

GRESHAM LAW IN POLITICS: WHY ARE POLITICIANS NOT THE MOST
REMARKABLE MEN FOR PROBITY AND PUNCTUALITY?

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“What you do in this world is a matter of no consequence. The question is what can you make people believe that you have done”

Sherlock Holmes, *A Study in Scarlet*

I.- GRESHAM LAW IN POLITICS

Economists have always criticized politicians. Adam Smith called them “crafty” and “insidious”; and thought they were not the most remarkable men for probity and punctuality . And, in modern economics, Geoffrey Brennan and James Buchanan (Brennan and Buchanan 1985) have applied Gresham Law to politics to draw the conclusion that “good” politicians are driven out from the political market by the “bad” ones. The Brennan and Buchanan model focuses on the supply side of the problem. But it does not offer a good explanation of the reasons why these “bad” politicians are elected for public offices by voters. This paper presents some reflections on this problem. In the analysis of politicians’ behaviour, a model of repetitive games shows that probity may be of little relevance for many politicians. And, concerning voters behaviour, it is argued that asymmetric information can explain why voters often elect “rascals” even if probity is a highly-esteemed value in society.

Gresham law is an adverse selection problem. There are two possible cases in which bad money drives out good money. Let us assume that the payer has complete information on the quality of the money and can choose the money the payee will get. In the first case, since bad money is legal tender, it is exchanged for good money at a fixed rate. So the payee has to take the money, whatever its quality is; and everybody will keep the good money and pay with the bad one. This is the traditional approach to Gresham Law. But there is a second case in which good money is driven out from the market by bad money. Even if the bad money is not legal tender and no fixed exchange rates exist, it can drive out good money if the payer has better information than the payee. Let us take the case of a debased currency , where the content of gold in the coins is lower than the one officially established. If information is asymmetric, the

payer –the better informed party of the contract- will use bad money and the payee will take it without knowing its poor quality.

This asymmetric information can also be found in politics. Information concerning the behaviour of political candidates is often fuzzy; and, since information is scarce and expensive, it is rational for individual voters not to invest too much time and money in obtaining it. Therefore honest politicians may lose elections and be driven out by dishonest candidates even when voters have clear preferences to punish corrupt politicians. The incentives that the average politician has to be honest are, therefore, very limited.

II.- What is Corruption?

Government is one of the oldest institutions of mankind and, for this reason, corruption understood as “the incorrect use of public power to obtain private benefit” is one of the oldest and most universal of vices. The importance of corruption has increased substantially in recent times, and in the last decade -and more precisely in the last few years- the problem has become one of the main concerns of social researchers. But although there is unanimity over the gravity of the problem, there is rarely any other basis for agreement. In all other aspects, numerous discrepancies exist not only because of the difficulty in understanding the phenomenon of corruption in itself but also because it can be found in a multiplicity of forms¹ and because of the diversity of those involved. In fact, corruption has proved to be a difficult field for economists to study given the serious problems in measuring it and the ambiguities in reaching a definition of the problem.

The sensitivity of public opinion towards corruption varies considerably from country to country and between different cultures. Thus, the same behaviour can be considered corrupt in one society and not corrupt in another, depending on cultural standards or social practices². In a similar way, what is accepted and considered correct, and even on occasions desirable, in the private sector, in the public sector would be judged corrupt. For example, in the private sector giving gifts to clients or finding

¹ The overall concept of corruption includes such terms as bribery, embezzlement, fraud, favoritism and nepotism.

² For example, in Thailand, giving gifts is valued highly and the people believe that if a civil servant gives a good service one should show one's appreciation with a gift, whereas this behaviour in many other countries would be considered a bribe.

jobs and contracts for friends or members of the family is quite usual but this same behaviour in the public sector would be inadmissible. In the same way, the extent of corruption is another source of disagreement because as corruption is, in synthesis, a clandestine transaction, the very fact that it takes place in secret hinders any attempt to measure it. Therefore, any attempt to compare corruption in different periods or different countries seems a difficult task³.

The disagreement mentioned above remains unchanged and even increases when one attempts to reach a definition of corruption. For this reason, this article uses a wide definition of the concept of corruption when analyzing the object of our study: political corruption. Although cases of corruption can be found at all levels of the political and economic system, corruption among political leaders is a particularly worrying phenomenon⁴.

The World Bank and Transparency International define corruption as “the abuse of public power to obtain private benefit”, in other words, a person who holds a privileged position receives benefits or the promise of benefits which arbitrarily favour a part of society and which entails an act of disloyalty towards the group or organization to which he or she belongs. Corruption is also defined as “a transaction between members of the private sector and members of the public sector by means of which collective wealth is converted illegitimately into private gain”. (Heindeheimer *et al.* 1989).

