services cannot be organized, this does not spell the end of corruption. Corrupt opportunities can still be encountered

[4] See Kölnische Rundschau, 20 January 1998: "Im Kreishaus Anzeigen entwendet und an die Temposünder verkauft".

[5] See Chicago Sun, 9 December 1997: "AId. Frias plans to argue entrapment at bribe trial" and 12 December 1997: "Tape shows Frias approved payoff" and the Associated Press, 30 July 1998: "securities lawyer convicted of wire fraud and bribery".

[6] This is particularly the case if the expected penalty for middlemen is relatively low. Either their activity may not be the subject of legal sanctions in the first place, or they may be more mobile so as to escape prosecution. Finally, even in case of prosecution, they may be in a good position to defend themselves as mere arbitrators and facilitators, leaving the major criminal charges with their clients.

[7] See Washington Post, 9 June 1998: "Corruption Flourished in Abacha's Regime—Leader Linked to Broad Plunder".

at random. The most obvious opportunities arise between business partners with established legal relationships (Rose-Ackerman, 1999, p. 12). As their relationship deepens, they may encounter the opportunity to collude at the expense of their firms or departments. In this case, corruption takes place as already existing relationships deteriorate into illegal relationships. It is not corruption which brings together people in the first place. The exchange turns out to be parochial, excluding those without existing legal ties. Legality and corruption cease to be two opposing forms of relationships. Instead, a legal relationship represents a vehicle for establishing a corrupt relationship and the latter is parasitically linked to the former.

2.2. Determining contract conditions

Offering a bribe to someone who might refuse on moral grounds or simply due to insufficient criminal capacity is a risky undertaking. But even those who are potentially corrupt can at times prefer to denounce their counterpart in order to win public approval for their alleged dislike of corruption. Such cases can occur, particularly, if the bribe offered is worth less than the reputational gains from denunciation (della Porta and Vanucci, 1999, p. 195). This raises concern for how to determine the appropriate value of a bribe. The risk of denunciation must be weighed against the risk of paying more than necessary for the requested service.

Negotiating a corrupt agreement also requires consent with respect to the type of return. Instead of monetary inducements, partners may prefer gifts or favors whose connection with corrupt services may be difficult to detect and prove for prosecution authorities. The public may perceive such favors to be less of a bribe than a direct monetary payment. Invitations to lavish dinner, as in Japan, may appear to be a regular means of exchange and not an illegitimate inducement. Paying for the US education of the daughter of a foreign politician may be seen as a way to promote cultural exchange rather than outright bribery. But the disadvantages of in-kind exchanges rest with the difficulty of matching mutual desires and the indivisibility of the media of exchange—standard arguments which brought about the evolution of money.

Another danger arises if the conditions of a corrupt deal are not sufficiently specified at the beginning. Partners in a corrupt transaction may avoid precision so as to preserve the chances to find better excuses later, and to suggest that their deal is nothing else but an exchange of gifts between friends. An example will be given where an insufficient specification of contract conditions lead to dispute and denunciation afterwards (p. 15).

Partners may also conceal payments. Substituting a bribe for a loan can provide a legal appearance to a payment. The actual bribe is then hidden in the lack of repayment or in favorable conditions associated with it. A bribe can also be concealed by burying it in a different transaction, e.g. the exchange of a commodity at a price above or below its market value. A case study at hand relates to a Russian finance minister and three of his employees who were suspected of having obtained a royalty for their book on the history of privatization in Russia. The excessive magnitude of the payment was seen in connection with the preferential treatment the publisher received from the ministry in the privatization

process.[8] In Miami, it was alleged that employees of the port authority illegitimately used public resources for providing funding to a political party. Almost US$ 200,000 were paid to the "Democratic National Committee" by a private firm who, in exchange, was not charged for the use of the port's cranes.[9] Instead of making outright monetary payments, in 1996 the Dutch telecommunications company KPN incurred a financial risk to reciprocate a favor. In exchange for being sold a 17 percent stake of Telkomsel, an Indonesian state-owned telecommunications concern, the Dutch firm provided a free put option to Mr. Djody, a friend of (and presumably a broker for) the Suharto family. The KPN guaranteed a US$ 91 million bank loan for Mr. Djody to purchase another 5 percent share of Telkomsel and provided him with the option to either return the loan or the shares in 2001.[10]

Disguising the nature of a return is helpful to a corrupt deal, but it goes along with transaction costs. The last case illustrates this. The market value of the put option is roughly US$ 30 million. Usually, exchanging such an option makes sense if the recipient values it higher than the issuer. These differences in valuation can occur if the issuer can hedge the risk by another open position or because asymmetric information puts him at an advantage in evaluating a firms true value. Neither of these arguments fits for the above case. Since exchanging the option, valued by itself, may not have been beneficial to the partners, it represents a cost which is related to the disguising of the corrupt nature of the arrangement: the Indonesian side may have preferred a simple, say, US$ 15 million bribe while the Dutch valued the risks associated with the option much higher.

Linking the return of a favor to a different (legal) transaction also has another disadvantage. While the legal transaction will be enforceable by courts, this may not be the case for the corrupt side of the deal. This aspect carries over to opportunism and contract enforcement, to be investigated in the next section.

3. Contract enforcement

Formal models of corrupt behavior usually assume that contracts can be enforced, requiring no further costs. This assumption appears realistic only in the rare case of market corruption. Usually, the corrupt deal entails the necessity of one partner in the transaction providing the service before the return is obtained—or obtaining the return before the service is delivered. This is the rule in larger transactions, where the corrupt service is too complex to be provided at once. A corrupt service may require the manipulation of tendering procedures or steady lobbying for certain decisions, actions which take place over

[8] See Die Welt, 17 November 1997: "Jelzin hält trotz Affäre an Tschubais fest", Los Angeles Times, 16 November 1997: "2 More Yeltsin Aides Fired in Bribery Scandal", Der Spiegel, 48/1997, "Der letzte Fehler" and The New York Times, 23 November 1998: "Gore Rejected C.I.A. Evidence of Russian Corruption".

[9] See Reuters, 4 June 1998: "Ex-Miami port chief charged with embezzling". It was later ruled, however, that the revenues from the ports accrued to a private firm which paid a fixed franchise fee to the county, so that the defendants were acquitted of misusing public funds, Reuters, 7 June 1999: "defendants cleared in Miami port corruption trial".