Political corruption takes place at the highest levels of political authority. It is when politicians and political decision-makers (heads of state, ministers and top officials) who are entitled to formulate, establish and implement the laws in the name of the people, are themselves corrupt. With political corruption, we are dealing with highly placed individuals who exploit their positions to extract large bribes from contract scams or who embezzle large sums of money from the public treasury into private bank accounts. Political corruption is furthermore when policy formulation and legislation are tailored to benefit politicians and legislators (Moody-Stuart, 1997; Doig and Theobald, 2000).

³ In recent years there have been several attempts to quantify corruption. One of the most important of these is the CPI (Corruption Perception Index) carried out by the University of Göttingen under the direction of Johan Lambdorff. The CPI establishes the level of corruption of a country based on the perception held by the public and experts of the level of corruption existing in that country.

⁴ A study of the differences which exist between the prevailing models in the countries of the ex-Soviet Union and those in some Latin American countries provides a good illustration of this.

Political corruption should be distinguished from bureaucratic corruption. The first is usually called “grand corruption” whereas the second is known as “low level” or “street level”. The distinction between the two types is ambiguous and depends, to a large extent, on the independence of the public administration from politicians. However, for the purpose of our study, it is important to differentiate the two types of corruption. Political corruption means that the politicians misuse the regulatory and legislative bodies or manipulate them for their own private benefit. Bureaucratic corruption, on the other hand, is the type of corruption that citizens experience on a daily basis in their contact with the public administration and in the securing of services such as health, granting of permits, public order, taxes ...in short, it is the corruption of public administration in its everyday dealings.

On many occasions, both types of corruption occur simultaneously and sometimes the one encourages the other. Political corruption is supported by bureaucrats driven by their desire to get rich; in the same way, corrupt high-level politicians influence low-level civil servants who end up imitating their superiors' behaviour.

One of the arguments most frequently given as the cause of corruption is the existence of authoritarian régimes; that is to say, the hypothesis is held that the level of corruption is reduced when the country becomes more democratic. But in different studies on the subject it has been seen that the relation between corruption and democracy is not linear but bell-shaped. It seems apparent that the more authoritarian régimes are able to control corruption, as happens for example in countries in Southeast Asia, whereas countries in transition have a higher level of corruption.

One could believe it was a question of time and that as soon as the democracy was consolidated the corruption would be reduced. But when a more in-depth study is undertaken of the relation between the type of government and the level of corruption, the results are quite controversial. In fact, when an attempt was made to show the relation using indexes such as the CPI (Corruption Perception Index) and the Freedom House's Rankings for Levels of Corruption, it was found that the negative relation between the level of corruption and democratization is not very strong. Furthermore, it seems that it is a statistical relation which does not necessarily reflect a causal one. Paldam (1999) shows that, in general terms, corruption decreases when democracy increases, but that the covariance depends a lot on the existing levels of democracy and thus suggests that the direct effect of democratization on the level of corruption is false..

Given that poor countries are more corrupt than rich ones and that poor countries generally have more authoritarian régimes than rich ones, it is impossible to conclude whether economic growth (that is to say, economic factors) or democratization (that is to say, political factors) is the determinant in the reduction in corruption, in much the same way it is impossible to conclude whether economic growth causes democratization or viceversa.

On the other hand, it has been observed that the existence of democratization causes a reduction in the levels of corruption in certain areas (for example reelection of politicians causes the candidate to be more motivated to be honest, as will be analysed later), but at the same time the same system causes corruption to spread as a means to gain victory in the desired reelections (political campaigns imply large investments of money and for this reason politicians need to be able to count on the support of possible backers whose financial support they will have to compensate in the future). For all of these reasons, one can say that the effect of democratization on corruption is not at all clear and alternative formulas should be found to explain the existence of corruption amongst politicians even in democratic systems.

III.- REPUTATION AND INFORMATION

Political corruption can be understood as being caused by two problems of asymmetric information. It is well known that adverse selection is the result of the existence of private information or the withholding of information. In the case we are analysing the lack of information on the politicians who stand for election leaves room for the politicians to lie to their voters before the elections, or not to tell all of the truth. We could believe that one of the politicians is going to be different from the rest; but what reason do we have to expect it? After all, it is in the politician's interest to say that he is not going to be corrupt, whether he is corrupt or not; and the voter cannot distinguish which politicians are telling the truth and which are not. Since one cannot lie forever, the voters will react by believing only half of what the politicians promise, so that the voters will believe that there are no totally honest politicians, only politicians

who are partially corrupt. In the end, both parties will be hurt by the impossibility to communicate credible information on the politicians' integrity. On the one hand, only the most corrupt politicians will be interested in taking part in this game (the "bad politicians" end up driving out the "good politicians") since the honest ones are not going to be interested in taking part if they are judged like all the rest, irrespective of what their intentions are; and the voters end up choosing amongst the worst politicians. As a result, the difficulty in conveying each candidate's qualities truthfully ends up creating a market for lemons.

Furthermore, in the political world we often observe a difference of interests between politicians and their voters. This difference in objectives gives rise to strategic behaviour that causes politicians to follow their own interest instead of those of their constituents. The reason politicians proceed in this way is because of the difficulty in controlling them, which gives them a lot of freedom in what they do. From this we should deduce that the problem of corruption is a problem of moral hazard, where the voters lack the necessary information to observe the elected politicians' behaviour and thus prevent them from straying from the objectives they promised. Before being elected, politicians promise to be honest and to act in the citizens' interest, but once they are elected their objectives change drastically. The politicians decide to make the most of their position of superiority and their actions are aimed at obtaining benefits for their own good.

The main problem presented here is to ascertain why the voters make the same mistake of repeatedly electing politicians to public office who are not very honest and, in so doing, fail to create the necessary incentives to reduce political corruption. Let us look at two possible explanations which initially seem alternative explanations, but which can also be seen as complementary.

From the first point of view, politicians do not need to have an honest reputation, because integrity is not a strategy which allows them to obtain maximum benefit, although the other economic agents are perfectly conscious of their dishonest behaviour. In other words, the politician does not maximize his utility function by acting honestly and therefore the logical result is that he will not act honestly. From the second point of view, we start, to the contrary, from the premise that an honest reputation is useful for the politician: but, due to the existence of asymmetric information, it is possible to convey signs of honesty to get the voters' support and it is not important, at least in the short term, that these signs are false.

Let us look at the first of these models. The idea that the value of a reputation is different for each economic agent depending on his situation in the market is almost as old as economic thought itself. Adam Smith saw the problem clearly when he analysed the reasons why one should expect a higher or lesser level of integrity among people in a certain profession. Smith's argument, presented in his *Glasgow Lectures*, is based on the idea that the frequency of the activity a person carries out determines the integrity of his behaviour. Smith's argument comes quite close to the idea that the repetition of a game leads a player to follow a cooperative strategy rather than a confrontational strategy. The actual problem that Smith analysed was why the merchants of a certain country (Holland) were more trustworthy than those of another (Scotland); and why those who work in a certain profession (trade) are usually more honest than those who work in another (politics). Excluding the idea that the differences in the level of honesty can be explained by ethnic reasons, and that individuals with a lower level of integrity, on principle, go into politics, the argument is based on the restrictions which each of the two groups are subjected to.⁵

To simplify, let us suppose that there are only two professions –merchants and politicians- and that it can be proved empirically that the level of integrity is less in the second profession than in the first (actually Smith's model is more complicated since, as we have seen, there are different levels of honesty among merchants, and politicians are not the people with the worst reputation for keeping their word since, in Smith's opinion, ambassadors occupy that category). Let us assume, also, that before choosing a profession, everyone has the same level of integrity and that, therefore, their profession is the main determinant of their behaviour.

Figure 1 shows the merchant's model. In it M can choose, in each of his moves, a strategy of honesty (H) or one of lies (L). Let us assume that the strategy of lies brings him large benefits in the short term, but prevents him from continuing in his profession successfully because he earns a reputation as an untrustworthy person. Therefore, if we call B the benefit the merchant hopes to gain, each act of dishonest behaviour will have a higher value than an honest act in each of the plays:

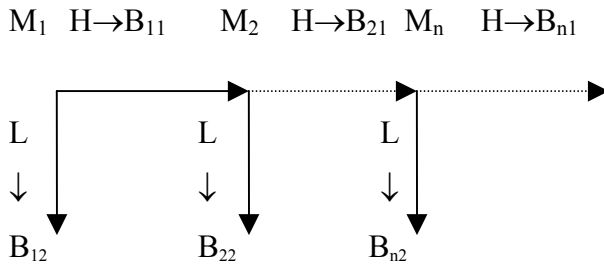
$$B_{12} > B_{11} \text{ , } B_{22} > B_{21} \text{ } B_{n2} > B_{n1}$$

⁵ A. Smith (1766-1978), pp. 538-539

But the sum of the benefits that the merchant obtains when he can make another move for being honest in the previous move is superior to what he would gain by being dishonest. That is:

$$B_{11} + B_{21} > B_{12} \dots\dots B_{n1} + B_{n+1,1} > B_{n2}$$

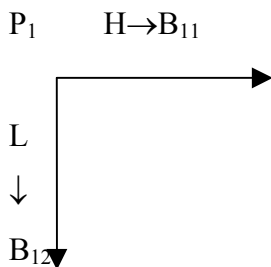
Figure 1.- Merchant's model



The conclusion is clearly that honesty is profitable and the merchant who wants to maximize his gains will be honest. However, this does not seem to be the case of politicians as seen in figure 2, in which the game can only be played once. The economic agent here is the politician (P). As in the earlier case, we assume that $B_{12} > B_{11}$

But, in this case, P has no incentives to follow the strategy (H) since the strategy which brings him more benefits is L. Therefore, he will not behave honestly. A good reputation has no value in games which are only played once.