[10] See Wall Street Journal, 31 March 1999: "KPN Arranged Loan to Gain Telecom Stake". A more detailed description was presented by the Dutch television station KRO, a political magazine named "Network", 28 March 1999 and 23 June 1999. KPN largely admitted the charges.

a longer period of time. Such cases give one partner the possibility of reneging on the deal (Rose-Ackerman, 1999, p. 17 and 98). After obtaining the corrupt service he may refuse to provide the return, or after obtaining a bribe he may defect on the delivery of the negotiated service (Boycko et al., 1995). He may also raise the price of the service later or simply demand another payment. Or he may sell secrets about competitors' bids in a public tender to many competitors at the same time, each time invalidating the previously sold information.

The World Bank (1997, p. 34) cites a businessman accordingly: "there are two kinds of corruption. The first is one where you pay the regular price and you get what you want. The second is one where you pay what you have agreed to pay and you go home and lie awake every night worrying whether you will get it or if somebody is going to blackmail you instead". This brings forward the necessity of investigating potential mechanisms to secure corrupt agreements, i.e. to guarantee the delivery of what was negotiated. A variety of such mechanisms and their usefulness for corrupt agreements will be discussed in the following subsections.

3.1. Legal enforcement

The first question with respect to enforcement is to what extent legal institutions, that is courts, can be engaged to resolve conflicts in corrupt agreements. The first obstacle arises as engaging courts is only possible when partners in a corrupt agreement need not fear prosecution. Such a lack of prosecution may arise particularly when bribe-takers are foreign public servants, since such cases have in the past not been prosecuted in OECD countries.[11] Further problems arise with the necessity to produce evidence, which is needed for legal resolution. But those making corrupt deals may abstain from the production of such evidence so as to avoid unintended leakage of information. Written contracts, receipts, support by witnesses and similar instruments of authentication are often "not available".

Yet, even in cases where sufficient evidence can be provided to allow for third party resolution, legal enforcement of corrupt contracts is usually not possible. In Germany, §138 of the Civil Code (BGB) declares transactions void which conflict with public morals (German: sittenwidrig). According to current jurisdiction, corrupt agreements are interpreted in this sense which prohibits legal enforcement of claims resulting from corrupt agreements.[12] Similar regulation exists in other countries.[13] It is therefore, commonly acknowledged that corrupt deals are not legally enforceable (Rose-Ackerman, 1999, p. 92 and 96) and Dick (1995, p. 26).

---

[11] This situation has change lately, see (Wiehen, 1996, p.116) and (Lambsdorff, 1998).

[12] There is a noteworthy difference between the usual arguments regarding the lack of legal enforcement and the arguments brought forward here. Lacking possibilities for legal enforcement commonly result from excessive complexity of contracts and the impossibility of measuring the relevant item, leading to "non-contractibility" of contractual specifications (Hart, 1987, p. 168) and (Hart, 1991). In the case of corruption, it is the explicit decision of the judiciary not to enforce such contracts. The idea behind this is that improper contractual relations should not be supported by legal enforceability. In this context, courts take it consciously into account that the proceeds of an improper contractual relation are randomly divided between the corrupt partners (Fikentscher, 1987, p. 89).

[13] Influence peddling for public contracts and the resulting claims by such lobbyists are considered void under French law (Jarvin, 1986, p. 31).

However, such regulation can be circumvented by making use of middlemen. The idea would be to pay a "regular commission" to such middlemen who then undertake the "dirty work", i.e. the payment of bribes. Payments to such middlemen can be based upon written contracts and appear to be legal. Such a middleman can pay out bribes and arrange deals, and after providing the corrupt service she can claim the promised return or; if rejected, threaten to use legal recourse. Alternatively, such middlemen can work as an *intervening purchaser*, acquiring contracts for themselves by means of bribery and selling the contract afterwards to the firm which initially wanted to obtain it. In such a case, contracts can be written which pre-specify price and condition between the firm and the middleman, containing a compensation for the required bribe payments. [14]

In the past such arrangements often failed. At first, the risk of contract enforcement is merely shifted from the private firm and the service provider to the relationship between the middleman and the service provider. The middleman risks that after payment the corrupt service is not delivered. Enforceability, therefore, remains a problem. Second, the contract between the firm and the middleman is not necessarily legally enforceable: if it is apparent that the commission to the broker was mainly for the payment of bribes, the contract may not be enforced by courts.

For example, in Germany, a supplier of brewery equipment was sued by a British broker for the payment of commission for arranging contracts with a Nigerian local government. The claimant declared she had arranged the payments of bribes totaling DM 300,000. The claim was rejected by the German High Court (Bundesgerichtshof) in 1985, since the contract violated §138 of the Civil Code. It was argued that the main job of the broker was the arrangement of bribe payments with local public servants and that payment for this service was the basis of the commission (Fikentscher, 1987, p. 86). A similar decision was made by the Arbitration Council of the International Chamber of Commerce (ICC) in 1982, case 3916 (Jarvin, 1986, p. 31). An Iranian broker arranged various contracts between Iranian authorities and a Greek firm with a written agreement that he would receive at least 2 percent of the total value of the contracts. After the Iranian revolution put an end to this business deal, the Greek firm still owed some commissions and rejected payment. The Iranian broker brought the case to the Arbitration Council. The arbitrator concluded that the claimant's activity was primarily the "influencing" of public officials. This was sufficient to declare the contract void and reject the claim by the Iranian broker.

Based on such court decisions, many private firms have in the past refused to pay commissions due to middlemen, claiming a violation of moral codes of conduct—after having received the promised service (Knapp, 1986, p. 999). As a result, middlemen are unlikely to make up-front bribe payments and usually request their commission simultaneously with making illegal payments. The companies are then still faced with the problems of enforceability and the inclusion of middlemen may not contribute to the solution of this problem.

[14] See della Porta and Vanucci (1999, pp. 156–165) and the Wall Street Journal, 29 September 1995: "Greasing Wheels—How US Concerns Compete in Countries Where Bribes Flourish". Reselling of contracts and subcontracting in public procurement, is therefore, often prohibited. In Singapore, private firms which engage in such deals face a 5-year ban on public contracts.

3.2. Hostages

Lacking legal ways of enforcing a corrupt agreement, partners must seek private alternatives (Williamson, 1985, pp. 163–205; Klein et al., 1978, p. 303; Klein, 1996). Contracts must be written in a manner that guarantees cooperative behavior at all stages of contract fulfillment, i.e. contracts must be *self-enforcing*. This is usually achieved by credibly threatening premature contract cancellation in case the partner does not fulfill his part of the bargain. Alongside such retaliatory action, partners must weigh whether their costs, e.g. in the form of lost opportunities for future profits, will be higher than the possible gains from opportunistic behavior.

Usually, corrupt agreements are not self-enforcing in and of themselves. Special mechanisms are required to achieve this. One potential instrument is the use of "hostages" (Williamson, 1983) and (Wiggins, 1991, p. 640). Much like a collateral, this is a valuable asset given by someone who might profit from opportunism to those on the other side of the contractual agreement, who are in a position to be harmed by opportunistic behavior. In case of non-delivery of the proposed service, keeping the hostage is an obvious threat. With respect to corrupt agreements such a hostage can be provided in the form of a down payment. Public servants who fear that a promised bribe might not be paid after service delivery will demand parts of the bribe in advance (Moody-Stuart, 1994, p. 15). Such payments must be well balanced, since excessive amounts may provoke opportunism from the other side. Service delivery and payment schemes must be synchronized in such a way that the risks and costs of premature contract cancellation are reduced to a minimum (Rose-Ackerman, 1999, p. 35).

While such payment schemes can be found in any kind of contractual relationship, in the special case of corrupt agreements another option can be observed: the corrupt agreement can be linked to a legal agreement in such a way that the latter provides safeguards against opportunism in the former. Resources owned by someone else (e.g. the state in the case of public procurement) can be used to serve as an enforcement device for corrupt contracts. This can be illustrated by the following case study: submarines manufactured by the Howaldtswerke Deutsche Werft AG (HDW) were ordered by the Persian government in 1978. The total value exceeded DM 1 billion, of which the Shah claimed a commission of DM 109 million for himself. The deal was arranged by letting the Persian government make an advance payment of DM 231 million to HDW from which the requested commission could be passed on to the Shah's Swiss bank account. [15]

The idea in this case was to allocate third party found, i.e. those of the Persian government, to the enforcement of the corrupt agreement. If the Shah reneges on the contract, HDW could threaten to keep the down payment. Similarly, there was no risk on the Shah's side since he was paid in advance. The whole risk of contract enforcement was borne by someone not at all profiting from the corrupt agreement: the Persian government, which might lose its outlay in the event of conflict. While this strategy in general appears workable, it was not successful in this case. The Iranian revolution put an end to the Shah regime and the new leaders canceled the above mentioned purchase of the submarines, claiming back the deposit. HDW rejected the claim, arguing that the down payment had already been used

[15] See Focus, Germany, Vol. 44, 1995, p. 65.

for necessary investments. In 1991, the case was brought to the arbitration council of the ICC in Paris. It was decided that only expenses directly related to the deal could be kept by the HDW, but the commission to the Shah could not be considered such an expense. The commission had to be paid back to the Persian government. And of course, HDW could not reclaim the money from the Shah. In case third parties whose assets were misused as enforcement devices by corrupt partners are able to reclaim their property, the risk associated with non-enforceable contracts remains with the corrupt partners.

3.3. Reputation

Another potential enforcement device for corrupt agreements is to establish a reputation, Williamson (1985, p. 260 and 375–377), (Kreps and Wilson, 1982), (Kreps, 1990) and (Rose-Ackerman, 1999, pp. 99–102). If advantage was not taken of opportunistic self-enrichment in the past, this may indicate a preference for honesty over profit to third parties. Past actions in this case reveal an individual moral attitude—and can certainly turn out to be profitable in the long run.

Corrupt public servants who behaved opportunistically in the past may risk a bad reputation (Bardhan, 1997, p. 1324). Based on past experience, potential partners may reject future collaboration. Maintaining a good reputation turns out to be profitable, along the lines of a popular joke: "I am a man of principle. Once bought, I stay bought". [16] Ironically, being corrupt does not imply being dishonest. Establishing a reputation for being honest and virtuous is not alien to corrupt partners (Husted, 1994, p. 24). On the contrary, disputes regarding legal agreements can be settled through recourse to the law and depend less on the mutual trust than do corrupt agreements.

Dishonesty, broadly defined, is sometimes seen to cause corruption. It induces public servants to pocket a bribe instead of serving the public. But any argument along this line must better define the moral attitudes involved. Preference for honesty can have a rather ambiguous effect on corruption. It may restrict the inclination to become involved in corruption, but it can also help to enforce corrupt contracts. A negative attitude towards opportunism and a positive attitude towards reciprocity could promote corruption more than it helps to inhibit it. In a survey of the general public in Bulgaria it was asked in 1998, "in case someone has successfully used his contacts, do you think that he/she would feel obliged to give a present to the person that helped him?". 60 percent of the respondents approved of this proposition (Center for the Study of Democracy, 1998). Feeling obliged under such circumstances is certainly an aid in enforcing corrupt agreements.

A reputation does not become public knowledge on its own. It requires some mechanism to process and deliver the respective pieces of information. As in legal markets, suppliers of corrupt services must find ways to advertise their honesty. But in contrast to legal markets, the information should be withheld from prosecuting authorities, which prohibits their public delivery. Establishing a good reputation is particularly an option for middlemen, emphasizing again this institutional device for corrupt agreements. Unlike the actual supplier of a corrupt service, a broker may be in a position to publicly disclose her past record and establish a reputation for dealing honestly. Reneging on an agreement would result

[16] This joke among politicians in the US has been reproduced in Drew (1983, p. 97).

in disreputable news about the broker, preventing such a behavior in the first place. This provides a clear advantage for middlemen in arranging a corrupt agreement as compared to the actual partners. A middleman can thus act as a guarantor of a corrupt deal, someone who links up the parties involved (della Porta and Vanucci, 1999, p. 46). Oldenburg (1987, p. 522) provides an example of middlemen who offered to use their connections at the land consolidation department in India on behalf of their clients. When offering their services they sometimes provided a "money-back" guarantee to farmers, who were seeking nothing but fair treatment at the department. Not so much this announcement is astonishing, but that farmers believed it. According to della Porta and Vanucci (1999, p. 61), the importance of one's reputation has been stressed by a broker for corrupt transactions: "above all, if you want to have a minimum of credit as a corrupter it is necessary to honor commitments and be as precise as a Swiss watch. If 10 million must be paid at 10 o'clock on the 10 November you have to be there 5 min early with not a six pence less than the sum agreed".

3.4. Repetition

There are economies of scale in setting up corrupt relationships. As new opportunities for corruption arise, it is preferable to deal with old partners. One reason for this is that the expectation of future deals provides a leverage to avoid current malfeasance. Threatening to reject cooperation in succeeding deals can be sufficient to serve as a deterrent against opportunism in current transactions. Control over future deals can be used to retaliate.