Figure 2.- Politician's model



Why do politicians find themselves in this situation? Smith's argument is that a politician is not making contracts every day and he can obtain large benefits in specific deals, with the result that the value of the loss of his reputation is less than the benefit obtained from his success in the short term. But the model is designed, no doubt, for a different world than our own, where the politician, at least in a democratic system, is constantly in the eye of the public so that he should think that the loss of his reputation would cost him dearly. And yet there are serious reasons to believe that today, as before, politicians do not stand out precisely for their integrity and for keeping their word.

The reason could be that, although today one's reputation is important for politicians too, this reputation does not correspond to real behaviour but rather to the signals the politicians give to the public; signals which do not have to reflect reality. The model which follows corresponds to a classical structure of the relation principal-agent, in which the voter plays the role of principal and the politician that of agent who acts on his own behalf and, presumably, in the voter's interest. Let us assume the case of a politician who is running for election in which there are n candidates, all of whom have a similar intellectual level and professional capacity, but whose levels of honesty may differ and be unknown to the voter. In other words, the voter does not know if the politician is going to behave honestly –by which we mean that he will work in the voter's interest- or dishonestly –that is, he will work in his own interest. The defense of a voter faced by what he considers inadequate behaviour is not to reelect the politician. In other words, if the politician has followed the L strategy and the voter is aware of it, the voter prefers not to make a new contract with him.

Figure 3 shows this situation. The game begins with the politician (P) giving out signals to the voter (V) with the aim of gaining his vote. These signals may be received positively or not by the voter who decides if he will offer the politician a contract to represent him. If he is offered a contract, the politician will decide if the conditions of the contract interest him or not. He may have been elected in conditions in which he prefers to reject the contract; for example, if after the elections, the contract is for a government without a majority which will not allow him to carry out his objectives, he may prefer to wait for a better opportunity. But in the majority of the cases in which he receives the offer, he will accept it; and, he will become the representative of the voters in government. Once in office, he will be faced with two options. First, to act in the voters' interest –what we have called honest behaviour-: secondly, to act in his own

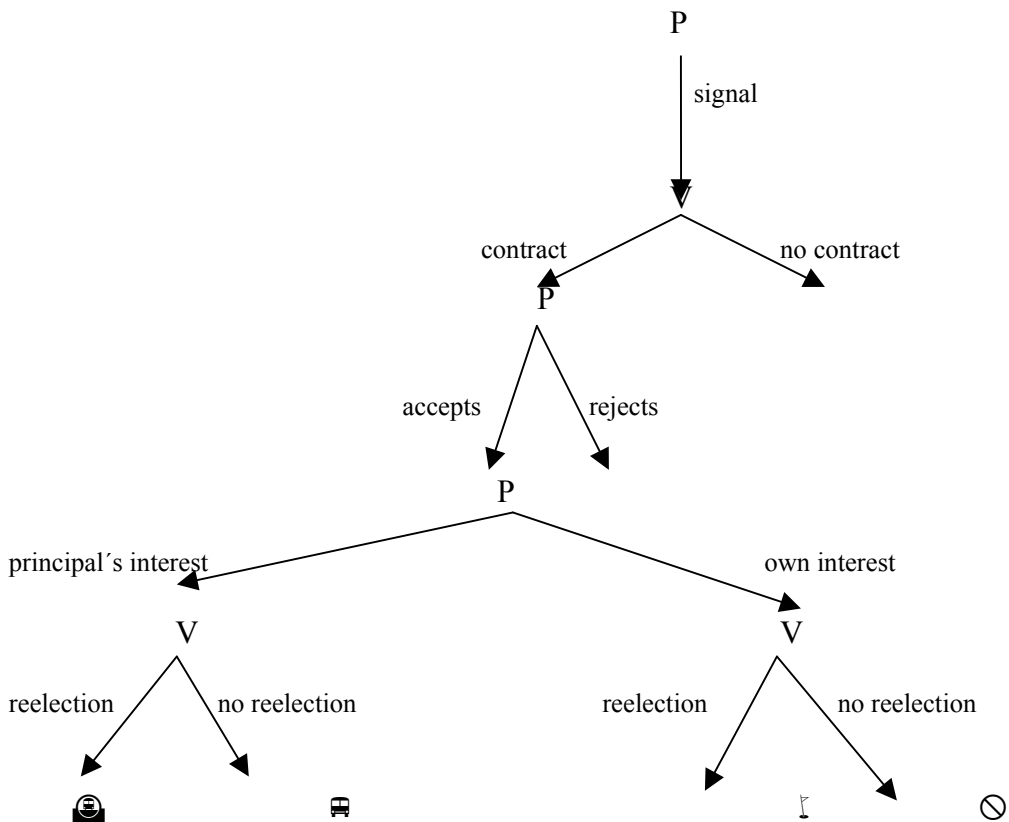
interest. The figure shows the possible results of the different strategies. Since we assume that the main objective of the politician is to stay in office and that the voter wants the politician to defend his interests, the order of preference for the two players is the following:

For V: 1 P 2 P 4 P 3

For P: 3 P 1 P 4 P 2

Given perfect information, if P plays “principal’s interest”, V will play “reelection” and the result of the game will be the situation defined as 1. If P plays “own interest”, V will play “no reelection”, giving the result 4 which implies no reelection. Since the results of reelection (3 and 1) are preferred by P to the results of no reelection (4 and 2), the strategy “own interest” will not allow him to make the most of his situation given the expected strategy of V. Therefore, foreseeing V’s strategy, P should play principal’s interest; V then will play reelection and the final result will be 1, which both for the principal and for the agent is superior to 4.

Figure 3.- Politicians and voters strategies



The problem, however, becomes more complicated when perfect information is not available and the politician tries to supply V with wrong information so that, acting in his own interest, V chooses the reelection strategy and the result is 3, which is the best one for P

In short, the existence of corruption can be explained as a result of the difficulty in obtaining information in the political market. The absence of information makes it more difficult to distinguish the corrupt politicians from the honest ones, thus creating a market for lemons of corrupt politicians. The difficulty in obtaining reliable information on the activities of elected politicians results in politicians acting corruptly given the inability of voters to control their behaviour.

IV. Is it possible to solve the information problem?

As we have seen, the group of voters (the principal) face two types of problems:

- 1.- How to distinguish between the honest politicians and the corrupt ones to avoid creating a market for lemons in the political world.
- 2.- How to establish a system of incentives to encourage politicians to be honest, in short to find options that solve the problem of moral hazard.

As for the first problem, it is well-known in the literature that abstention in an election is rational and efficient behaviour by the individual voter. The reason is that the cost of exercising one's right to vote is higher than the benefit the voter may obtain from the victory of his electoral choice multiplied by the probability that his vote will affect the outcome of the election. Even if he should decide to vote, it is still logical not to invest more than a given amount in obtaining information. In this case, the voter's dilemma could be presented in the following terms: for a voter it may be inefficient to invest in information when the cost of the information is higher than the benefit he expects to get from voting for the candidate closest to his interests. Therefore, it is not unreasonable that the vote ends up being given to the corrupt politician when the voter is confronted by signals he cannot verify without incurring expenses.

The theory of the superiority of results obtained by members of small groups as opposed to those of larger groups can also be applied here. In our case, it would seem reasonable to suppose that the group formed by those who want less corruption among politicians is made up by most members of society. If the problem we are facing is a lack of information and the inability to distinguish between different signals, the most efficient solution would be to put a small amount of resources for each citizen towards improving this information. In this case, the cost per capita would be minimal, given the large number of members who make up the informal group; and what is not efficient for the individual voter, would be efficient for the group as a whole. But this raises the well-known Olson problem of collective action: the transaction cost would make it impossible for the group even to act as such. On the other hand, small, well-formed interest groups would obtain better information and, as G. Grossman and E. Helpman have shown, it is frequently the case that the better-informed groups get more results from the politicians' actions than those obtained by worse-informed groups (Grossman and Helpman, 2001). The problem we are faced with here is a problem of common agency, in which an agent and many principals exist. In these cases two types of problems of asymmetric information are raised. On the one hand, there is the asymmetry of information between the agents and the principals taken as a whole. But there is also a second problem of asymmetric information between the different principals. This second asymmetry can condition the politician's behaviour causing him to be inclined towards the interest of certain groups defending their specific interests as the most effective strategy to assure his reelection.

As for the second problem presented at the beginning of this section, there is little doubt that the best situation for society would be to create very strict moral principles for politicians, which would encourage them to act with integrity. In this climate, the politician who behaved dishonestly would have to pay such a high moral cost (the contempt and boycott of his colleagues, families, friends...) that it would make him reject any temptation to be corrupt. However, the dilemma of putting these principles into practice as a solution to the problem of political corruption is that these of rules of conduct are not something that can be created and imposed artificially. For these principles to be self-confirming, it is necessary for them to be present among the majority of the population, which would require

changes in citizens' education and moral conduct, so we are talking here about a solution in the very long term

In the previous section we have seen the problems which arise from using reputation as an instrument to secure the election of honest politicians, given the possibility of conveying false signals which are difficult to verify. The idea is generally accepted that being corrupt has a negative impact on the probability of surviving in the political world so that the logical reaction for the politician is to put out signals that his behaviour is honest.⁶ If the politician successfully conveys the signal that he is honest through the reputation he has gained, this could mean he wins in the next elections and, in this sense, the politician would be interested in establishing a reputation as an honest person. But the potential costs of being honest and the uncertainty of the possible benefits can be very high and politicians may think that this is not the best strategy for gaining reelection.