That repetitive games can result in cooperation has already been shown in the seminal contribution by Axelrod (1984). An application to corruption within a principal-agent framework has been undertaken by Pechlivanos (1998).[17] He investigates the impact of repetitive collusive opportunities on agents' behavior and argues that collusion is sustainable only when punishing non-conforming behavior is possible by canceling future business. The following case study illustrates the function of repetition as an enforcement device. Allegedly, the German firm Avia obtained oil from Saudi Arabia at a price below market prices and paid US$ 378,000 to a German and a Lebanese agent every 2 weeks. The agents "arranged" the contract with Saudi Arabian public servants. The profitability of this arrangement secured the loyalty of all partners. When serious disputes arose about how to share the proceeds they could quickly been settled, owing to the fear that they might threaten future business.[18]

The threat of losing future business is not only valid for future corrupt agreements, but also for succeeding legal ones. Partners in a legal relationship can use their already existing ties as an enforcement mechanism for the corrupt side-contract. Opportunistic behavior within the corrupt agreement can now be deterred by threatening cancellation of the legal market relationship. This threat may not be effective given strong competition in the legal

[17] In contrast to Pechlivanos (1998), most principal-agent models neglect the existence of transaction costs, e.g. Kofman and Lawaree (1996, p. 390), Laffont and Tirole (1993, p. 478) and Olsen and Torsvik (1998, p. 433).

[18] See Der Spiegel, Germany: Vol. 18, 1984, p. 79. A related case study from Italy is provided by della Porta and Vanucci (1999, pp. 129–131).

market: other competitors can be sought, and cancellation of market exchange would not invoke losses. But when limited competition exists and the legal relationship is characterized by a high importance of trust between partners, threats to end a long-standing exchange impose damage upon both sides. Such threats which should be used for the smooth functioning of the legal agreement can also be misused for securing a corrupt agreement. This consideration works in favor of the argument that corrupt deals can be a by-product of legal agreements.

Also with regard to government regulation, corruption may emerge as a by-product. Regulation often requires repeated control, e.g. monitoring the fulfillment of pollution requirements, probation orders or entitlements to subsidies. Regular contact can help lower the transaction costs for arranging corrupt agreements, rendering some public servants particularly apt to taking bribes. For example, Borner and Schwyzer (1999) argue that policemen can lower the transaction costs of corrupt agreements with criminals by regularly controlling the activities of such people.

3.5. Vertical integration

Another way of securing corrupt contracts can be designed by common ownership (Klein et al., 1978; Wiggins, 1991, p. 607; Williamson, 1985). This is a standard instrument to provide incentives for complying with the original terms of a contract. Those who deliver and those who receive services or goods integrate vertically to form a new company under common ownership and control. Raising the profit of the firm is now in the self-interest of each partner.

This type of arrangement can also be used for corrupt agreements. A political decision, e.g. the construction of an infrastructure project, can be "bought" by founding a joint-venture and giving free shares to the respective politicians. Or a public servant is given an option to buy shares of the joint-venture. The advantage of this kind of arrangement is obvious: the recipient of the favor obtains some legal documentation of his property and is simultaneously provided with an incentive to comply with the terms of the contract. A failure to deliver the corrupt service will result in worthless shares. The actual bribe payment then takes place in the form of entitlements with respect to future profits of the joint-venture.

Allegedly, former President Suharto of Indonesia and many of his friends and relatives possess shares in a variety of joint-ventures in Indonesia's airline, power utility, oil and gas industry. These shares were not obtained in exchange for cash, but rather in return for government licenses and contracts.[19] Another case from Indonesia is similar to the one reported on p. 6. The US mining company Freeport found large deposits of copper, silver and gold in Irian Jaya, Indonesia. In 1991, Freeport therefore sought to claim more time and area for exploration. In exchange, the Indonesian government required that Freeport should incorporate its local subsidiary in Indonesia and sell a 10 percent stake of this subsidiary to a "local interest". Only one bid was provided—by Indonesia's Bakrie Group, run by a friend of the Minister of Mines. The shares were bought via a Virgin Islands company and

[19] See the Financial Times 2 November 1998: "Indonesia: companies try to buy Suharto stakes".

it was alleged that high ranking politicians had a stake in this company.[20] Politicians with such a stake have an incentive to provide the concessions for exploration to Freeport and are unlikely to behave opportunistically.

Another possibility to vertically integrate is by giving hierarchical control rights to the provider of corrupt services. Refusal to provide the promised payment becomes improbable due to the direct and unpleasant impact this would have on the future cooperation with somebody holding control rights. One way of doing this can be to award a public servant with a position on a firm's board (Jagannathan, 1986).

3.6. Social embeddedness

Institutions can be designed so as to safeguard against opportunism and help to enforce contracts. In this case, social relationships are influenced by individualistic optimizing behavior and the resulting strive to economize on transaction costs. But quite often the causality can be reverse: corrupt relationships can be setup with partners with whom some kind of organizational link already exists. For example, someone seeking a corrupt partner may prefer to strike a corrupt deal with a fellow board-member, since opportunism becomes more unlikely the more the partners are obligated to any type of future cooperation or politicians can easily lobby for contracts to be awarded to companies in which they already have a stake themselves. This results in corrupt agreements emerging as a by-product of already existing legal relationships. Hierarchical relationships and existing ownership structures serve as a safeguard against opportunism.

Pre-existing social relationships can lay the foundation for economic exchange by providing the required safeguards against opportunism. Economic exchange is thus facilitated by being embedded in a social structure (Granovetter, 1992). For members of a social structure, the advantages to be gained in the long run from benefiting another member may regularly outweigh the motivation to behave opportunistically or to denounce another member. Such social structures can easily be used to facilitate the sealing of a corrupt contract (Rose-Ackerman, 1999, p. 98; Cartier-Bresson, 1997, p. 163). A large variety of potential social structures come into question, e.g. relationships such as kinship or belonging to the same ethnic or cultural group. Other types of social relationships include secret societies or criminal organizations, particularly when they establish rules of reciprocity (Gambetta, 1998, p. 59; Schrag and Scotchmer, 1997; Anderson, 1995, pp. 42–47). Their capability to use violence against people can provide them with a prime position to prevent opportunism. In case they are perceived to impartially settle disputes, they can also offer their service as a middlemen to third parties (della Porta and Vanucci, 1999, pp. 221–231). Also political parties can assume the role of a guarantor of corrupt agreements (della Porta and Vanucci, 1999, pp. 103–109, 122–123). Social structure may also be helpful in spreading information on corrupt opportunities. Group-members can be entrusted with delicate

[20] See MSNBC, 15 November 1998: "the price for a pot of gold" the Washington Post, 30 November 1998: "Mining Company Fills a Hole" and the Wall Street Journal, 30 September 1998: "Hand in Glove. How Suharto's Circle and a Mining Finn Did So Well Together". It is not apparent at first sight that a favor was provided by Freeport to the Indonesian side. But it was argued that the price for the shares was by f r too low and that the Bakrie Group hardly incurred a financial risk because a US$ 173 million bank loan to finance the US$ 212.5 million purchase was guaranteed by Freeport.

pieces of information which should not be spread outside the group. In this respect, they are preferred over markets, where anonymous recipients of information may deliberately cooperate with law enforcement authorities.