To establish a good reputation means an investment in time and money which perhaps does not pay the dividends if the proper signal is not conveyed adequately. The politician should proceed in an honest way but, more importantly, he should be able to convey to the voters that he is an honest person. This is why each time more money is spent in electoral campaigns in trying to find better means of conveying the politicians' virtues. But although the politician stakes his money on making himself a good reputation, no one guarantees him victory in the next elections. In the first place, because although it is a repeated game (the elections are held periodically) so much time passes between the celebration of elections that the voters forget the politicians' virtues. In fact, it is used to hear about "the voters' bad political memory"; the voters forget what has happened during the electoral term and usually only remember the most recent events. Proof of this is that with the approach of elections, it is usual for governments to invest in those areas (road repairs, improved health care...) the public can see easily and associate with a politician who is looking after his voters' interests. If the politicians could rely on the reputation they have built up in the past, they would not have to turn to "last minute solutions" to win the elections. Also the uncertainty of the rentability of

⁶ This result only makes sense in a democratic system where there is a negative relation between corruption and political survival. However, in those cases where political patronage is the dominant policy, the relation between corruption and reelection is much weaker.

investing in one's reputation can increase if votes can be bought⁷, voters being paid to elect a certain candidate. If some politicians have sufficient funds (legal or illegal) to "convince" a large number of voters which one is the best candidate, it is absolutely no use for the other contenders to act honestly. In fact, if the politicians who bought the votes win, the citizens are sending the signal that electing honest politicians is not their first priority.

Furthermore, depending on the probability the politician has of being reelected, the investment in his reputation will be more or less profitable. In the case of unstable governments, it is probable that we will see corrupt politicians who are not interested in building up a good reputation. This instability means that no coalition believes it can stay in power for any length of time so many politicians use their time in power to amass personal fortunes, instead of gaining a good reputation which does not guarantee them reelection in the future. But at the same time in stable systems, where the politician has a high probability of being reelected, he is not going to invest here either in making himself a good reputation because his victory is almost certain whatever he does. So the ideal situation to encourage politicians to invest in their reputation is one that makes politicians adopt a long-term policy and foresee whether they have a good chance of winning or losing the elections. The candidates should not be sure of winning, but they should believe they have a good possibility of being reelected to office. The opposition parties play the role of watchmen, threatening to make corruption a central theme of the electoral campaign.

Therefore, it is important to consider the influence that placing limits on a politician's reelection can have on the level of corruption in a country. Those countries which prevent the reelection of a politician after a certain number of terms convert these politicians into players of a single game for whom there is no sense in investing in their reputation, since they cannot continue in power however they behave.

⁷ Direct payment to voters has a long history which in the Western World goes back to the 19th century. In these countries reforms have restricted the use of payments, but they still play a part in electoral politics in many countries. In Italy, for example, the "political bosses" try to win the vote using government resources such as political nominations and other types of government favours which determine their election (Della Porta 1996). In Spain, the promise to guarantee farmers' subsidies has influenced the victory of a certain political party in Andalusia (Haywood, 1996). In Thailand, in the elections of 1996, a direct payment was made to voters which included a postelection bonus if the candidate won (Ackermann, 1999).

We should also point out that the importance of reputation will differ depending on whether the electoral system has open electoral rolls or closed ones. In a closed electoral roll, the party decides the order of the candidates on the ballot paper so that the candidate who occupies the first place will have to please the party hierarchy to win. In other words, he will have to gain a reputation that persuades his superiors to put him on the rolls instead of winning a reputation that convinces the voters to vote for him. In the case of an open electoral roll, the order of the candidates selected is decided by the voters who not only choose the party but also express their choice of candidate. Here the politicians must compete among themselves and, therefore, it is in their interest to gain a good reputation which gives them the victory over their competitors.

The next question would, therefore, be to find a credible way to convey the information of honesty to the voters. A way used frequently in other markets is to offer warranties. When a salesman offers us a guarantee he is sending us the signal that the product is a quality one. This signal is credible because the repair costs the salesman would incur if he was guaranteeing poor-quality products would be so high that the salesman would suffer great losses and would even be forced out of the market. The question we must ask here is: Can the politician offer warranties that would convince the voters of his honesty? The candidates could promise, for example, to leave office if they did not reach certain goals established in their electoral programmes, such as a certain level of economic growth or a certain level of unemployment. It would be important that the goals proposed by the politicians be clearly defined and that there should not be large discrepancies when measuring the selected variables.