4. The aftermath

> I took my first bribe in my second term on the city commission . . . . It's a terrible thing, like cheating on your wife for the first time". [21]

Typically, contracts are assumed to end with the exchange of services and return. Contractual problems as they are typically discussed are those associated with securing and arranging the actual exchange. After the fulfillment of mutual claims it is assumed that there are no further problems associated with a contractual relationship. While this may be true of legal contracts, corrupt agreements may have further repercussions, owing to the fact that each partner has the option of denouncing the corrupt agreement. Both have locked themselves into mutual dependence and the corrupt agreement has a binding impact upon the partners even after the contract has been fulfilled. Having the means to impose harm on his counterpart, one partner in a corrupt contract can attempt to extort the other by threatening exposure.

In fact, information obtained from people who have themselves been involved in corrupt dealings are quite often an important source of information for prosecuting authorities (Rose-Ackerman, 1999, p. 53; Anderson, 1995). The public prosecutor specializing in organized criminal activities in Frankfurt am Main in Germany, W. Schaupensteiner, declared that the major sources of information used by prosecuting authorities:"... were often insiders. Their information is usually obtained anonymously. The most important cases in recent years were started by such anonymous tip-offs". [22] Similar experience is reported by G. Colombo, public prosecutor in Milan, Italy, and part of the "Clean Hands" Movement (Colombo, 1995).

4.1. Denunciation and extortion

Miscellaneous motivations exist for denunciation. The largest company in France, Elf Aquitaine, allegedly setup an internal financial network aimed at providing funding for corrupt political purposes. This so-called "Investment Board" consisted of relatives and friends of the chairman of the board. This institution was well established and succeeded for a while, but the booting out of one member put an end to its operation. The outcast had taken revenge and denounced operations of the network. [23] Clearly, some type of conflict can motivate one party to take revenge or to prefer honesty to involvement in illegal transactions.

[21] This impression was voiced by a former mayor of Miami beach, who accepted a monthly bribe of US$ 1000 from a banker and was sentenced in 1992 to 17 months imprisonment for tax evasion and taking bribes, see USA Today, 22 April 1998: "Miami's corruption endemic, brazen".

[22] See Frankfurter Neue Presse, 14 April 1998: "Korruption: Der Appetit kommt beim Essen", own translation.

[23] See Rheinischer Merkur 27 November 1997: "Schmutzige Geschäfte".

Apart from collaborators conflict can also arise with well informed people who were not part of the corrupt deal. Insiders privy to corrupt agreements may denounce particularly if they need not fear prosecution. This puts them in a prime position to extort hush-money. This appeared to be the case with the Christian Democratic party in Hesse, Germany. A staff member in the party's office was alleged to have embezzled 1 mio. DM of party funds. But he was given impunity due to fears he may denounce the party's illegal hidden accounts and even some of his debt was paid by the party, raising allegations these payments represent a form of hush-money. [24] Another case of hush-money was reported from Vietnam, where citizens posing as reporters used a hidden camera to try to extort money from border police whom they filmed taking bribes from drivers in exchange for turning a blind eye on lacking licenses. [25]

As argued on p. 5, corrupt agreements are particularly likely to breed conflict because the initial conditions of the deal are often insufficiently specified. One case involved allegations against the former Israeli prime minister Netanyahu and his wife who were suspected of accepting free moving and cleaning services. In return, the contractor Yaakov Amedi was allegedly slated to receive a government contract after election. But after Netanyahu was defeated in the election and Amedi did not get the government contract he submitted a US$ 110,000 bill to Netanyahu. Since Netanyahu rejected payment the case was brought to court and became public. [26] The partners apparently forgot to specify whether the favor was supposed to be reciprocated at any rate or only after successful election.

Another motive for providing information on illegal transactions may also result from monetary inducements by third parties. While prosecutors may offer crown witnesses a reward in exchange for inside information, private agents may also bid on such information, e.g. as a means to regain access to markets lost to corrupt competitors (Rose-Ackerman, 1999, p. 56). For the media, it is common practice to pay for tip-offs, enabling them to report on political scandals. Crucial information about corruption by Benazir Bhutto and her husband in Pakistan could be obtained from a collaborator in London. Pakistani prosecutors obtained these pieces of information in exchange for a payment of US$ 1 million. [27] As people, for a variety of reasons, can profit from obtaining such information and may be willing to pay a price, a market has emerged for inside information on corrupt agreements.

As pointed out by Rose-Ackerman (1999, p. 53), penalties imposed on payers and recipients of bribes are often asymmetric. Assume that an entrepreneur can somehow escape prosecution, but the public official bribed could be heavily penalized if detected. Payment of the immune witness or any other non-monetary benefit gained from taking revenge can easily provide an incentive for denunciation. The immune entrepreneur can use this situation to blackmail the public servant. This raises classical questions as to whether extortion works. Commonly, such a threat is ineffective if the blackmailer cannot convincingly assure his victim that he will be safe if he pays. However, if there is some chance that the partners may repeat a corrupt agreement sometime in the future, such threats may turn out

[24] See Süddeutsche Zeitung, 4 February 2000: "Hessische CDU zahlte angeblich Schweigegeld".
[25] See South China Morning Post, 13 July 2000: "Cameras Turned on Corrupt Police".
[26] See the Associated Press, 28 March 2000, "Police: Book Bibi!".
[27] See the Straits Times, Singapore 1 February 1998: "paper trail points to illicit Bhutto hoard".

to be effective. As long as future business is sufficiently profitable, the entrepreneur does not have an incentive to denounce the public servant. This forces the public servant to seal future corrupt agreements with the entrepreneur so as to maintain the latter's incentive not to expose him. Above that, profit sharing rules will change. While the division of proceeds during the first corrupt agreement was characterized by the risk that a failure to cooperate would result in zero profit for both sides, failure to cooperate now induces the entrepreneur to denounce the public servant. The entrepreneur is thus in a much stronger position. At a court in Bochum, Germany, an employee of the road construction authority confessed to accepting bribes for contracts relating to marking roads. Beginning in 1987, and lacking business experience, he passed on names of competing firms in a public tender. After this incident, he received an envelope filled with DM 2000 from the private firm who obtained the favor. "Suddenly, I knew that I had begun to be at his mercy", was the explication given in court and the justification for why he afterwards became entrapped in this corrupt relationship. [28]

4.2. Resulting contract design

Anticipating such dependence, public servants may prefer not to start with corrupt agreements in the first place. At the same time, those entrepreneurs who need not fear prosecution—for whatever reason—may appear very generous when it comes to granting a first favor. This phenomenon has also been described as a kind of "feeding", i.e. giving favors in order to place the other side at one's mercy. This may include gifts without requesting any return in the beginning. Yet, acceptance of the gift becomes the first step to dependence. Rejecting a genuinely corrupt agreement sometime thereafter suddenly becomes more difficult since declaring acceptance of earlier gifts may be troublesome and give rise to suspicion of more severe misconduct. The resulting relationship has been described by Galeotti and Merlo (1994, p. 14) in the case of Italian ministers:

> ... once the first transaction has been accomplished, the equilibrium pay-off share of the minister has to decrease as his bargaining power decreases. In other words, acceptance of the first offer brings about fairer gain shares in future transactions as the partners come to be 'hostages' to each other.

If the proceeds from corruption do not accrue to public decision makers but the department or political party they work for, rotating personnel can be a helpful instrument to increase bribes. New public servants or politicians can demand higher bribes than their predecessors who live at the mercy of others. Galeotti and Merlo (1994, p. 14) and della Porta and Vanucci (1999, p. 43) suggest this type of organization for the Italian government, where former ministers had been captured by private parties and a change of ministers was intended to increase the pay-offs ministers collected for their political parties.

There are two noteworthy effects of the risk of exposure after a corrupt contract has been fulfilled. The first one involves the consequences of increasing penalties. Typically, economists suggest that criminals regard penalties as a form of cost (Becker, 1968; Becker and Stigler, 1974). Increased penalties are then passed on to the recipients of their services in

[28] See Westdeutsche Allgemeine Zeitung/Cityweb, 10 February 1998: "Mit jedem Gefallen tiefer in den Sumpf".

the form of higher bribes.[29] But this suggestion is not without strings. Particularly, for the case of public servants who live at the mercy of immune entrepreneurs higher penalties for public servants increase their dependence on the entrepreneur. This lowers their bargaining position and thus reduces the level of bribes.

The second side-effect involves problems in enforcing corrupt contracts. Anticipating the risks of exposure can serve as a mechanism to enforce the corrupt agreement. This is illustrated by the following two cases: in a current case against India's former premier minister, Narasimha Rao, a London-based trader in herbs claimed that in 1983, Rao had promised him preferential treatment in public procurement in exchange for a bribe of US$ 100,000. Yet, after the payment was made the favor was never provided in exchange, which motivated the trader to bring the case to court in 1997.[30] The Aerospace Engineering Design Corporation (AEDC), registered in Panama, is alleged to have arranged the sale of aircraft equipment from Rolls-Royce to the Saudi Arabian Air Force, worth 20 billion British pounds. Commissions of up to 15 percent had been agreed upon. In exchange, the Panamanian firm maintained "close relationships" with prominent Saudi Arabian nationals. Allegedly, Rolls-Royce did not pay as negotiated. AEDC brought the case to the high court in Great Britain. Following a High Court writ, Rolls-Royce feared for its reputation, as did the British government, which had always denied any bribery payments in connection with the deal. This induced Rolls-Royce to settle the case out of court, causing AEDC to withdraw the case.[31]

In both cases, corrupt deals led to opportunism on one side of the agreement. The case was brought to court. In contrast to legal enforcement as described earlier, the function of the court was not to resolve the conflict—which it may have rejected. Instead, the court was used in order to draw public attention to the partner in the corrupt agreement and expose him—less to prosecution than to public disdain. In this way, one partner made use of the fact that he could easily escape prosecution while his counterpart would suffer from public exposure. As in the second case, such a denunciation can help to counter opportunism and enforce the initial corrupt agreement. The expected penalties become a means of securing the corrupt deal and stabilizing an illegitimate relationship.

Partners who face little harm or are risk lover may be in a good position to extort. A corrupt agreement, therefore, requires that each partner must equally value the losses resulting from denunciation thus refraining from such actions. Another solution can again be the engaging of middlemen. One of their obligations may be to remain silent about the identity of their clients, preventing partners from being in a position to blackmail each other afterwards. Such brokers then act as a "fall guy", someone who takes the responsibility or blame for another's dereliction or delinquency, a scapegoat, serving as a firewall to absorb the risks which otherwise may harm their client. Such a person acts as a front and is expected to keep silent with respect to the identity of her client, even after arranging the contract and

[29] See (Rose-Ackerman, 1975, 1978, p. 189, 121), (Andvig and Moene, 1990), (Neugebauer, 1978, p. 15), (Mookherjee and Png, 1995, p. 150) and (Gupta and Chaudhuri, 1997, p. 333). Rasmusen and Ramseyer (1994) report discrepancies between costs and proceeds of such activities. This is also described as the "Tullock Paradox" (Bardhan, 1997, p. 1326), (Rasmusen and Ramseyer, 1994) and (Tullock, 1980).

[30] See the Straits Times, Singapore, 9 November 1997: "Rao's reforms found more favor with foreigners" and CNN, 4 November 1997, "former India premier's bribery case opens".

[31] See the Financial Times, 20 December 1997: "Rolls-Royce: Silent on Saudi Talks".

exchanging service and return. In case the counterpart then denounces the deal afterwards, the broker must be willing, that is paid or forced, to take the full blame. [32] One possibility in this respect is available to managers who employ company members lower down in the hierarchy. Such persons can be assigned the task of arranging corrupt agreements. Their silence can be ensured, e.g. by threatening to fire them. Company boards may deliberately encourage employees to pay bribes as long as they can deny any involvement afterwards. In Japan, such persons are called "Yogore Yaku", a well paid lower-level employee with special benefits given to his family in case of conviction. Another means of control is available to clients in possession of compromising information about their middlemen (della Porta and Vanucci, 1999, p. 56).

5. Conclusions

The smoke screens and concealment required for corrupt agreements largely increases the costs arising from the transaction. The need to develop private mechanisms for enforcement is another dear factor of a corrupt deal. Furthermore, threats of denunciation lock-in partners of corrupt agreements even after contracts have been fulfilled.

In order to economize on transaction costs, various types of brokers can be employed to act as facilitators, guarantors and "fall guys". Another conclusion of this study is that corruption often takes place as a by-product of other relationships. These relationships may be characterized by a market exchange based on trust, hierarchical relationships or social structures. Such structures help in economizing on the costs of searching and spreading information, facilitate the disguising of a favor, support contract enforcement and avoid extortion or exposure.

There has been debate with respect to the welfare effects of corruption. Some authors suggested that corruption might help to re-establish the efficiency of market exchange where excessive bureaucracy and regulation impedes economic activity. For a review on these issues, see (Bardhan, 1997, p. 1322) and (Andvig, 1991). The existence of large transaction costs adds another dimension to this controversy. It limits entry and exit in corrupt markets, restrains exchange to insiders, converts corrupt deals into a long-term relationship and restricts competition (Rose-Ackerman, 1999, p. 30). Parochial corruption becomes the dominant form of corruption. As a result, corruption can at best replace politically motivated inefficiencies with those inefficiencies associated with the lack of competition.