The problem of this type of warranties lies in that there is no way of punishing those who offer these guarantees and then do not honour them. The voters would find it very difficult to remove a politician from office for not keeping his promise since he could always say he has done everything possible and therefore has kept his promise, and that the deviation in the growth rate of the GDP is due to external factors such as an international crisis. Besides, contrary to the warranties offered by merchants, where it is easy to identify those affected negatively by the breach of contract, in the political world, the people harmed by the failure to honour the guarantees would be all of the voters. This would make it practically impossible to

coordinate all of them to bring a claim to throw those politicians out of office who had broken their promises.

V Institutional Constraints

Since the use of reputation or the offer of guarantees cannot be considered the best means of getting information to the voter on politicians' honesty, it is highly probable that the politicians finally elected will make no effort to keep their electoral promises and will pursue their own personal gain rather than that of their constituents. In this section we suggest some means to encourage those politicians who pursue their own interests to keep their promises and act in the interests of the community.

A politician will tend to be corrupt if the benefits he can expect to gain if he is corrupt are higher than the costs. So anticorruption measures should be directed at reducing the expected benefits and/or increasing the costs of corrupt behaviour. In short, these measures should change the calculation of cost/benefit made by politicians who think the benefits to be gained from corruption are positive. A politician will be corrupt if

$$E = nE(G) - p(Pu) > 0$$

where E is the net expected gains from corruption

n is the number of acts of corruption involved

G is the gain from each act of corruption

P is the probability of being punished

Pu is the punishment for an act of corruption

The anticorruption measures which result from a cost-benefit analysis for creating incentives to influence the decisions of politicians could be the following: to reduce the number of transactions in which politicians can play a part, to reduce the benefits from acts of corruption, to increase the probability of being punished in the case of illegal behaviour and, finally, to increase the punishments for acts of corruption.

These strategies correspond, basically, to models developed in economics that show that the supply of offences depends on the benefit one can gain from illegal behaviour, the punishment the offender may receive as a result of his behaviour, and

the probability that the crime will be detected and the punishment really applied; with first derivative positive for the benefit and first derivatives negative for the punishment and the probability of its application. Let us analyze how these ideas can be applied to the problem we are studying. According to the above, the first step would be to reduce the number of transactions politicians could take part in. With this measure, the situations in which politicians could make some illegal gain would be automatically reduced and the social costs of corruption would be less if the corrupt politicians lack the means by which they could make a profit. The social costs of a corrupt government have, in conditions of *ceteris paribus*, an inverse relation to the relative weight of the public sector in the national economy. If we define this, in its simplest form, as public expenditure/gross national product, and if we observe the historical evolution of this variable, we must conclude that for a certain level of corruption, the social cost has grown substantially. Whereas, at the beginning of the twentieth century, public expenditure accounted for approximately 10% to 12% of the GNP in most European countries, it is to be expected that the costs of corruption, which no doubt existed, were much less than those we can find in an economy where the public expenditure accounts for approximately 50% of the GNP.

Therefore, it can be argued that through the liberalization of the economy (deregulation, privatization, reduction of monopoly power, reduction of trade barriers ...), it should become less advantageous to pay bribes to politicians and the possibility of illegal dealing by corrupt politicians should be reduced. But recent experience in Eastern Europe has shown that the process of privatization of the main sectors of the economy has resulted in the appearance of different means of corruption so that the total number of cases of corruption has, in fact, increased.

Another way to reduce corruption would be to establish restrictions on politicians' power and discretion in making decisions in public affairs. In a government with strong checks and balances no public institution is all-powerful. The limits on the power of politicians include the separation between the legislative and the executive branches which puts a limit on politicians' freedom of movement; in these conditions, to overcome these restrictions is a very complex matter which means an increase in the cost of corruption and a reduction, therefore, in the net gains of illegal activities.

The second type of measures should be aimed at increasing the cost the politician has to pay for being corrupt. The first of these would be to increase the probability that the corrupt politician is punished. For this there would have to be a higher probability of illegal behaviour being detected, prosecuted and punished. The politician would thus be conscious that the controls have been increased and, therefore, the probabilities of being caught have increased also. Let us analyze the different mechanisms which exist to supervise and limit politicians' activities.

A/ To audit the politicians to decide whether they are behaving fraudulently during their term. This control could include compelling elected politicians to make public their economic investments and their estate before taking office and to account for any increase in their estate at the end of their term. The obligation to justify any increases would make it harder to get rich illegally; however, if the politicians knew of the existence of these obligations ahead of time, they could make provisions to launder the benefits they obtained.

B/ An independent, competent judicial power⁸ is a necessary control of executive and legislative powers. Although almost no one doubts the advantages of an independent judiciary power, putting it into practice can be very complicated. In any case, the problem of judiciary reform is beyond the aims of this study.