Corruption is sometimes associated with moral decay. But transaction cost analysis presents a challenge to this viewpoint: individual moral attitudes can actually be a useful instrument for partners in corrupt agreements, since they can serve to guarantee contract fulfillment (Rose-Ackerman, 1999, pp. 97–99). Even the common notion that the penalizing of individuals is crucial to containing and fighting corruption is challenged by transaction cost analysis. This study suggests that under certain conditions penalties imposed on individ-

[32] This proposes the existence of different forms of middlemen as suggested by Oldenburg (1987, p. 531). Brokers who advertise a corrupt service and build up a reputation of honesty should be sufficiently independent from their client so as to avoid any apparent link. This contrasts to brokers who are closely controlled by their client so as to guarantee their long-term discretion.

uals can help to secure corrupt agreements and stabilize corrupt relationships. If corruption emerged as a by-product of market exchange, it must be considered to what extent this exchange can be penalized, e.g. by blacklisting firms and thus excluding them from future public contracts. Once hierarchical relationships have been used to facilitate corruption the responsibility for malfeasance rests primarily with a firm and less with its employees. This calls for corporate criminal liability as a way of imposing penalties on the offending organizations and not just on the individuals who might be "fall guys" or public servants entrapped into corruption after a minor misconduct. [33]

Since Tullock (1971), transaction costs are commonly assumed to lower welfare. In the case of transaction costs *of corrupt* agreements this argument does not hold (Lambsdorff, 2001). Since corruption is detrimental to economic development, associated transaction costs may help to contain the level of corruption and therefore operate in favor of public welfare (Gambetta, 1998, p. 59). Our observations indicate methods for fighting corruption by restricting the smooth operation of institutions that are used to facilitate corruption, this way increasing transaction costs of corrupt agreements. The actions of brokers deserve scrutiny in this respect and discussions should focus on methods to sanction them, e.g. by imposing penalties or requiring registration and improved accountability. For example, in Nigeria crude oil was formerly sold to cronies of the military regime who acted as middlemen. New regulation was designed to cut out middlemen and sell crude oil only to end-users who own a refinery or to globally-recognized traders. [34]

Research into the causes of corruption may profit from considering the role of transaction costs. The role of the judiciary in increasing the value of enforceable contracts is interesting in this connection. Social structures, in their tendency to favor reciprocity at the expense of the general social good, could well contribute to opportunities for corruption. Investigating organizational structures and firms in their propensity to facilitate corruption is another worthwhile avenue for future research. Survey work focusing on such aspects, such as the one presented from Bulgaria, are likely to contribute to the understanding of corruption. And, finally, cross-country investigations into the causes of corruption may discover appropriate instruments for observing to what extent institutional facilitators actually contribute to a country's overall level of corruption.

Acknowledgements

The author is grateful to Arvind K. Jain, Klaus Meyer, Charles Sampford and an anonymous referee for helpful comments. Many thanks to Chris Ernsting Christoph and Michael Schinke for proof-reading and revising the manuscript.

[33] Arlen (1994) alerted that corporate criminal liability may decrease corporate enforcement expenditures and monitoring systems so that firms avoid the discovery of charges for which they would be held liable. But she points out that these shortcomings can be overcome if corporate penalties take into account whether firms took "due care" of their employees or if information disclosed by a corporation cannot be used against it in criminal litigation.

[34] See Transparency International (1999, p. 7) and the Financial Times, 18 August 1999: "oil: Nigeria awards licenses".

References

Alam, S.M., 1990. Some economic costs of corruption in LDCs. Journal of Development Studies XXVII, 89–97.
Anderson, A., 1995. In: Fiorentini, G., Peltzman, S. (Eds.), Organized Crime, Mafia and Governments: The Economics of Organized Crime. Cambridge University Press, Cambridge, pp. 33–54.
Andvig, J.C., 1991. The economics of corruption: a survey. Studi Economici XLIII, 57–94.
Andvig, J.C., Moene, K., 1990. How corruption may corrupt? Journal of Economic Behavior and Organization XIII, 63–76.
Arlen, J., 1994. The potentially perverse effects of corporate criminal liability. Journal of Legal Studies XXIII, 833–867.
Axelrod, R., 1984. The Evolution of Cooperation. Basic Books, New York.
Bardhan, P., 1997. Corruption and development: a review of issues. Journal of Economic Literature XXXV, 1320–1346.
Becker, G.S., 1968. Crime and punishment: an economic approach. Journal of Political Economy LXXVI, 169–217.
Becker, G.S., Stigler, G.J., 1974. Law enforcement, malfeasance, and compensation of enforcers. Journal of Legal Studies III, 1–19.
Borner, S., Schwyzer, C., 1999. In: Pieth, M., Eigen, P. (Eds.), Bekämpfung der Bestechung im Lichte der Neuen Politischen Ökonomie. Korruption im internationalen Geschäftsverkehr, Bestandsaufrahme, Bekämpfung Prävention. Luchter, Basel, Frankurt am Maln.
Boycko, M., Shleifer, A., Vishny, R., 1995. Privatizing Russia. MIT Press, Cambridge.
Cartier-Bresson, J., 1997. In: della Porta, D., Mény, Y. (Eds.), The Economics of Corruption: Democracy and Corruption in Europe. Pinter, London, pp. 148–165.
Center for the Study of Democracy, 1998. Relations between Citizens and Public Administration and Public Opinion on Corruption in Bulgaria. Draft Paper. Sofia, Bulgaria.
Colombo, G., 1995. Korruption als Flächenbrand. Bekämpfungsstrategien in Italien. Korruption in Deutschland—Ursachen, Erscheinungsformen, Bekämpfugssfrategien. Friedrich Ebert Stiftung, Berlin, pp. 37–44.
della Porta, D., Vanucci, A., 1999. Corrupt Exchanges, Actors, Resources and Mechanisms of Political Corruption. de Gruyter, New York.
Dick, A.R., 1995. When does organized crime pay? a transaction cost analysis. International Review of Law and Economics XV, 25–45.
Drew, E., 1983. Politics and Money: The New Road to Corruption. Macmillan, New York.
Fikentscher, W., 1987. Ersatz im Ausland gezahlter Bestechungsgelder. Praxis des intenationalen Privat-und Verfahrensrechts, Vol. II, pp. 86–90.
Galeotti, G., Merlo, A., 1994. Political Collusion and Corruption in a Representative Democracy. Unpublished Manuscript. Universitá di Roma “La Sapienza” and University of Minnesota, Minneapolis, USA.
Gambetta, D., 1998. Comment on Corruption and Development, by Susan Rose–Ackerman. In: Proceedings of the Annual World Bank Conference on Development Economics, 1997, pp. 58–61.
Granovetter, M., 1992. Economic action and social structure: the problem of embeddedness. In: Granovetter, M., Swedberg, R. (Eds.), The Sociology of Economic Life. West-view Press, Boulder, pp. 53–81.
Gupta, M.R., Chaudhuri, S., 1997. Formal credit, corruption and the informal credit market in agriculture: a theoretical analysis. Economica LXIV, 331–343.
Hart, O.D., 1987. Incomplete contracts. In: Eatwell, J., Milgate, M., Newman, P. (Eds.), The New Palgrae—Allocation, Information and Markets. Macmillan, London.
Hart, O.D., 1991. Incomplete contracts and the theory of the firm. In: Williamson, D., Winter, S.G. (Eds.), The Nature of the Firm: Origins, Evolution, and Development. Oxford University Press, New York, pp. 138–158.
Heymann, P.B., 1995. Korruption in den USA Rechtliche, wirtschaftiiche und ethische Aspekte. Korruption in Deutschland—Ursachen, Erscheinungsformen, Bekämpfunsstrategien. Friedrich Ebert Stiftung, Berlin, pp. 49–56.
Husted, B.W., 1994. Honor among thieves: a transaction-cost interpretation of corruption in third world countries. Business Ethics Quarterly IV, 17–27.
Jagannathan, N.V., 1986. Corruption, delivery systems, and property rights. World Development XIV, 127–132.
Jarvin, S., 1986. Aus der Praxis des ICC Schiedgerichtshofes. In: Böckstiegel, K.H. (Ed.), Recht und Praxis der Schiedsgerichtsbarkeit der Internationalen Handelskammer. Schriftenreihe des Deutschen Instituts für Schiedsgerichtsverfahren. Heymann, Köln, pp. 7–51.

Klein, B., 1996. Why hold-ups occur: the self-enforcing range of contractual relationships. Economic Inquiry XXXIV, 444–463.
Klein, B., Crawford, R.G., Alchian, A.A., 1978. Vertical integration, appropriable rents, and the competitive contracting process. Journal of Law and Economics XXI, 297–326.
Knapp, W., 1986. Sittenwidrige Vermittlung von Regierungsaufträgen durch Beste-chungsgelder. Recht der Internationalen Wirtschaft, RIW, pp. 999–1001.
Kofman, F., Lawaree, J., 1996. On the optimality of allowing collusion. Journal of Public Economics LXI, 383–407.
Kreps, D.M., 1990. Corporate culture and economic theory. In: Alt, J., Shepsie, K. (Eds.), Perspectives on Positive Political Economy. Cambridge University Press, Cambridge, pp. 90–143.
Kreps, D.M., Wilson, R., 1982. Reputation and imperfect information. Journal of Economic Theory XXVII, 253–279.
Laffont, J.-J., Tirole, J., 1993. A Theory of Incentives in Procurement and Regulation. MIT Press, Cambridge.
Lambsdorff, J. Graf, 1998. An empirical investigation of bribery in international trade, European Journal of Development Research X, 40–59. Reprinted in: Robinson, M. (Ed.), Corruption and Development. Frank Case Publishers, London.
Lambsdorff, J. Graf, 1999. Korruption als müliseliges Geschäft—eine Transaktionskostenanalyse Korruption im internationalen Geschäftsverkehr. In: Pieth, M., Eigen, P. (Eds.), Bestandsaufnahme, Bekämplung, Prävention. Frankurt am Main: Luchterhand, Basel, pp. 56–88.
Lambsdorff, J. Graf, 2001. Corruption and rent-seeking. Public Choice, 1–29.
Moody-Stuart, G., 1994. Grand Corruption in Third World Development. Transparency International (TI) Working Paper. Transparency International, Berlin.
Mookherjee, D., Png, I.P.L., 1995. Corruptible law enforcers: how should they be compensated? The Economic Journal CV, 145–159.
Neugebauer, G., 1978. Grundzüge einer ökonomischen Theorie der Korruption. Eine Studie über die Bestechung. Basler sozialökonomische Studien. Schulthess Polygraphischer Verlag, Zürich.
Oldenburg, P., 1987. Middlemen in third world corruption: implications of an Indian case. World Politics XXXIX, 508–535.
Olsen, T., Torsvik, G., 1998. Collusion and renegotiation in hierarchies: a case of beneficial corruption. International Economic Review IXL (2), 413–438.
Pechlivanos, L., 1998. Self-enforcing corruption and optimal deterrence. Unpublished Manuscript. Université des Sciences Sociales, Toulouse, France.
Rasmusen, E., Ramseyer, J.M., 1994. Cheap bribes and the corruption ban: a coordination game among rational legislators. Public Choice LXXIV, 305–327.
Rose-Ackerman, S., 1975. The economics of corruption. Journal of Public Economics IV, 187–203.
Rose-Ackerman, S., 1978. Corruption—A Study in Political Economy. Academic Press, New Haven.
Rose-Ackerman, S., 1998. The role of the World Bank in controlling corruption. Law and Policy in International Business XXIX, 93–114.
Rose-Ackerman, S., 1999. Corruption and Government: Causes; Consequences and Reform. Cambridge University Press, Cambridge.
Schrag, J., Scotchmer, S., 1997. The self-reinforcing nature of crime. International Review of Law and Economics XVII, 325–335.
Scott, J.C., 1972. Comparative Political Corruption. Prentice Hall, Englewood Cliffs, NJ.
Transparency International, 1999. Newsletter. Transparency International, Berlin.
Tullock, G., 1971. The cost of transfers. Kyklos XXIV, 623–643.
Tullock, G., 1980. Rent seeking as a negative-sum game. In: Buchamm, J.M., Tollison, R.D., Tullock, G. (Eds.), Toward a Theory of the Rent-Seeking Society. Texas A&M University Press, College Station, pp. 16–36.
Wiehen, M., 1996. OECD recommendations and enquiry. In: Proceedings of the Uganda International Conference on Good Governance in Africa. Transparency International, Berlin, pp. 115–122.
Wiggins, S.N., 1991. The economics of the firm and contracts: a selective survey. Journal of Institutional and Theoretical Economics CXLVII, 603–661.
Williamson, O.E., 1983. Credible commitments: the use of hostages to support exchange. American Economic Review LXXXIII, 519–540.
Williamson, O.E., 1985. The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting. Free Press, New York.
World Bank, 1997. World Development Report 1997. World Bank, Washington DC.