C/ The media can be a means of control if they are in private hands and are free to criticize the government without fear of retaliation, since by transmitting information about acts of corruption they are pointing out the corrupt politicians and rising the costs of their illegal actions.⁹ For these controls to be effective, therefore, it is important that the media are not jeopardized by threats and intimidations from the authorities or the government. In this sense, laws that punish insulting politicians in office or which give a wide definition to libel can have a particularly negative result (R. Ackermann, 2000). The truth is that even non-democratic rulers are probably sensitive to public opinion if they wish to avoid social unrest. Freedom of the media is an essential control, especially in those democratic countries which do not have other means to control politicians and bureaucrats.

D/Control agencies, created at the request of the governments themselves, such as external auditing companies, parliamentary committees, or the figure of the

⁸ The fact that an independent judiciary reduces corruption is confirmed by Ades and Di Tella (1996), Goel and Nelson (1998) and Gurgur and Shah (1999, 2000).

⁹ Freedom of expression is related negatively with the level of corruption (see Brunetti and Weder, 1998)

ombudsman, as well as international watchdogs –for example, Transparency International or the World Bank- can be positive factors in reducing corruption. In the case of internal agencies, these institutions should keep a distance from state power. A committee against corruption which only informs the ruler of the country runs the risk of becoming a means of repression or another source of bribery, rather than a power that guarantees transparency in government. In these cases we come up against the typical problem of who and how to control the controlling body which can itself be corrupt. International agencies which are not dependent on any country have better possibilities of being efficient in the transmission of information on corruption.

Finally, we should point out that in democracies the opposition parties can play an important part in the control and the spreading of information on illegal behaviour by politicians of the other party: and it is not rare for cases of corruption to be revealed since these are an important weapon in electoral campaigns. Accusations of corruption, well-documented or not, have often brought about the fall of political leaders.

But, inspite of their undoubted importance, the efficiency of these external controls (judiciary power, media, non-governmental organizations) cannot be guaranteed. All of them can be controlled by the very people they are meant to be controlling. Newspaper reporters can be paid for writing certain articles, pressure groups can easily accept corruption in exchange for specific advantages, other social groups can be taken over by political agents and institutions can be corrupted. So, as we showed earlier, the problem is how to guarantee the independence of the controllers since, if this is not guaranteed, the voters will not be sure whether the information given by the different means of control is true or not.

The other way of increasing the punishment is based on increasing the amount of punishment for corruption. Theory suggests that these punishments should be severe since serious problems exist, as we have shown earlier, in discovering the corrupt behaviour of politicians. From Adam Smith to modern literature on the economic analysis of crime, we know that there should be a direct relation between the difficulty in discovering and punishing a crime and the punishment which is applied, in order to maintain the expectation of a certain level of punishment (Cabrillo, 1986). Unfortunately, we do not have sufficient empirical evidence to analyze the deterrent effect of the establishment of serious punishments as an

instrument to reduce corruption. But some studies have questioned the effectiveness of this type of reform. It has been observed that some countries that have followed this type of strategy have not obtained the results they expected. This is the case, for example, of Malaysia, a country where the punishment for acts of corruption were increased in 1997 from 5 to 10 years imprisonment, and yet the levels of corruption are still similar to those in existence before these changes. So it would appear that more severe punishment¹⁰ is not always a deterrent which has a significant influence on the level of corruption. It has been argued that it would be more sensible to focus legislative reform not so much on increasing the applicable punishments but rather on clarifying the punishment established for acts of corruption; on occasions, ambiguity has led to insecurity which has, in turn, created an increase in criminal acts.

VI.- CONCLUSIONS

Starting from Brennan and Buchanan's idea that Gresham Law can be applied to political activity, in the sense that the "good" politicians are driven out of the market by the "bad" politicians, this article offers some ideas on the theoretical explanation of why this happens. The data on political corruption is abundant and there is little doubt that corruption is a phenomenon found all over the world. The relevant problem is to determine why, even in democratic systems, voters seem to be prepared to vote repeatedly for politicians who, once in power, indulge in illegal behaviour.

Our theory is that we are faced by a problem of asymmetric information which is difficult to solve. In a world of incomplete information and high costs, the voter makes his decisions based on the signals made by the politicians. These signals, in many cases, do not reflect reality, but they can convince the voter. To get better information would cost too much for the individual voter; and collective action does not seem feasible to reduce the cost to the individual, except, perhaps, in the case of small specialized groups who act to defend specific interests.

Although it seems difficult that corruption will disappear completely, institutional constraints should be applied to allow the voter to improve his

¹⁰ Countries like China and Vietnam, which are considered very corrupt countries, have sentenced people to death for acts of corruption.

information without incurring high costs, and to establish incentives for politicians not to behave illegally.

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